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Recent Cases Interpreting Notice Provisions in Legal Malpractice Insurance Policies as to Potential Claims

by David A. Grossbaum

Recent cases from 2013 interpreting legal malpractice policies resulted in lawyers losing coverage for claims made against them because the lawyers failed to comply with notice provisions, particularly for failing to give timely notice of potential claims. Unlike actual claims, more easily determined as a demand for money or services, potential claims by their very nature are more amorphous. Lawyers and insurers continue to do battle as to whether and when an insured must give notice of an incident that is a potential claim.

Policies Requiring Insureds to Give Notice of Potential Claims

It appears that carriers are more frequently defining a "claim" to include a situation where an insured is aware of circumstances which may result in a claim. This means that once insureds have knowledge of a potential claim, they must report this during the policy period in which they acquire such knowledge, or forfeit their coverage. This is a change from prior policies, which only required notice of an actual claim, usually defined as a demand for money or services. It appears to be one more way that insurers are protecting themselves from covering claims that arise from circumstances that might lead to a claim and that are known to an insured when the policy commences. Insurers also use limitations in the insuring agreement and exclusions to accomplish the same goal.

The Definition of "Claim" includes Potential Claims

In *Minnesota Lawyers Mutual Insurance Company v. Baylor & Jackson, PLLC*, 531 Fed. Appx. 312 (4th Cir. 2013), the policy defined claim as including: "an act, error or omission by any INSURED which has not resulted in a demand for DAMAGES but which an INSURED knows or reasonably should know, would support such a demand." The court held that the insured breached the notice provision by failing to notify its insurer when the trial court granted summary judgment against its client due to procedural failures by the insured. The summary judgment decision was rendered on August 22, 2006, but the insured did not give notice until July 2009, when the summary judgment decision was affirmed on appeal. Therefore, the insured did not give timely notice of the claim.

In a Pennsylvania case, the insured also failed to timely notify the insurer under a policy that defined a claim to include situations where an insured "first becomes aware of any act, error or omission by any INSURED which could reasonably support or lead to a demand for damages." *Pelagatti v. Minnesota Lawyers Mutual Insurance Company*, 2013 WL 3213796 (E.D. Pa. June 25, 2013). The court found that the insured had a duty to notify the carrier once the trial court dismissed the action because of the insured's lack of compliance with statutes in New Jersey, and he knew he was not licensed to file the case in the first place. He failed to give notice until years later, after he exhausted numerous appeals.

Similarly, in *Illinois State Bar Association Mutual Insurance Co. v. Gold*, 2013 WL 4029129 (Ill. App. August 7, 2013), the definition of "CLAIM" included an "incident or circumstance of which YOU have knowledge that may result in demand against YOU that seeks DAMAGES arising out of YOUR WRONGFUL ACT." The insured did not immediately report to his insurer that the client claimed that the insured committed malpractice. This was not a breach of the notice provision because the client continued to use the insured's services and initially said he would not sue the insured.

The Discovery Clause Requires Notice of Potential Claims

The Seventh Circuit Court of Appeals, applying Indiana law, held that a

discovery clause in a policy, usually interpreted to allow an insured to trigger coverage for a potential claim, actually required notice of a potential claim. From *Koransky, Bouwer & Poracky, P.C. v. The Bar Plan Mutual Ins. Co.,* 712 F.3d 336 (7th Cir. 2013), the key language in the discovery clause was as follows:

> *If* during the policy period…an insured first becomes aware of a specific incident, act or omission… which may give rise to a claim for which coverage is provided under this policy *and* during the policy period… the insured gives written notice to the company…*then* any claim that may subsequently be made against the insured arising out of such incident, act or omission shall be deemed for the purposes of this insurance to have been made during the policy period... (emphasis added).

Contrary to the court's conclusion, it seems arguable that the italicized words appear to give the insured the option to give notice of a potential claim, but not require such notice.

When is a Problem a Reportable Potential Claim

When is an Unhappy Client a Potential Plaintiff?

In 2013, two courts discussed coverage where an insured knew he had committed malpractice or a client made this accusation, but the clients initially said they did not intend to bring a claim.

In *Pelagatti v. Minnesota Lawyers Mutual Insurance Company*, 2013 WL 3213796 (E.D. Pa. June 25, 2013), discussed above, after the client's initial suit was dismissed in 2007, the lawyer tried in vain numerous times in the trial and appellate court to reinstate the case. Subsequent to the first dismissal, the insured applied for renewal coverage stating that he was not aware of any "claim(s) or circumstances that could reasonably result in claims or disciplinary actions that have not been reported to" the insurer. The policy also required that any potential claim be reported during the policy period or within 60 days after the end of the policy period.

The final appeal was denied in 2009. Later that year, the insured informed the client that the case was lost. The insured said that, upon being notified that the case could not be resurrected, the claimant said she "just wanted closure" and had no "intention of suing" the insured. In February of 2010, the client filed a legal malpractice claim against the insured and this was reported to the carrier.

Although the client disputed the statements attributed to her, the court credited these for the purposes of summary judgment. Nonetheless, it still found that these statements, if true, did not negate the fact that the insured was aware of a potential claim as the statements "neither foretold nor foreclosed a future malpractice suit by" the client.

In *Illinois State Bar Association Mutual Insurance Co. v. Gold*, 2013 WL 4029129 (Ill. App. August 7, 2013), noted above, the court found in favor of the insured under similar circumstances. After the client's case was dismissed in late 2003, the client wrote to the insured in early 2004, stating that: 1) the client had presented the insured with all the information needed to succeed in the underlying case; 2) the cause of action and the pleadings were inadequate; 3) the insured did not provide any independent judgment, but simply submitted to the court statements written by the client; and 4) the insured gave the opposing party information it needed to defeat the client's claim. The client said he had three options: 1) allowing the insured to file the appeal with the same poor quality of representation, with the likely result that the client would lose the case; 2) going to war against the insured, and seeking full reimbursement for all of the fees and damages he suffered from losing the underlying case; or 3) settling the case for whatever the opposing party would pay. The client indicated his intention to follow the third option "for the simple reason, I can't function in this state of continual anger. Anger against the defendant I can deal with. Anger against my own attorney is a whole other matter."

The client agreed to accept a settlement offer in the amount of the attorney's fees that would be incurred by the opposing party in defending the appeal, if the insured would agree not to seek any legal fees from the client. The underlying case was resolved in 2005.

Thereafter, the insurer renewed the policy in 2004, 2005 and in 2006 never disclosing these communications. Finally, in 2007, three years after the client's original letter, the client sued the insured for legal malpractice. The insurer agreed to defend under reservation of rights and then filed an action for declaratory judgment.

The policy required notice of a potential claim. The insurer took the position that the letter from the client in 2004 constituted knowledge of a "claim" as defined to include a potential claim. The trial court disagreed, finding that this was not a potential claim because of the three year interval between the date of the letter (2004) and the date the client sued (2007), the fact that the client continued to use the insured's services, and stated his intention not to sue for malpractice. Consequently, the trial court granted summary judgment for the insured. For these same reasons, the appellate court affirmed the decision.

Allowing coverage in situations like these cases appears to be the minority position, and places the loss on an unsuspecting insurer if the client changes his or her mind and decides to make a claim. Moreover, it appears to be a modest burden on an insured to report these situations to the insurer. *See e.g. Coregis Ins. Co. v. Wheeler*, 24 F. Supp. 2d 475, 479 (E.D. Pa. 1998) (disputes over "whether the defendant believed, on the basis of his relationship with his client or his impression of that client's reaction to the situation, that the client would not make a claim is not relevant to our analysis"); *Brownston & Washko v. Westport Ins. Co.*, 2002 WL 1745910 (E.D. Pa. 2002) (comments by client's new lawyer that prior lawyer was "off the hook" did negate potential claim). Nonetheless, there is precedent for following the rule announced in *Gold*.

See Coregis Ins. Co. v. Goldstein, 32 F. Supp. 2d 508 (D. Conn. 1998) (insured not obligated to report potential claim as he actually disclosed to the client his failure to file suit and received an ambiguous response that did not indicate that the client intended to sue).

Delaying Notice Until the Underlying Case is Resolved

In *Koransky, Bouwer & Poracky, P.C. v. The Bar Plan Mutual Ins. Co.*, 712 F.3d 336 (7th Cir. 2013), discussed above, the firm represented the buyer, a real estate transaction. The seller executed the contract and returned it to the firm on January 31, 2007. The client executed the contract on February 9, but the firm mislaid its files. On February 11, counsel for the seller asked about the status of the contract. On February 22, the seller's counsel, not having received the signed contract, rescinded the contract and declared the contract null and void. The very next day, an associate at the law firm sent an email to the seller's counsel indicating that the contract had been misfiled by the firm, enclosing a copy of the signed document, and admitting fault for the misfiling. The seller's counsel was unmoved and insisted that the contract was null and void. Lawsuits were then filed between the client and the seller. An independent lawyer representing the client in the litigation opined that the client would win.

While all this was going on, the firm was in the process of renewing its professional liability insurance to commence April 15, 2007. It submitted a renewal application and responded in the negative to the question, "does the firm or any attorney or employee in the firm have knowledge of any incident, circumstance, act or omission, which may give rise to a claim not previously reported to us?" The application also instructed the firm to report all known circumstances, acts or omissions which could result in a claim before the existing policy expired.

In August 2007, the client told the firm that it was making a malpractice claim, and this was reported to the insurer. The insurer concluded that the insured was aware of a reportable incident prior to the commencement of the 2007 policy and denied coverage based on a policy exclusion for any claim where, prior to the effective date of the policy, the insured "knew or should reasonably have known, of any circumstance, act or omission that might reasonably be expected to be the basis of that claim." The policy also included a prior knowledge limitation in the insuring agreement, barring coverage for known potential claims. The carrier further argued that it was entitled to rescind the 2007 policy based on misrepresentations in the application.

A lawsuit ensued between the insured and the insurer and the federal district court ruled that coverage was precluded. The insured argued: 1) the insurer was promptly notified once an actual claim was made, and that is all the policy required; and 2) the insured had no reason to anticipate a claim prior to the actual claim because the lawsuits were pending and an independent lawyer said the buyer would win. The carrier responded by arguing that the misfiling of the contract, the admission by the associate of a mistake, and the filing of the underlying lawsuits constituted a potential claim that triggered the prior knowledge exclusion and also established a misrepresentation on the application.

On appeal, the court held that the firm was aware of the potential claim prior to the April 15, 2007 inception date for the reasons stated above. As such, this triggered the prior knowledge limitation, and the prior knowledge exclusion.

As to the insured's reliance on the advice of outside counsel that its client would prevail in the underlying case, this did not excuse the delay in reporting a problem to the insurer. The court noted that the question of how a court would eventually rule was irrelevant in determining whether the insured "had reason to believe that their acts or omissions 'may' result in a claim for malpractice required by the discovery clause."

The court further rejected the insured's argument that requiring notice when any act or omission "may" result in a claim would be too burdensome as it would require law firms to report even trivial errors. The court found that the present case was not a close one, although there might be such situations where close calls had to be made.

Similarly, in *Minnesota Lawyers Mutual Insurance Company v. Baylor & Jackson, PLLC*, 531 Fed. Appx. 312 (4th Cir. 2013), mentioned above, the court ruled that the insureds had knowledge of a potential claim once the trial court granted summary judgment against the insured's client in 2006 due to procedural failures by the insured. The insured argued that it was not until the appeals court decision in 2009 that it was required to report a potential claim. The court found that any reasonable insured should have known of the procedural requirements for opposing summary judgments and certainly knew so at the time of the judge's decision pointing out the deficiencies.

Also, in *Pelagatti v. Minnesota Lawyers Mutual Insurance Company*, 2013 WL 3213796 (E.D. Pa. June 25, 2013), referred to previously, the carrier disclaimed coverage based on failure to give notice in 2006, when the insured became aware that the suit he filed had been dismissed by the trial court because of the insured's lack of compliance with statutes in New Jersey, notwithstanding that the insured filed various appeals thereafter, and the final appeal was not denied until 2009. He did not give notice until 2010.

Disciplinary Proceedings as Triggering Notice

A Pennsylvania case found that a disciplinary proceeding, albeit one that did not result in any disciplinary action against the insured, provided the insured with knowledge of a potential claim that triggered a "prior knowledge" limitation in the policy—*Fishman v. The Hartford*, 2013 WL 5429272 (E.D. Pa. Sept. 27, 2013).

In that case, the insured had failed to timely file a civil rights claim on behalf of his client (a prisoner) and informed his client of this in 2008. At the time, the client was being prosecuted for a crime arising from the same incident, and the insured said he did not want to bring a

civil case when the criminal case was still pending. In 2009, the Disciplinary Board in Pennsylvania dismissed a complaint from the client, but nonetheless sternly criticized the insured for his failure to either file the suit in a timely fashion or to inform the client clearly that the insured was not going to do so. The bar authorities dismissed the complaint based on the insured's lack of any prior disciplinary complaints.

About a year and a half later, in 2010, the client brought a malpractice claim against the insured. The insurer denied coverage on the basis that the insured was on notice of the potential claim as early as the May 2009 disciplinary complaint and ruling by the Disciplinary Board.

The insured tried to salvage coverage by arguing that the claims brought by the client were "broader than just missing the statute of limitations" on the civil rights claims, and included claims that the insured failed to pursue malicious prosecution and conspiracy claims. The court rejected this argument based on the language of the prior knowledge clause, which barred coverage if the insured was aware of "a claim," rather than requiring that the insured be aware of the specifics of all claims. In any event, the court found that the insured could have foreseen a claim based on his failure to pursue malicious prosecution and conspiracy claims because he should have known that these claims would have been part of his filing. Still further, the finding of the Disciplinary Board was a general finding that he had failed to specifically inform the client of any alleged limitations on his representation.

In a somewhat novel argument, the insured argued that the prior knowledge limitation was against public policy. He argued that because the policy did not use the word "reasonably" in the prior knowledge limitation, this made the prior knowledge limitation overbroad and against public policy as it would exclude even those claims which an insured did not reasonably foresee. The court found this argument unpersuasive, particularly because prior Pennsylvania cases had simply imposed a reasonableness requirement in cases such as this, where the word "reasonable" did not appear in the clause.

Conclusion

The cases from 2013 continue a long legacy of coverage cases involving disputes between insureds and insurers as to the reporting of potential claims. The lesson for insureds is that they need to err in favor of reporting incidents that may seem as if they will not turn into claims, but where they certainly could. The present sentiments of a wronged client not to make a claim, or the prospect that an appeal will vindicate an insured's conduct are not excuses in all states. The lesson for insurers is that some courts are hostile to disclaimers that are based on the failure to report potential claims, and this defense is not always a sure fire winner.

Some of the cases discussed in this paper are designated as "not for publication". Therefore, lawyers need to consult their local rules before citing these in court pleadings.

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