Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

What Did You Know, When Did You Know It?

Law360, New York (January 7, 2011) -- Law firms seeking to switch their professional liability insurance carriers are often asked to fill out an application which asks, among other things, whether any of the covered attorneys are aware of "any acts that could form the basis for a malpractice claim against them." Lawsuits arising out of acts that occurred prior to the application process typically will not be covered under the newly issued claims-made-and-reported professional liability policy — even if the actual claim for legal malpractice arises during the new policy period.

This deceptively simple language begs several questions, however. Precisely when will a lawyer be deemed to be "aware" of an act that "could" form the basis for a malpractice claim? When a disgruntled client complains? When a court issues a disagreeable decision? Can an insurance company simply say, "You may not have known a malpractice claim was coming ... but you should have known," and refuse to defend the underlying claim?

Fortunately for legal practitioners, the answer is no. Such was the decision in the recently decided Liberty Insurance Underwriters Inc. v. Corpina Piergrossi Overzat & Klar LLP, __ N.Y.S.2d ___, 2010 WL 4825892 (N.Y.A.D. 1st Dep't, (Nov. 30, 2010) (Corpina).

In Corpina, a law firm represented a client in connection with a medical malpractice claim for personal injuries allegedly caused by vaccinations administered when the client was an infant. Id. at *1. During the course of the representation, an associate at the law firm wrote a letter to the client's father, informing him that the deadline to file a claim under the National Vaccine Injury Compensation Program (NVICP) was approaching, and requesting materials to complete said application. Id. The application was never filed, the deadline passed, and the firm ceased its representation of the client. Shortly thereafter, the law firm purchased its first legal malpractice policy from Liberty Insurance Underwriters.

Some years later, the former client's new attorney advised the law firm by letter that he had been retained to prosecute a legal malpractice claim based on the failure to file the NVICP claim. Id. The law firm promptly provided notice to Liberty.

Rather than defend, however, Liberty brought a declaratory judgment action against the law firm, arguing that the policy excluded coverage for "any claim arising out of a wrongful act occurring prior to the policy period if ... you had a reasonable basis to believe that you had breached a professional duty, committed a wrongful act, violated a Disciplinary Rule, engaged in professional misconduct, or to foresee that a claim would be made against you." Id.

The law firm argued that even if the associate (and, by imputation, the law firm) knew of the NVICP and the deadline, the law firm did not know that the failure to file a timely administrative claim under the NVICP had the additional legal consequence of foreclosing any civil action for damages. Because they did not learn this until after the inception of the Liberty Policy, they argued, the known-claims exclusion should not apply to bar coverage, at least for the portion of the malpractice claim alleging the firm's negligence had prohibited the plaintiff from collecting civil damages.
The Supreme Court of New York agreed with Liberty and granted its motion for summary judgment, declaring that Liberty

had no duty to defend or indemnify the law firm. On appeal, the Appellate Division, First Department, applied a two-pronged test in which the court "must first consider the subjective knowledge of the insured and then the objective understanding of a reasonable attorney with that knowledge." Id. at *2.

More particularly, the court stated, "The first prong requires the insurer to show the insured's knowledge of the relevant facts prior to the policy's effective date, and the second requires the insurer to show that a reasonable attorney might expect such facts to be the basis of a claim." Id. (citing Executive Risk Indem. Inc. v. Pepper Hamilton LLP, 13 NY3d 313, 322 (2010)).

The court then held that:

"The inference that the attorneys did know that the failure to file a petition in accordance with the NVICP would preclude a civil action for damages may be a reasonable one ... Regardless of whether the inference is reasonable, it is not inescapable and it cannot be the basis for granting summary judgment to the insurer.

"The insurer also objects that the attorneys are in essence seeking to be rewarded for their ignorance in connection with the medical malpractice action for which they were retained. The reward of coverage, however, is the necessary and intended consequence of a test with a subjective component. The insurer is in essence objecting to the practical reality that enables it to sell any malpractice coverage, including retroactive coverage on a claims made basis. To obtain protection from the consequences of their ignorance is a key reason why attorneys purchase and insurers are able to sell malpractice insurance. A purely objective test would provide insurers with far greater protection against the risks of both 'adverse selection' and outright fraud. But if attorneys had to run that gauntlet to obtain coverage, they would have little or no reason to buy malpractice insurance. After all, the promised retroactive coverage would be illusory if it could be denied solely because a reasonable attorney would have known at the time of the act or omission that a malpractice claim could be made." Id.

The trial court's decision was overturned, and Liberty's motion for summary judgment denied.

The U.S. District Court for the District of Maine, applied a similar analysis to determine whether a law firm should have foreseen that a malpractice claim could be against it. In Westport Ins. Co. v. Lilley, 292 F.Supp.2d 165 (D. Maine 2003) (Lilley), the law firm of Daniel G. Lilley PA undertook the representation of a woman, Mrs. Walker, in a medical malpractice case against a hospital and doctor, based on the death of the woman's husband. Lilley, 292 F.Supp.2d at 168.

The representation began in the mid-1990s; trial commenced in September 2000. Id. At the conclusion of the medical malpractice trial, it initially appeared that the jury had issued a verdict against the hospital in the amount of almost $1.5 million for wrongful death; however, the jury indicated on the verdict form that the decedent was comparatively negligent and reduced the wrongful death award to $32,000. Id. Walker's attorney failed to request that the jury be polled, because he believed that the jury had merely reduced the award by $32,000, not to $32,000. Id.

Following several rounds of motion practice, the court ordered a new trial due to confusion over the jury's intended verdict and problems with the wording of the verdict form. Id. The second jury found there was no negligence on the part of the defendants. Id. The Lilley firm appealed, but was unsuccessful. Id.

In May of 2002, Lilley received a telephone call from Walker's malpractice counsel, who indicated that Walker intended to file a claim against Lilley for professional negligence. Shortly thereafter, Lilley put Westport, its professional liability carrier, on notice. Westport, however, reserved its rights, arguing:

"The effective date of your policy with Westport is March 20, 2002. When the first trial was concluded in September 2000 you knew that an error in the jury verdict had occurred. In addition, as of May 2001, you knew that the second trial had resulted in a defendants' verdict. Therefore you knew prior to the effective date of your policy, which was March 20, 2002 that a [wrongful act] had occurred in this matter and knew or could have reasonably foreseen that such [wrongful act] could result in a claim against you." Id. at 169.

Westport then filed a declaratory judgment action, seeking a judgment that it did not owe a duty to defend or indemnify the Lilley firm in connection with the Walker claim. The court disagreed with Wesport, holding:

"By its terms, whether the exclusion applies turns directly on the facts known to the Lilley defendants prior to the effective date of the policy. Based on those facts, the court must decide whether a reasonable attorney in the possession of such knowledge would reasonably foresee that a malpractice claim might be forthcoming. This test incorporates both subjective and objective elements. Whether the Lilley defendants could have reasonably foreseen Walker's malpractice claim is an objective test that can be determined as a matter of law, but it must be determined based only on those facts and circumstances that [the lawyer defendants] were subjectively aware of." Id. at 171.

The court continued:

"To say that the Lilley defendants could have reasonably foreseen a claim against them in September 2000, means that any trial attorney who loses a substantial jury verdict, whether representing plaintiff or defendant, should put his carrier on notice that the client may ultimately seek compensation from the lawyer ... It is conceivable that had the Lilley defendants asked the Superior Court to poll the jury, the jurors might have revealed that the final amount indicated on the form was a scrivener's error and that they intended to make a million-dollar award. Despite this hypothetical, I do not agree that a reasonable attorney would have reasonably foreseen, as of the Superior Court's ordering of a new trial, that the attorney-client relationship would likely end in a malpractice claim. Although any 'act or omission' by an attorney that did not result in a hugely favorable outcome to the client 'might' lead a client to make a claim and 'foreseeability' is a virtually limitless concept, the touchstone here is reasonableness, not conceivability." Id. at 172.

Thus, the court held that Westport was required to provide the Lilley defendants with a defense for the Walker action.

Of course, sometimes a court finds that an attorney simply cannot reasonably argue that he did not foresee the possibility of a claim. In Ross v. Continental Cas. Company, 2010 WL 3721542 (C.A.D.C. Sept. 22, 2010) (Ross), an attorney purchased a professional liability insurance policy from Continental Insurance Company. In the application, the attorney represented that he was not aware of any acts which might form the basis of a claim against him — despite the fact that he was in the process of appealing the entry of a default judgment for over $900,000 against his client, resulting from his failure to file an answer for the client. Ross, 2010 WL 372154, at *1.

The district court applied a two-part subjective/objective analysis that first looked at the facts of which the lawyer was aware at the time he filled out the application, and then asked whether a reasonable lawyer would have believed those facts could form the basis of a malpractice claim. Id. The district court determined that given the lawyer's actual knowledge of the default judgment, a reasonable lawyer would have believed a malpractice claim was possible — a decision upheld by the court of appeals.

Conclusion

Lawyers should not accept at face value their insurance company's interpretation of what they "should have" or "could have" known. While professional liability carriers are often quick to argue that lawyers "should have known" that a malpractice claim was forthcoming, and that coverage for the claim is therefore not afforded, courts are not so quick to agree.

Most jurisdictions look at what an attorney actually knew (i.e., his subjective understanding of events) as well as what a fictional "reasonable attorney" would have deduced (i.e., an objective review) before determining whether a claim was, in fact, foreseeable. Under these holdings, lawyers who have been blindsided by their clients need not also be blindsided by their insurance companies.

--By Diana Shafter Gliedman, Anderson Kill & Olick PC

Diana Gliedman (dgliedman@andersonkill.com) is a shareholder in Anderson Kill's New York office.

The opinions expressed are those of the author and do not necessarily reflect the views of the firm, its clients, or Portfolio Media, publisher of Law360.