

Lawyers' Professional Liability Claims Trends: 2013

Insurer Survey

Introduction & Overview

Law firms can typically expect a surge in malpractice suits when their own clients experience a drop in revenue or reduced earnings. Thus, in past recessions, there had been a noticeable uptick in claims filed against lawyers.

The economic downturn of 2007-2009 was no different. Distressed companies sued their legal counsel as a way of recovering losses; however, this time around it seemed much of this claim activity was slower to develop. For one, many law firm clients first sought relief from other parties involved in failed business transactions or real estate deals. Only after these actions did not result in full recovery, did they turn their sights on their lawyers. Secondly, many such claims have a fairly long development pattern and aren't fully recognized as claims until years after the original error or assumed loss. As a result the law firm market still experienced an uptick both in the frequency and severity of malpractice claims in 2012.

During the second quarter of 2013, Ames & Gough, a trusted risk and insurance advisor to law firms, conducted its third annual survey of Lawyers' Professional Liability claims. This year's survey looks at the volume of claims insurers experienced over the last year, as well as trends with respect to larger claims. It also identifies the types of issues most likely to cause malpractice claims and practice areas that have seen the greatest amount of claims activity. We also examine how insurers are managing claims, including their use of outside counsel and rates paid for legal defense.

Seven of the leading insurance companies that write Lawyers' Professional Liability Insurance coverage participated in this year's survey, including AIG/Lexington, Alterra, AXIS, Beazley, CNA, Ironshore, and Swiss Re Corporate Solutions. Together, they insure approximately 80 percent of the AM Law 250 firms, with four of the seven insurance companies insuring 50 percent or more of the AM Law 100 firms. We are grateful for their participation in our study and are pleased to present the findings in this report.

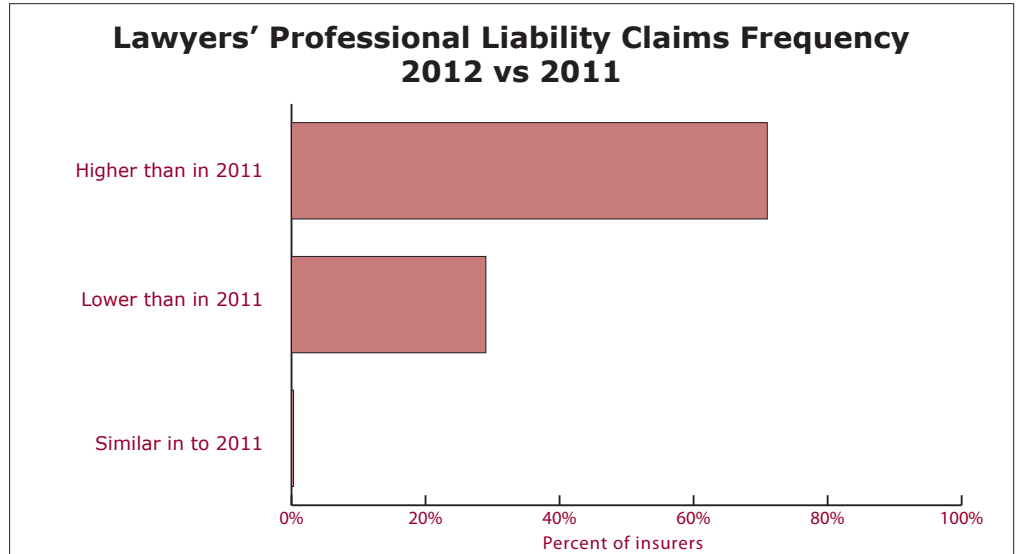
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Survey Findings

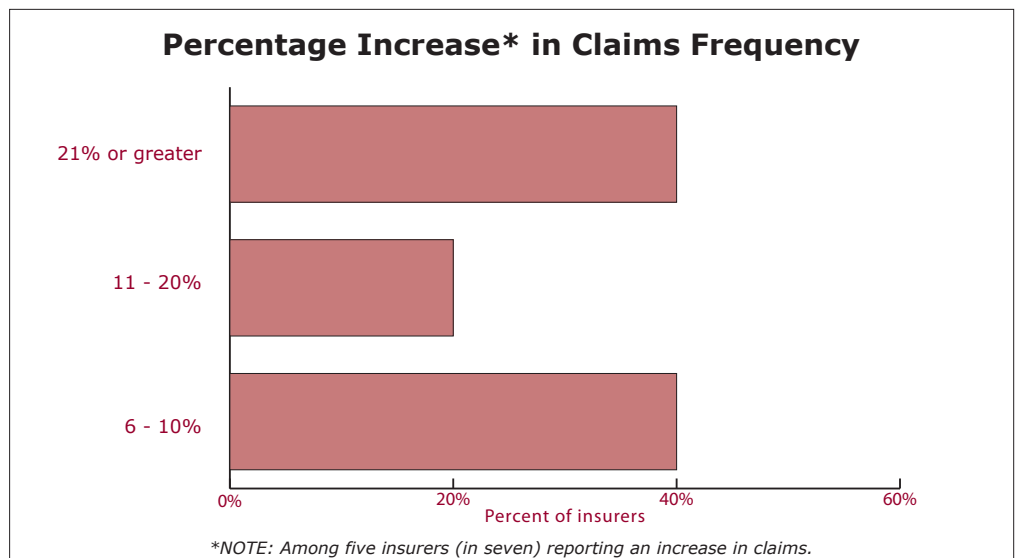
(1) Legal malpractice claims frequency is rising.

Although the incidence of legal malpractice claims appeared to be declining at the start of 2012, the number of new malpractice claims brought against law firms actually has trended upward since then. This generally fits the pattern of more claims as in previous post-recession periods (although some might say that the claims were slower to be filed than in past recessionary periods).

Of the insurers participating in this year's survey, 71 percent indicated the number of new claims filed in 2012 is higher than in the prior year.



Unfortunately, for some insurers, claims frequency is up markedly. Of those insurers experiencing an increase in law firm malpractice claims, 40 percent indicated frequency increased by 21 percent or more, while another 20 percent pegged the increase at 11 – 20 percent, and 40 percent saw an increase of 6 – 10 percent.

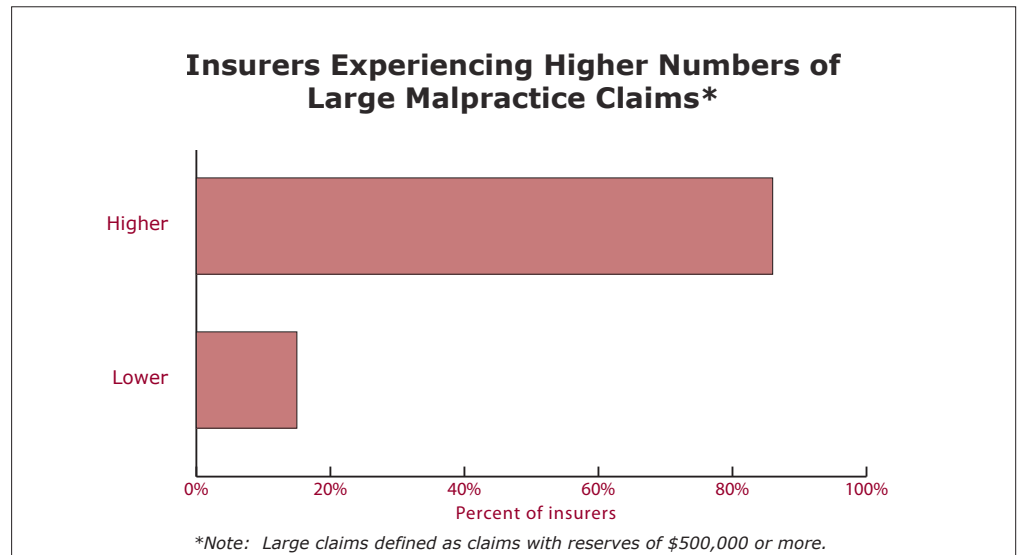


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2) Severity of legal malpractice claims is increasing.

Besides the unsettling jump in claims frequency, the number of large claims is growing significantly as well. Some industry analysts attribute the increase in claim severity simply to larger transactions and, therefore, larger potential damages. Yet others point to unconventional legal theories that inflate damages; while still others say escalating defense costs are driving the increase.

Six of the seven insurers in the survey have seen an increase in the number of claims with a reserve (including loss and expenses) of more than \$500,000 in the past year. In fact, five of the seven indicated they have more than 21 claims of this magnitude, one has 11 – 20 such claims, and one insurer has fewer than 5.

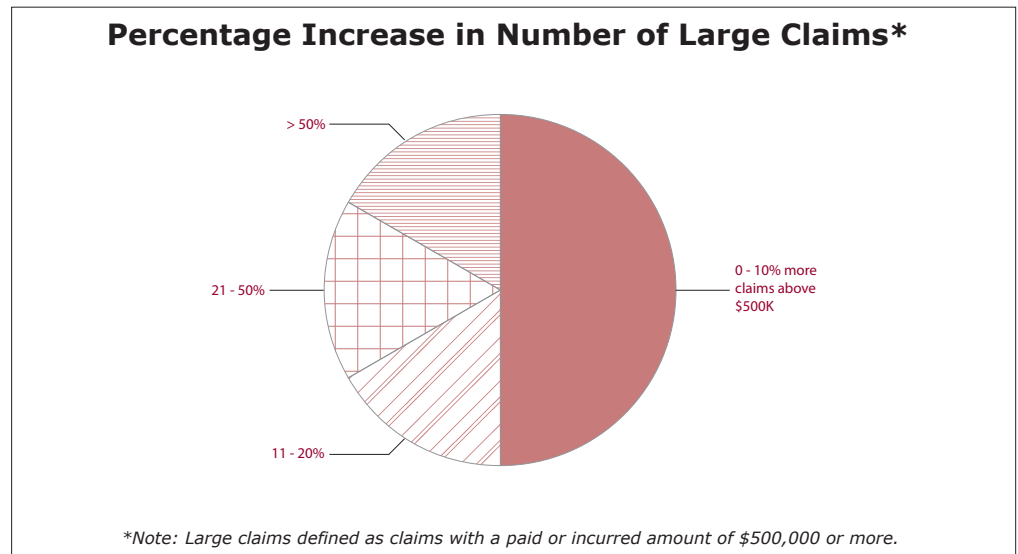


This finding is indicative of several developments:

- There is an added complexity to many legal malpractice claims (with multiple parties involved, complex corporate deals at stake, and key forensic and expert analysis required).
- During the past decade, rates charged by defense counsel have increased significantly. This has been especially true of the rates charged by larger firms being called upon to handle “bet the firm” litigation, where it is not uncommon to see hourly rates of \$600 or more.

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Three of the six insurers that reported an increase in the number of large claims, indicated the number of such claims increased by 11 percent or more. This included one insurer that reported a greater than 50 percent increase in such large claims year over year. In turn, three of six insurers reporting increased large claim activity indicated the number of such claims increased by 10 percent or less.



3) Most insurers have paid a claim of \$100 million or more.

The share of claims resulting in multi-million dollar payouts continues to grow. More than 85 percent of the survey participants (6 of 7 insurers) reported participating in a claim with a payment of \$50 million or more. Within this group, four of the six insurers indicated their company had paid or had participated in paying a claim of \$100 million or greater. Although it is likely that several insurers may be involved in the same claim payout (if, for example, they are providing excess limits or quota sharing the coverage), there's still no question the proportion of claims resulting in multi-million dollar payouts has expanded.

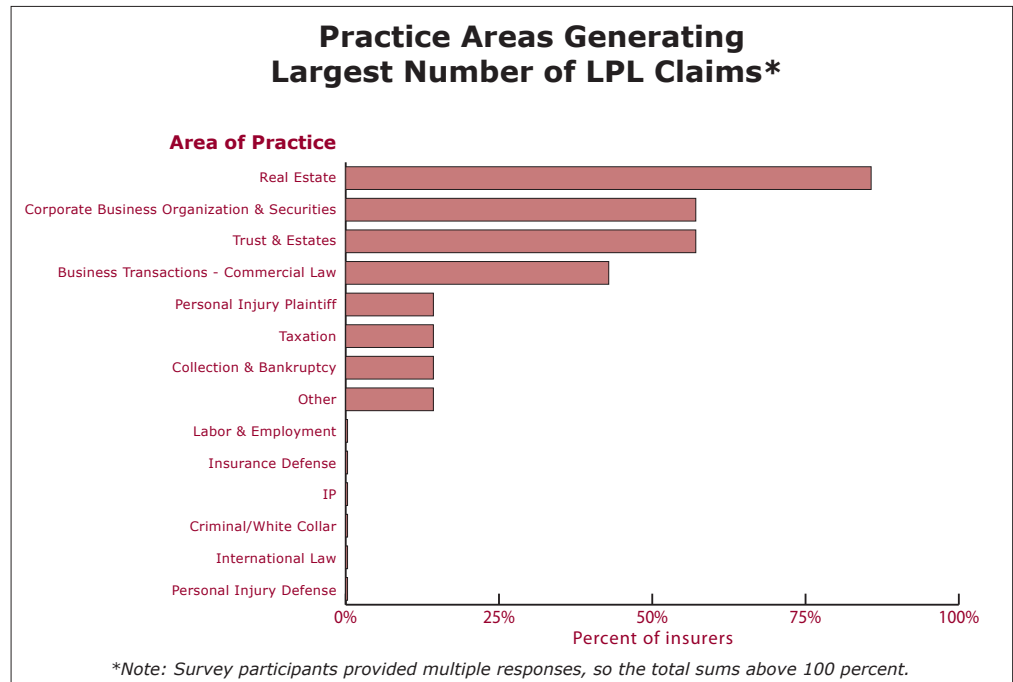
The increasing severity of legal malpractice claims also underscores the need for law firms to carefully consider whether or not they have adequate insurance limits to cover and defend a case. The amount of insurance coverage a firm purchases generally should be guided by the type of risks it faces, but also must take into account growing defense costs and an environment that seems to generate increasingly large judgments and settlements.

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4) Despite a significant surge in malpractice claims related to Trusts & Estates, most claims still come from Real Estate.

Six of the seven insurers polled identified Real Estate as the practice area continuing to see the largest number of legal malpractice claims. This trend is even more pronounced than survey findings of the prior two years and is also consistent with the ABA's recent legal malpractice study, *Profile of Legal Malpractice Claims: 2008 - 2011*, released at the end of 2012.

Although it appeared last year that legal malpractice claims stemming from real estate matters were beginning to level off, that clearly was not the case in 2012. Some suggest this may be related to a spate of failed commercial real estate deals which took longer to mature than residential related transactions.



Trust & Estate claims, meanwhile, have also been on the rise and now rank second, along with Corporate & Securities, in terms of practice areas most likely to encounter a malpractice claim. Business Transactions was fourth in claims frequency.

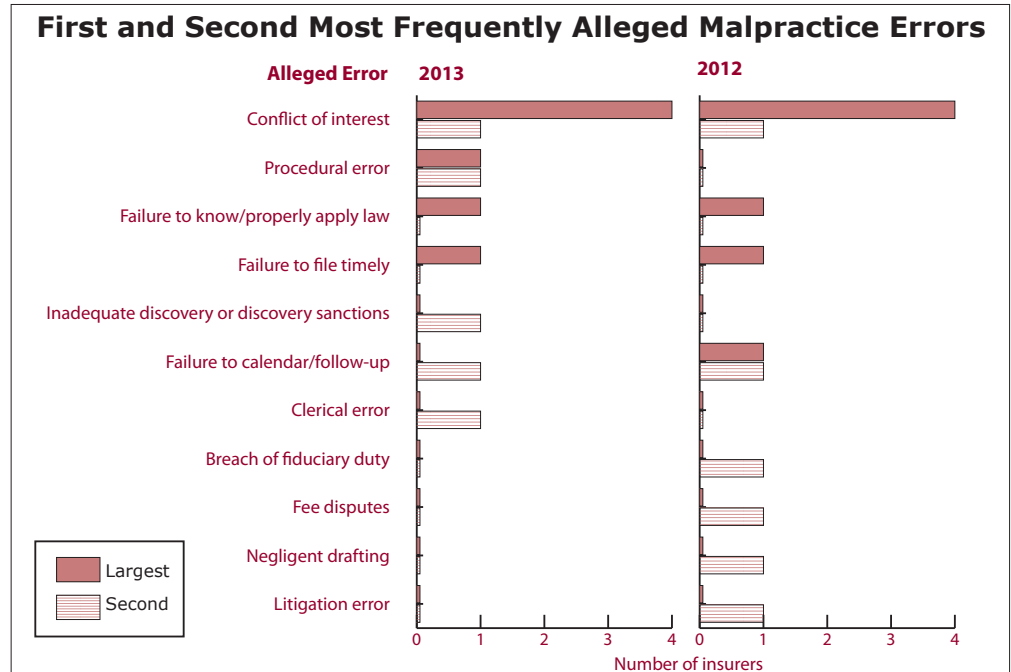
Anecdotal evidence suggests claims associated with trust and estate work are continuing to rise as the majority of jurisdictions no longer shield attorneys from liability to third-party beneficiaries. These jurisdictions hold that attorneys may owe duties to third-party beneficiaries of wills, trusts and estates with whom they have never consulted.

Irrespective of practice area, in the age of the internet, new communication risks have emerged, including: implied attorney client relationships from email exchanges; risks to third parties who receive forwarded emails; and inadvertent disclosures to unintended recipients of emails. As a result, attorneys in all areas of practice need to ensure they adapt their policies and business practices to accommodate the new technology and not inadvertently create relationships with third parties where there is no intention of representation.

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5) Most frequent alleged malpractice error: *conflict of interest*.

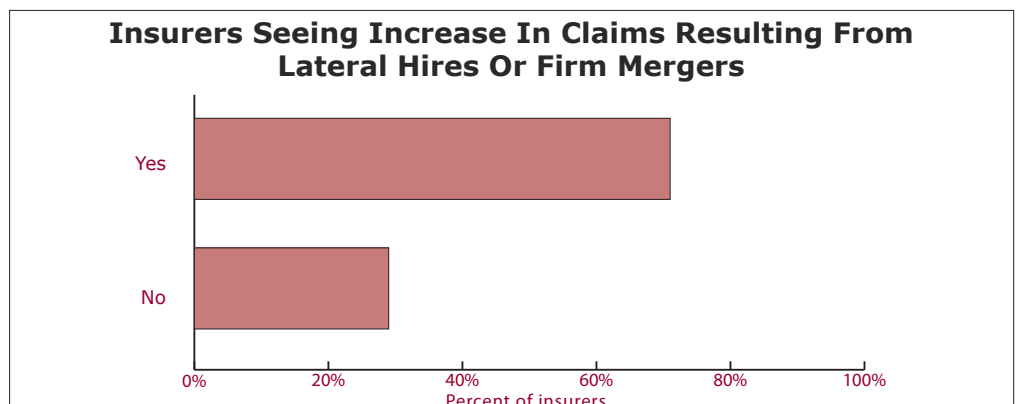
Among insurers participating in this year's survey, five of seven cited *conflict of interest* as either the first or second most frequent cause of malpractice claims. This is consistent with the finding for the prior year. Two listed *procedural error* as first or second. *Failure to know/properly apply law* and *failure to file timely*, each were cited by one insurer as the most frequent alleged malpractice error.



6) Law firm mergers, lateral hires driving up malpractice claims.

The imperative for survival; the drive to expand the firm and develop new practice areas; and the desire to win business have led many law firms to seek merger opportunities or to hire attorneys from other firms. However, along with the exciting potential opportunities growth brings, such initiatives represent elevated risks of malpractice claims involving divided loyalties (conflicts of interest) with respect to whom the firm can and should represent.

Among survey participants, 71 percent (5 of 7 insurers) indicated experiencing an increase in malpractice claims as a result of mergers and lateral hires. All five insurers experiencing claim increases cited new, lateral-hired attorneys – who continue to work on clients of their former firms while employed at their new firm – as creating potential claim issues. Two insurers also indicated that new attorneys were not trained or supervised properly, and one insurer also traced issues to law firms not resolving potential conflicts of interest.

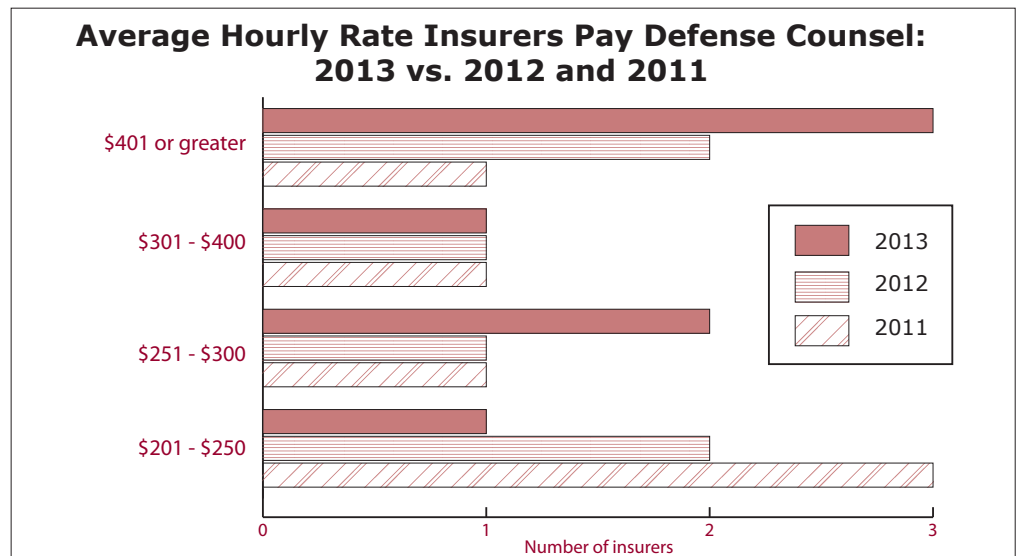


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7) Most insurers increased defense counsel rates in 2012.

In 2012, six of the seven insurers increased the rates they pay defense counsel. Two of the six increased their rates by 5 – 10 percent, and four increased them by 2 – 5 percent.

Four of seven insurers say they pay rates of \$300 or more per hour for defense counsel. Of these four, three indicated their typical rates are \$401 or more per hour. This is a shift from 2011 when only two of six insurers paid rates of this amount or more. Two other insurers paid rates between \$251 - \$300 per hour, and one paid rates of \$201 - \$250.



Conclusion: Facing larger claims, insurers seek higher rates; market conditions favor law firms with the tightest risk controls.

With both the frequency and severity of malpractice claims increasing, many insurers are raising their premium rates for legal malpractice insurance. Our recent experience suggests that law firms should generally budget for an increase in their premiums of 5 - 10 percent. If a firm has had claims, the size of this rate increase may even be greater. These likely increases must, however, be kept in perspective as rates have, up until 2013 generally declined for a number of years.

Is it possible to maintain a flat premium, or even lower a firm's premium on renewal? Even though most firms generally will see an increase in their premium rate in this hardening market, flat renewals or some reductions may be possible if a firm is willing to change insurers. In a drive for growth, some insurers will take on new business with premium reductions they can't or won't write for existing clients – even those with favorable risk profiles. For these reasons, it is important to develop a strategy with your broker to determine the best way to approach the market.

As they look for ways to keep rate increases to a minimum, law firms should stay focused on their risk management and proactive claims management efforts; ultimately, these efforts will help firms save premium dollars, as well as loss and defense expenses. Often, the manner in which a malpractice claim is handled in the initial stages (including how and when such a claim is reported) goes a long way in determining whether the resolution of the claim will be satisfactory.

While the lawyers' professional liability landscape and the claim environment continue to evolve, one thing is certain – solid risk management and active claims monitoring can pay off.

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Screen your clients carefully. If a potential client cannot afford a retainer agreement or has already sued another attorney, it raises serious red flags.

2. Make sure your firm has a strong system for conflict checking, especially if there are partners in other offices. Disparate locations can lead to confusion and disorganization with regard to "clearing" conflicts.
3. Be very specific regarding what work you plan to do for a client and whom you're representing in your engagement letter. Some attorneys have been sued by individuals whom they didn't even consider to be clients, underscoring the importance of laying out the specifics of each engagement in writing beforehand in order to manage client expectations.
4. Construct concise retainer agreements. Attorneys often forget to revisit the scope of the retainer agreement during an engagement, and conflicts may arise as new parties are added in the practice. These agreements should also include conflict waivers, which it seems some top defense firms neglect to include, often at their own peril.
5. Craft a friendly termination letter at the end of each matter or engagement. This is a nice way to thank the client for the work; finalize the current engagement; and request your firm be called on as counsel the next time the client has a legal matter they need handled. Meanwhile it avoids any confusion about your ongoing role.
6. Keep on top of fees by billing and collecting regularly. This helps eliminate the possibility of a huge outstanding amount that might prompt a client to sue as opposed to paying.
7. Ask lateral hires for documentation of the insurance coverage maintained by their former firms. Make sure these attorneys report any potential claims to their former firm's insurer before bringing them to your firm. And consider asking your insurer to add the lateral hire attorney to your policy with a "prior acts date," so the attorney will be covered under your policy only for malpractice committed after joining your firm.
8. Finally, if an error is made, don't hide your mistakes. Be upfront and remember to notify your insurer.