

Shopping for Professional Liability Insurance: Something Every Lawyer Should Have

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A. Introduction

This is the first of a series of articles on professional liability insurance. This article focuses on the economics which it is believed justify having professional liability insurance and the basics on obtaining coverage.

B. The Mathematics of Professional Liability Insurance

$$y = \frac{cd + dd + (2lr)}{gb}$$

- **y** = Years you have to practice without a claim for “going bare” to make sense
- **cd** = Cost of defending yourself in a legal malpractice action
- **lr** = Lost revenue during the pendency of a legal malpractice claim
- **dd** = Cost of responding to or defending a disciplinary complaint
- **gb** = Savings from “going bare.”

For purposes of this equation, I have made the following assumptions:

- The minimum cost of defending a “no liability”/slam dunk legal malpractice claim is \$10,000. For a legal malpractice claim where there is “possible liability,” it is not out of the ordinary for defense costs to run anywhere from \$50,000 to \$150,000. For a legal malpractice claim where there is real liability, the cost of defense can be much higher. Averaging the minimum and high costs of defense, \$80,000 is a realistic figure for the cost of defense for an average legal malpractice claim.

- The average life span of a legal malpractice claim is two years.

- A lawyer who has been sued for legal malpractice will experience an annual 10- to 20-percent decrease in his or her gross revenues.

- Assuming the average lawyer grosses \$150,000 per year, the anticipated loss of revenue for a lawyer sued for legal malpractice will be \$45,000 (15 percent x \$150,000 x two years).

- Almost every lawyer will in their legal career will have to respond to a disciplinary complaint filed by a disgruntled client and a lawyer is well advised to have independent counsel assist them in responding. The cost of responding to a disciplinary complaint is generally not outlandish, but it is an expense. What many lawyers do not realize is

that most professional liability policies issued today provide for a reimbursement, generally up to \$2,500, for such an expense.

- The average annual premium for professional liability insurance is \$2,500.

Applying these assumptions to the formula above, in order to justify not purchasing professional liability insurance, a lawyer would have to practice 51 years without a legal malpractice claim for “going bare” to make any economic sense. Of course, this calculation does not take into consideration the cost of paying a settlement or judgment which might be involved in the legal malpractice claim contemplated by this formula.

C. Shopping for Professional Liability Insurance – Shop early and everywhere.

- The first “art” of shopping for legal malpractice insurance is to shop early. If you wait until the *Christmas Eve* of the renewal of your professional liability insurance, you will lose the opportunity to shop for the best policy at the best price. I would recommend that you begin shopping no later than 60 days before your current policy’s renewal date and 90 days is better.

- The current professional liability insurance market is not what one would characterize as a tight market. There are sufficient companies currently providing coverage to New Mexico lawyers. A list of those (possibly not a complete list) is included as a sidebar to this outline. However, as is discussed below, the number of companies now writing in New Mexico should not lull a lawyer into a sense of complacency.

- You should solicit a bid or quote from each of these companies. While it is alright to utilize staff to assist in this process, the lawyer (or a member of the firm) should be intimately involved in this process.

- Longevity with a company (renewing with the same company) is often very desirable. However, even if you will likely renew with your present carrier, it is wise to shop the market. Price is seldom a good reason for choosing one carrier over another and you will find that the various companies in the market will be reasonably comparable in terms of price. The reason you want to shop every year is for policy and coverage issues (defense within limits, amount of indemnity coverage, disciplinary coverage, tail or prior acts coverage, etc.). At the risk of sounding too cute, has your existing carrier eliminated one of those bells and whistles (*e.g.* the automatic windows and locks) and another

carrier is now offering that feature.

- Utilize the brokers. Develop relationships with the brokers. Be honest with the brokers. You want them to know all your problems.

- Where the professional liability insurance market has changed is in the decision to aggressively engage in underwriting. For years, the legal malpractice carriers seemed to pay little attention to the details of an individual lawyer’s/law firm’s claim history and instead relied on regional loss data. In the last five years this has changed. Companies are now focusing on each insured, and through the application process companies are gathering detailed information on claims, losses, cost of defense information on past claims, information on disciplinary complaints and more precise information on an applicant’s practice in terms of areas of practice. Based on this information, companies are making decisions on whether to insure and are adjusting premiums accordingly.

- The preceding bullet deserves additional comment. The application process has become extremely important in the process of purchasing professional liability insurance. As noted above, this is not a task the lawyer should delegate to his or her legal assistant or office manager. It is critical that the information provided on any application should be completely accurate. Neglecting to report a disciplinary complaint or a past claim or mischaracterizing the firm’s areas of practice can result in the carrier challenging coverage through a declaratory judgment action when a claim is later filed. In the old days, insurance companies were extremely hesitant to challenge a lawyer on its professional liability coverage, but those days are over. There is *no more Mr. Nice Guy* in the professional liability arena. Companies have experienced large losses in the legal malpractice arena and they are not bashful in seeking to avoid coverage where a lawyer insured has not fulfilled his or her duties and obligations in the application process.

D. Conclusion

Whether maintaining professional liability insurance should be every lawyer’s professional responsibility and obligation is the subject of considerable debate today. Regardless of which side of that debate you favor, the mathematics (the economics) strongly suggests having and maintaining professional liability coverage only makes sense.