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GOT COVERAGE? WHAT EVERY LAWYER NEEDS TO KNOW ABOUT LAWYERS' PROFESSIONAL LIABILITY INSURANCE

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I. INTRODUCTION

Regardless of whether or not a lawyer has read the terms and conditions of his professional liability insurance policy, if he has never made a claim under the policy, the chances are that he is unaware of the carrier's interpretation and construction of the policy. Most of us simply practice from day to day working on the assumption that, *if* a client or former client were to assert an E&O claim, we have insurance coverage to deal with that situation. But, do we? Even if an individual lawyer is innocent of wrongdoing, can the conduct of another lawyer in the firm result in a forfeiture of coverage? Whether or not your insurance coverage practice includes lawyer professional liability, every lawyer should know the answer. This article will explore E&O insurance coverage for lawyers, including what constitutes a "wrongful act," construction and application of "innocent insured" provisions, disclosure of prior claims or acts, prior knowledge exclusions, dishonesty/crime/fraud exclusions, attempts to rescind lawyer E&O policies, and how the wrongdoing of a single lawyer might be imputed to the rest of the firm.

II. WRONGFUL ACTS & LEGAL SERVICES

A. WHAT CONSTITUTES A "WRONGFUL ACT"?

Legal E&O policies generally afford coverage for damages arising out of any wrongful act, error or omission of the insured in rendering or failing to render professional legal services for others. At common law, it is recognized that Texas attorneys owe no legal duty to non-client third parties. *Barcelo v. Elliott*, 923 S.W.2d 575, 577 (Tex. 1996); *Alpert v. Crain, Caton & James, P.C.*, 178 S.W.3d 398, 405 (Tex. App. – Houston [1st Dist.] 2005, pet. denied). Notwithstanding this rule, one United States District Court held earlier this year that an E&O insurer had a duty to defend a suit by third parties against whom the law firm previously had taken a default judgment. *Westport Ins. Co. v. Cotten Schmidt, LLP*, 605 F.Supp.2d 796 (N.D. Tex. 2009).

Cotten Schmidt arose out of a suit filed by the insured law firm on behalf of its client in which it took a default judgment and then obtained a writ of attachment on the defendant's equipment, which was sold at auction for allegedly millions of dollars less than its true value. In attacking the default judgment, the defendant against whom it was taken (Russell) alleged that the law firm failed to strictly comply with an order of substituted service. The defendant successfully had the default judgments vacated for lack of proper service, and then filed suit against the law firm for wrongful execution, levy and sale, and for conversion. Westport filed a declaratory judgment action claiming that the suit against the firm did not allege a "wrongful act" as required by the policy because the firm owed no legal duty to Russell as a non-client third party. Westport's policy defined a "wrongful act" as follows:

[*] The opinions and conclusions expressed by the authors do not necessarily reflect the opinions or position of Clark, Thomas & Winters or its clients.

> Any act, error, omission, circumstance, personal injury or breach of duty in the rendition of legal services for others in the INSURED's capacity as a lawyer, and arising out of the conduct of the INSURED'S profession as a lawyer.

The district court rejected Westport's argument, finding that the common-law rule did not bar suit because the law firm was not being sued for malpractice. *Id.* at 801. The court applied the complaint-allegation rule and concluded that the law firm and its lawyers were being sued because of what they did in obtaining default judgments and a writ of attachment, and in executing upon the equipment – actions which the court found to fit within the definition of "wrongful act." The court noted that, "the plain language of the policy does not limit coverage to claims of breach of duty nor to clients of Cotten Schmidt. Instead…the policy extends to '*any* act, error, [or] omission…in the rendition of legal services for others in the INSURED's capacity as a lawyer." *Id.* at 802.

B. WERE LEGAL SERVICES RENDERED?

Earlier this year, the district court in *American Guarantee & Liability Ins. Co. v. Hoeffner*, 2009 WL 130221 (S.D. Tex. Jan. 16, 2009) considered an argument by an insurer that allegations that the insured lawyers engaged in a kickback scheme in the settlement of their clients' lawsuits did not involve a "legal service" as defined by the policy. The Hoeffner firm represented numerous plaintiffs in silicosis lawsuits that were settled. Hoeffner subsequently was sued by former clients in three separate lawsuits which alleged that the firm and its lawyers participated in the scheme to cause the silicosis claims to settle at arbitrary amounts that resulted in millions of dollars in attorneys fees for the firm. The law firm allegedly conspired with employees of The Hartford, paying them kickbacks in exchange for their agreements to settle the suits.

The policy provided coverage for "damages" that an insured becomes obligated to pay because of a claim "based on an act or omission in the Insured's rendering or failing to render Legal Services for others." *Id*. at *3. The policy defined "Legal Services" to mean "those services performed by an Insured as a licensed lawyer in good standing ... but only where the act or omission was in the rendition of services ordinarily performed as a lawyer." *Id.* The carrier argued that engaging in a kickback scheme is not an act or omission "ordinarily performed as a lawyer" and, therefore, was not within the policy's definition of "Legal Services." The court rejected this argument, concluding that the claims in the underlying lawsuit, when construed broadly, alleged acts committed by the firm and its lawyers in connection with the settlement of the silicosis lawsuits, and that settlement of a lawsuit is an act ordinarily performed as a lawyer. As a result, the court found that the claims in the underlying lawsuit fell within the definition of "Legal Services" within the meaning of the policy. *Id*.

III. PRIOR KNOWLEDGE EXCLUSIONS

Prior knowledge exclusions generally exclude coverage for acts or omissions which occurred prior to the policy's inception if an insured knew or could have foreseen that the act or