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Susan Saab Fortney

Texas A&M University School of Law, sfortney@law.tamu.edu

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Recommended Citation

Susan S. Fortney, *Insurance Issues Related to Lateral Hire Musical Chairs*, 2000 Prof. Law. Symp. Issues 65 (2000).

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Insurance Issues Related to Lateral Hire Musical Chairs

Susan Saab Fortney*

I. INTRODUCTION

Weekly legal newspapers bombard readers with reports of lawyers changing law firms. No longer can we characterize private practice as a tournament of lawyers in which associates commit to a firm with the hope of attaining the trophy of equity status.¹ Rather, associates with a short-term vision are changing firms with regular frequency.² A 1998 study conducted by the National Association for Law Placement revealed that 43 percent of the 10,376 associates represented in the study had left their firms within three years.³ Partners, as well as associates, are moving with increased frequency, causing one commentator to refer to lateral movement as "the most profound aspect of the metamorphosis of the legal profession of the last 20 years."⁴ Experts estimate that approximately 40 percent of

* Susan Saab Fortney is a Professor of Law at the Texas Tech University School of Law. Professor Fortney has developed a national reputation as an expert in law firm governance. Professor Fortney's service activities during 1998-1999 included work with the American Association Ethics 2000 Commission; the Texas Supreme Court Jury Task Force, Board of Disciplinary Appeals, and Grievance Oversight Committee; Board Member, University Ministries; Texas Center for Legal Ethics and Professionalism Committee; Palo Duro Presbytery Mission Task Group; State Bar of Texas Court Rules Committee; and Palo Duro Presbytery Coordinating Council. Law students recognized her as Outstanding Law Professor for 1995-96 and 1996-97 (tied). Recently, graduates created an ethics award in her name.

1. See MARC S. GALANTER & THOMAS M. PALAY, *TOURNAMENT OF LAWYERS: THE TRANSFORMATION OF THE BIG LAW FIRM* 87-102 (1991) (proposing the tournament model to explain the growth of law firms). For contemporary applications of the model, see David B. Wilkins & G. Mitu Gulati, *Reconceiving the Tournament of Lawyers: Tracking, Seeding, and Information Control in the Internal Labor Markets of Elite Law Firms*, 84 VA. L. REV. 1581 (1998) and Marc S. Galanter & Thomas M. Palay, *Large Law Firm Misery: It's the Tournament, Not the Money*, 52 VANDERBILT L. REV. 953 (1999).

2. See Debra Baker, *Cash & Carry Associates*, A.B.A. J., May, 1999, at 40, 41 (explaining that associates with "short-term vision" are no longer willing "to submit their lives to sweatshop-like schedules").

3. NALP Foundation for Research and Education, *KEEPING THE KEEPERS: STRATEGIES FOR ASSOCIATE RETENTION IN TIMES OF ATTRITION* 53 (1998). Within five years, two thirds of new associates had departed and three-quarters did so within seven years. *Id.* For a discussion of the measures that firms are taking to retain associates, see Karen Hall & P. Hann Livingston, *Perking Up*, AM. LAW., Feb. 2000, at 60.

4. Harry A. Harrison, *When Considering a New Partner, Don't Skip Those Due Diligence Steps*, LEGAL TIMES, Sept. 29, 1997, at §59.

partners at major law firms had been hired laterally from other law firms.⁵

In addition to discussing lawyer mobility, legal newspapers also report legal malpractice claims and statistics. The stories on mobility and malpractice converge when the malpractice claim relates to acts or omissions of an lawyer who was hired from another law firm. For example, in 1997 one firm attributed 80 percent of its malpractice claims to prior acts of firm lawyers who had been laterally hired, even though the "laterals" only represented 20 percent of the firm's lawyers.⁶ This firm's experience is not unique. Many contemporary law firms attribute some of their biggest malpractice claims and associated costs to lateral hire selection and oversight.⁷ Because a firm may not foresee lateral hires bringing malpractice claims with them, malpractice expert Anthony E. Davis evokes the image of the Trojan horse.⁸

Clearly, one way of dealing with the malpractice Trojan horse is through professional liability insurance. Ironically, in response to both the threat and experience of claims related to lawyer mobility, malpractice insurers have limited their exposure for such claims. After briefly providing a historical perspective on insurer reaction to lateral hire claims, this paper discusses various insurance issues relating to lawyer mobility. Specifically, the paper will consider underwriting, coverage and claims handling issues related to the prior firm, the new firm and the moving lawyer. The paper also provides some practical suggestions on how the moving lawyer and new firm can protect themselves.

II. HISTORICAL PERSPECTIVE

The change in malpractice policies from occurrence to claims made policies can create coverage gaps for claims related to lawyers who have moved from one firm to another. Occurrence policies which determine coverage by the date on which the act, error or omission occurred, began to disappear in the mid-1970's.⁹ Largely because the exposure under occurrence policies was very uncertain, insurers quit writing occurrence policies, opting to write claims made policies. A claims made policy provides coverage for claims made and reported during the policy period. Generally, the policy requires that a claims made policy be in effect at the time that a claim is made and reported. Unless a claims

5. Amon Burton, *Migratory Lawyers and Imputed Conflicts of Interest*, 16 REV. LITIG. 665, 666 (1997) (referring to a 1994 study conducted by Hildebrant, Inc., a consulting firm).

6. Harrison, *supra* note 4, at §59.

7. Margaret C. Hepper, *Contemporary Challenges to Maintaining Law Firm Competency*, 580 PLI/Lit 995 (1998).

8. Anthony E. Davis, *Professional Liability Insurers as Regulators of Law Practice*, FORDHAM L. REV. 209, 218 (1996).

9. See Andrew S. Hanen & Jett Hanna, *Legal Malpractice Insurance: Exclusions, Selected Coverage and Consumer Issues*, 33 SOUTH TEXAS L. REV. 75, 127-128 (1992).

made policy provides coverage for the particular claim, an insured is left without coverage.

This claims made feature of policies effectively limits the coverage provided to mobile lawyers. The limitation is best illustrated by an example in which Mobile Lawyer leaves First Firm. First Firm carries a claims made policy for a coverage period from January 1, 2000 to January 1, 2001. During the coverage year, Mobile Lawyer joins Second Law Firm which has its own claims made policy in effect. After joining the firm, Mobile Lawyer is sued for malpractice. At that point, Mobile Lawyer must be protected under a claims made policy in effect at the time that the claim is reported. Coverage turns on whether a covered claim against an insured person has been made and reported during the policy period. Depending on the specific language of the policies, Mobile Lawyer may be covered under one policy, both policies or no policy.

In the 1980's a similar situation captured the attention of insurers and firm managers. Following the failure of a savings and loan association, the Federal Deposit Insurance Corporation ("FDIC") filed suit against *Jenkins & Gilchrist*, a large Texas firm. In addition to naming the firm as a defendant, the suit named current and former partners of the firm. A number of the former partners had joined other law firms including *Akin, Gump, Strauss, Hauer & Feld* ("*Akin, Gump*" and *Baker & McKenzie*. In an effort to maximize recovery, the FDIC sought coverage under the insurance policies issued to the *Akin, Gump* and *Baker & McKenzie*.

With respect to the claims made against the *Baker & McKenzie* lawyers, the insurer sought a court declaration that the FDIC's claims were not covered under the insurance policy. The first ground for the declaration was that the claims were not timely reported to the insurer.¹⁰ The second ground was that the *Baker & McKenzie* policy did not cover the lateral hires for claims relating to their prior law firm.¹¹ Both the federal district court and Court of Appeals for the Seventh Circuit did not resolve the issue of coverage for lateral hires, opting to dispose on the case on the basis of late notice.¹² Speaking for the Court, Judge Richard A. Posner concluded that the FDIC's claims were not "first made" and reported as required by the FDIC's applicable policy.¹³

In the related case arising out of the FDIC's claims against the *Akin, Gump* lawyers, the federal court dissected the coverage for the FDIC's complaints. Interpreting the language of the policy issued to *Akin, Gump* (the new firm), the court concluded that the policy did not cover claims seeking to hold the lat-

10. *National Union Fire Ins. Co. v. Baker & McKenzie*, 997 F.2d 305, 307 (7th Cir. 1993).

11. *Id.*

12. Martha Middleton, *Baker & McKenzie's Claim: Too Late*, NAT'L. L. J., July 5, 1993, at 2 (noting that the court bypassed "the potentially explosive issue of whether a legal malpractice policy covers lateral partners for liability stemming from misconduct by their prior firm").

13. *National Union*, 997 F.2d at 307.

eral lawyer vicariously liable on account of the conduct of others at the prior firm.¹⁴ At the same time, the court concluded that the new firm's insurance policy required that the insurer at least provide a defense to the lateral for claims seeking to hold the lateral directly liable.¹⁵ Drawing the distinction between vicarious and direct liability, the court explained that the allegation that partners failed to supervise and train other lawyers at the prior firm amounted to a direct, rather than a vicarious liability claim.¹⁶

These cases and others involving coverage for claims related to the conduct of a lateral's prior firm caused insurers to reassess the risks associated by lateral movement. As explained by insurance expert Professor Charles Silver, "[t]he (lateral) lawyer may be a bad apple whom the prior firm expelled, or the lawyer may have changed firms to get away from bad apples left behind. Either way, the new lawyer is a source of risk for the new firm."¹⁷ Understanding this risk of lateral lawyers bringing liability baggage with them and the risk of stacking the policies,¹⁸ insurers tightened policy language to clarify that the new firm's policy did not cover claims brought in connection with professional services rendered for another firm.¹⁹

III. SPECIFIC POLICY PROVISIONS RELATED TO LATERAL HIRES

Evaluation of coverage for claims against lateral hires requires an examination of both the policy for the prior firm and the policy for the new firm.

A. COVERAGE UNDER THE PRIOR FIRM'S POLICY

The vast majority of professional liability policies provide coverage for former lawyers for claims related to professional services rendered for the prior firm.²⁰

14. *National Union Fire Ins. Co. v. FDIC*, No 3-90-0492-H, 1991 SW 716787, at 5. (N.D. Tex. Jan. 25, 1991) (relying on the policy language that states that the policy only covers claims arising out of "any act, error or omission of the insured" that "occurred in the insured's capacity as a lawyer, fiduciary or Notary Public").

15. The court applied the complaint allegation rule that requires the insurer provide a defense as long as the complaint alleges at least one cause of action within the coverage of the policy. *Id.* at 7.

16. Fletcher L. Yarbrough et al., *Director and Officer and Professional Liability Insurance Issues*, C880 ALI-ABA 535, 565 (1994). See Susan Saab Fortney, *Am I My Partner's Keeper? Peer Review in Law Firms*, 66 COLO. L. REV. 329, 330-333 (1995) (analyzing the vicarious liability and direct liability claims).

17. Charles Silver, *Professional Liability Insurance as Insurance and as Lawyer Regulation: Response to Davis*, 65 FORDHAM L. REV. 233, 238, n. 9 (1996).

18. See *id.* at 238, n. 9 and accompanying text.

19. *Davis*, *supra* note 8, at 217 ("a number of insurers are adding supplementary language expressly to deal with the issue of lateral hires and mergers").

20. According to an analysis of policy forms available in 1999, only three of the 77 policies listed provided "no" coverage for former attorney. Only the TIG policy was listed as providing coverage to former attorneys, without qualification. RONALD E. MALLEN & ROBERT J. ROMERO, *LEGAL MALPRACTICE: THE LAW OFFICE GUIDE TO PURCHASING LEGAL MALPRACTICE INSURANCE—1999 EDITION*.

Extending defense and coverage to former lawyers makes practical sense because the prior firm will probably be vicariously liable for its acts and omissions made in the scope of firm business.²¹

Although policies use different approaches, this coverage for former lawyers is typically limited by language in the insuring agreements or in the definition of "insured." For example, the following provision is used in the insuring agreements of the Specimen Policy for the Attorneys' Liability Assurance Society, Inc. ("ALAS"):

This Policy is to indemnify . . . the ASSURED in respect of any CLAIM made against the ASSURED during the PERIOD OF INSURANCE . . . by reason of any ACT . . . committed or alleged to have been committed:

A. by an ASSURED or any other person or entity in the conduct of any business conducted by or on behalf of the FIRM in its professional capacity as Attorneys, Counselors at Law, or Notaries, or

B. by any PARTNER, retired PARTNER, or EMPLOYEE of the FIRM acting in his or her professional capacity as Attorney, Counselor at law, or Notary, provided always that (i) a portion of any fee for such work that is to be earned by such person . . . shall accrue to the benefit of the FIRM or (ii) such work is performed for a then existing client of the FIRM and with the prior written approval of the Firm.²²

This insuring agreement effectively limits coverage to claims arising from business conducted for the named firm or firm clients.²³

Other policies use definitions to limit coverage for former lawyers. For example, under the Specimen Zurich-American Insurance Group Professional Liability Insurance Policy (for) Lawyers, "Insured" includes "any lawyer or professional legal corporation who was a former partner, officer, director or employee of the firm or predecessor firm(s) solely while acting in a professional capacity on behalf of such firms."²⁴

As illustrated by the provisions quoted above, the prior firm's policy gen-

21. See RONALD E. MALLIN & JEFFREY M. SMITH, *LEGAL MALPRACTICE*, 33.7, at 298-99 (referring to the "practical wisdom" of affording a defense to persons for whom insured attorneys are vicariously liable).

22. Specimen Attorneys' Liability Assurance Society, Inc. Professional Indemnity Policy (as amended through Jan. 25, 2000) at 1-2.

23. The ALAS policy also uses definitions to clarify the limited coverage extended to former attorneys. Under the ALAS policy, the definition of "ASSURED" includes "each partner no longer in the FIRM who was a PARTNER or EMPLOYEE in the FIRM at the time of the ACT and/or the estate of such person." *Id.* at 2.

24. Zurich-American Insurance Group Professional Liability Insurance Policy (for) Lawyers (Specimen Policy) at 2.

erally will cover claims against former lawyers if the alleged act, error or omission related to work performed for the prior firm. Therefore, a former lawyer should be protected, provided that the prior firm carries a claims made policy at the time the claim is actually made and reported.

A problem arises if the prior firm dissolves or otherwise fails to obtain insurance to cover claims against former lawyers. Professor Robert W. Hillman warns that it is unlikely that most lawyers are obtaining insurance for post-dissolution vicarious liabilities, because most lawyers are unaware of their liability exposure.²⁵ In that event, a coverage gap may be created unless the mobile lawyer is covered under the new firm's policy.

B. COVERAGE UNDER THE NEW FIRM'S POLICY

To determine if a new firm's policy will cover a claim of a lateral hire, you must study the specific policy provisions related to new lawyers. In the same way that policies vary in their treatment of former lawyers, policies also vary in their treatment of new lawyers. Some policies require that the addition of the new lawyer be reported to the insurer while other policies automatically extend coverage to new lawyers. Policies are most similar in providing coverage only for claims arising from work at the new firm.²⁶

Whether it be through language in insuring agreements, definitions or exclusions, policies generally eliminate coverage for prior acts related to another law firm. As illustrated by the ALAS insuring agreement quoted in Part A above, insuring agreements can specifically state that coverage is only provided for claims rendered on behalf of the named insured (the new firm). An act or omission committed by a lawyer before joining a firm does not meet this criterion that the claim arise from the conduct of firm business.²⁷

Another underwriting approach uses definitions to limit the scope of insurance for new lawyers. For example, a Lloyd's Policy extends coverage to new lawyers under the following definition of insured: "any lawyer who during the Period of Insurance becomes a partner, member, stockholder or employee of the Named Insured but *solely for acts on behalf of the Named Insured designated in item 1 of the Declarations.*" (emphasis added)²⁸

25. ROBERT W. HILLMAN, HILLMAN ON LAWYER MOBILITY: THE LAW AND ETHICS OF PARTNER WITHDRAWAL AND LAW FIRM BREAKUPS at §4.11.3, at 4:131 (1999).

26. "Most policies provide coverage to laterals, but many limit the insurer's exposure to the lateral's acts or omissions in rendering professional services for the insured firm." Fletcher L. Yarbrough, *Directors and Officers and Professional Liability Insurance Issues*, C665 ALI-ABA 305, 329 (1991).

27. Karen D. Kadushin, CAL. PRAC. GUIDE LAW PRAC. MGMT. Ch. 11B (TREATISE) (P 11:22 - P 11:46:5) at 11.41.1 (citing *Taub v. First State Ins. Co.* 44 Cal. App. 4th 811, 819-820, 52 Cal. Rptr. 2d 1, at 6).

28. Lloyd's Lawyer's Professional Liability Policy at 4.

Common policy exclusions may also operate to eliminate coverage for claims made in connection with a business enterprise which is not the named insured. The Executive Re Indemnity Inc. Policy excludes claims "based on or directly or indirectly arising out of or resulting from the service of any individual insured in his or her capacity as a partner, member, principal, director, officer, shareholder, counsel, of counsel, or employee of any entity other than the Firm."²⁹ Such an exclusion eliminates coverage for claims related to the prior firm or any other entity other than the named insured (the new firm). If the elimination of coverage for the lateral hire is handled in an exclusion rather than in the insuring agreement, one commentator suggests that the insurer will have heavier burden in relying on the exclusion.³⁰

Rather than relying on the standard policy exclusions, many insurers changed underwriting practices to specifically address the risk of lateral hires bringing malpractice claims with them to their new firms. Beginning in the 1980's, these carriers began to add "lateral hire" endorsements to professional liability policies. For example, National Union Fire Insurance Policy Specimen Endorsement states that the "policy will not cover claims against an insured if . . . the act, error or omission giving rise to the claim occurred prior to the date such insured . . . became an employee, partner, member or shareholder of the named insured."³¹ One Law Practice Management Guide sums up the availability of insurance for lateral hires as follows:

(M)any insurers now limit or exclude prior acts coverage unless a special endorsement is purchased. Even those carriers still offering full prior acts coverage may place special restrictions on it (e.g. number of "covered" years, that there is no other policy affording coverage for the prior act or omission, and the like). Thus the type of "claims-made" coverage you obtain for your practice will depend on what you want, what you are willing to pay, and what the carrier is offering.³²

This advice underscores the importance of both the new firm and mobile lawyer carefully evaluating the liability exposure and insurance angles related to lateral movement.

IV. ASSESSING AND HANDLING RISKS

The following section discusses how a firm and a lateral lawyer should study and address risks before consummating the move.

29. Executive Re Indemnity Inc. Lawyers Professional Liability Policy (sample policy) at 4.

30. Bruce A. Campbell, *Of Greener Grass, Bigger Bucks and Open Septic Tanks . . . Law Firm Break-ups, Spin-offs and other Changes*, TEX. B. J., Apr. 1998, at 322, 326 (explaining that the insurer will have a "relatively light burden" of establishing that no coverage exists under an insuring agreement as compared to the burden of proof of establishing that acts or omissions fall within some exclusion).

31. National Union Fire Ins. Co. Lawyers Professional Liability Policy, Specimen Lateral Hire Endorsement.

32. Kadushin, *supra* note 27.

DUE DILIGENCE BY THE LAW FIRM

Firms with experience in hiring laterals understand the importance of carefully screening the candidate. To assist firm managers in the screening process, some commentators provide due diligence checklists, identifying the areas that should be carefully reviewed.³³ Recognizing the liability exposure associated with lateral hiring, various checklists suggest that inquiries be made to assess liability risks. For example, obtaining the following information on the candidate will help the hiring firm determine possible liability exposure related to the lateral hire's practice:

1. Ethics complaints and malpractice claims;
2. Personal credit history and financial statements;
3. Criminal history;
4. Interviews with lawyers and other professionals with whom lateral hires have worked;
5. Conflict of interest issues, including philosophies regarding disclosures and waivers;
6. The lateral hire's philosophy regarding peer review and practice management oversight.³⁴

This information will help the hiring firm gauge possible liability and how the lateral hire would affect the cost and availability of malpractice insurance for the firm.

Having evaluated liability exposure, the due diligence review should focus on how to handle possible claims through professional liability insurance. Even some of the most comprehensive due diligence checklists do not identify insurance as an area to be examined.³⁵ This omission suggests that some firm managers may not be considering insurance issues related to lateral hires.³⁶ For those managers who appreciate insurance risks associated with lateral hires, insuring laterals is becoming a prominent part of hiring negotiations, according to Chicago lawyer Richard Mueller of Lord, Bissell & Brook.³⁷

In order to approach hiring discussions and negotiations with open eyes, the hiring firm has to consider its own insurance coverage and the insurance car-

33. Steven A. Felderstein, *Growth Issues*, 478 PLI/Comm 187 (1988).

34. Hepper, *supra* note 7, at 1001.

35. *See id.*

36. *See* Michael Kelter, *Include Malpractice Issues in Job Talks*, ILL. LEGAL TIMES, March, 1997 (a letter pointing out that a recent publication of a roundtable discussion on lateral hires failed to mention how lateral hires impact insurance). Mr. Kelter recommends asking the candidate to complete a one-page application that will identify many key aspects of that lawyer's history and credibility, allowing the firm "to better judge the candidate." *Id.*

37. Helen Lucaitis, *Malpractice Fears Lead to Caution on Firms' Use of "Lateral Hires"* CHI. DAILY L. BULL., Nov. 15, 1991 at 1.

ried by the firm the candidate is leaving. Starting with the evaluation of the hiring firm's own insurance, one insurance expert recommends asking the following questions:

What coverage does your policy provide to lateral hires?

Does it cover prior acts at the old firm?

What about vicarious liability for claims against the old firm?

Should your firm offer this type of coverage to lateral hires?³⁸

Depending on the number of laterals who intend to join the new firm, other policy provisions may be triggered. For example, if an entire practice group is joining the new firm, the following "material change" provision could apply:

If, during the Policy Period, the total number of attorneys in the Firm increases by more than five percent (5%) as the result of the Firm's merger with or acquisition of any other law firm or any group of attorneys who practiced together at another law firm, the Firm must promptly give the Underwriter written notice thereof, and the Underwriter will be entitled to impose such additional coverage terms and charge such additional premium in connection therewith as the Underwriter, in its sole discretion may require.³⁹

In addition to studying what coverage is provided under the new firm's current policy, it is also helpful to ask questions that will be asked by future insurance underwriters. Among other questions, the hiring firm should ask the candidate the following:

1. Have there been any disciplinary complaints, proceedings, grievances or inquiries, whether formal or informal, and whether complete or not, against or with respect to you and your legal services?
2. Have you ever personally been involved in a situation in which a party claims (whether or not through a formal complaint or proceeding) that you or your firm had committed legal malpractice of any kind?
3. Do you serve as an officer, director or general partner of any organization?
4. Do you serve as a trustee, conservator, administrator, executor or similar fiduciary capacity for any estate or individual?
5. Please list and describe any powers of lawyer that permit you to acquire or dispose of assets for a client (for example, buying or selling securities or writing checks against a client's funds).
6. Please describe your specialties and nature of your practice.
7. If you have been in private practice before coming to the firm, will your former firm or employer maintain insurance coverage for you with respect to acts, errors or omissions during the period you were there? If not, is extended reporting or "tail" coverage available and will it be purchased?⁴⁰

38. Kirk R. Hall, *Hiring Without a Net*, A.B.A. J., Nov., 1996, at 84.

39. Executive Re Specialty Insurance Co. Lawyers Professional Liability Policy at 8.

40. Donald J. Brayer, *Lateral Hires Can Pose Professional Liability Insurance Problems*, CHI. DAILY L. BULL., Jan. 6, 1992, at 2.

Other questions can be derived from insurance applications that the firm has completed in the past. This exercise of asking questions that will eventually be asked at insurance renewal time helps the firm evaluate how the new hire's past and law practice might adversely affect the cost and availability of insurance for the hiring firm.⁴¹

Having evaluated your own firm's insurance coverage and how the lateral will affect that coverage, the hiring firm is in a better position to evaluate the coverage carried by the firm the lateral is leaving (the "Prior Firm"). The hiring firm's representative should attempt to examine the Prior Firm's policy to confirm that the policy provides coverage for former lawyers for legal services rendered on behalf of the Prior Firm.⁴² The review of the Prior Firm's policy will also reveal whether extended reporting coverage is available in the event that the firm dissolves or otherwise does not purchase annual coverage.⁴³ The insured may have the option to extend the reporting period for one year, two years, three years or an unlimited time immediately following the expiration date of the policy.⁴⁴ All options and approaches should be reviewed with an insurance broker who knows the professional liability market.

Rather than buying an extended reporting coverage under the Prior Firm's policy, a firm might consider the availability of prior acts coverage under the hiring firm's own policy. For a premium, this coverage could be provided in a special endorsement added to the hiring firm's policy. This approach to addressing exposure for the lateral hire can be very risky and costly for various reasons. First, adding the lateral to the firm's policy may result in the firm's policy being tapped to defend and pay claims related to another law firm's business. That means that the hiring firm must pay the deductible for the claim and that claims expenses and indemnity payments will reduce the limits of liability available to pay other claims made under the hiring firm's policy.⁴⁵ Second, the claim made

41. In analyzing the role of professional liability insurers in regulating law practice, Anthony E. Davis suggests that policy provisions limiting prior acts coverage for lateral hires are "intended to require—or at least encourage—firms to exercise reasonable and prudent 'due diligence' as they embark on lateral hiring or merger negotiations." Davis, *supra* note 8, at 218.

42. The Prior Firm may not want the hiring firm to have access to the entire policy if the policy incorporates the application for insurance. As an insured under the Prior Firm's policy, the lateral should be entitled to review a copy of the policy. To avoid questions, the departing attorney should inform the Prior Firm before sharing the policy with attorneys at the new firm.

43. An extended reporting period is some specified period of time after termination of the policy during which a claim can be reported. Kenneth J. Sherk, *Malpractice Policy Considerations "Tail,"* ARIZONA ATTORNEY, Nov., 1993 at 27-28.

44. A. Craig Fleishman, *Potential Perils of the Professional Liability Insurance Policy*, COLO. LAW., Feb. 199, at 299, 300 (noting that the coverage is still limited to acts or omissions of professional services rendered before the insured's date of departure).

45. If the claim against the lateral hire is based on vicarious liability for acts and omissions at the prior firm, the new firm could even face a total loss of its insurance protection because of wrongful acts of an attorney who is not even a member of the firm. *Id.* at 299.

in connection with another firm's business will become part of the underwriting record and claims history of the hiring firm. This again can affect the cost and availability of insurance for subsequent years. Third, internal firm conflicts can arise if the firm's policy is being used to pay claims related to another firm.

For these reasons, experts caution firms against providing prior acts coverage to lateral hires.⁴⁶ In fact, if the firm's evaluation of its own policy reveals that the policy provides prior acts coverage for lateral hires, the firm may actually ask its insurers to write a lateral hire endorsement to eliminate coverage for claims related to services rendered before the lateral hire joined the new firm. If the firm takes such a tack, a firm representative should inform the lateral hire. With full disclosure, the lateral hire is in a better position to assess his/her own risks in joining the new firm.

B. DUE DILIGENCE BY THE LATERAL HIRE

The lateral hire, like the hiring firm, should carefully investigate insurance ramifications of changing law firms. This investigation starts with examination of the professional liability insurance policy issued to the firm the lateral is leaving. In particular, the lawyers should study all insuring agreements, definitions, exclusions and conditions in the policy relating to the coverage and adjustment of claims that may be made after a lawyer's departure from a firm.

As long as the prior firm maintains an insurance policy that covers prior lawyers for claims relating to professional services rendered for the named insured, the lateral probably does not need to worry. The situation changes if the firm dissolves or otherwise forgoes insurance coverage. In that event, the lateral lawyer should evaluate the availability of obtaining extended reporting coverage ("tail coverage").⁴⁷

If tail coverage is not available, the lateral may ask the new firm to purchase a special endorsement providing the lateral with full prior acts coverage under the new firm's policy. For the reasons discussed above, most firm managers won't be inclined to arrange such coverage. As a last resort, the lateral hire may attempt to purchase an individual policy to provide coverage for prior acts related to the prior firm. Although most carriers probably will not write such policies, some insurers may be willing to write the coverage for a large enough premium.⁴⁸

The lateral lawyer should also carefully scrutinize any professional services delivered before the date of departure, considering if any act or omission could give rise to a professional liability claim. If the lateral discovers some basis for a

46. Robert Daniszewski, *New Hampshire Legal Malpractice Developments*, 608 PLI/Lit 389, at 408 (1999) (recommending that hiring firms "think long and hard before agreeing" to obtain prior acts coverage for lateral hires).

47. State law may mandate and govern tail coverage. See, e.g., N.Y. Comp. Codes R. & Regs. tit. 11, 73.3 (1999).

48. See Kadushin, *supra* note 27, at 11:41 (explaining the coverage you obtain depends on what you want, what you are willing to pay, and what the carrier is offering).

malpractice claim, the lateral should report the potential claim to the firm's insurer before joining the new firm.⁴⁹

In order to limit continuing liability for the acts and omissions of the lateral's former partners, the lateral hire should give notice of departure to trade creditors and clients.⁵⁰ Applicable ethics rules, case law, ethics opinions, and commentary provide guidance on the form and timing of notice to clients and others.⁵¹

Even after departure, the lateral hire should continue to be concerned about the insurance coverage carried by the prior firm. For some period of time, such as five years, a lateral hire could annually monitor insurance coverage by asking for a copy of the prior firm's policy. By obtaining a copy of the prior firm's policy, the lateral can evaluate whether coverage is provided for former lawyers or whether other insurance arrangements must be made.⁵²

V. PROBLEMS RELATED TO ADJUSTING CLAIMS

A. PROBLEMS IN SORTING RISKS

The above discussion of policy provisions reveals that insurers attempt to sort risks in underwriting. As explained, a firm's policy should provide coverage for claims arising from the acts or omissions in rendering professional services for the insured firm. On the other hand, claims relating to professional services rendered at another firm should be covered under that firm's policy. This sorting of risks can be done when the record clearly reflects the law firm where professional services were rendered. The coverage analysis becomes murkier when the plaintiff's complaints may cover professional services rendered at both the lateral hire's prior law firm and the current law firm. Such a scenario could occur when a lateral hire brings client business from the prior firm to the new firm.⁵³ In fact, the hiring firm's

49. See Mark Hansen, *When the Case Lays an Egg*, A.B.A. J., March 2000, at 74 (noting the disclosure of potential claims to the insurer will preserve coverage in the event of suit).

50. See Angus G. Goetz, Jr., *Break Away Lawyers*, MICH. B.J. 1078, at 1081 (listing the matters that notice should cover).

51. E.g. ABA Standing Comm. on Ethics and Professional Responsibility, Formal Op. 99-414 (1999). For a discussion of the risk of post-departure liabilities and methods to reduce the risk, see Hillman, *supra* note 25, at § 4.11.2 - 4.11.4.

52. The prior firm may refuse to provide a copy of its policy to the attorney who has joined another firm. The prior firm may take the position that the attorney who has withdrawn as a partner or shareholder is no longer entitled to information. The lateral hire who is seeking information could respond to this resistance by explaining that s/he needs the policy to evaluate liability exposure for professional services rendered when the lateral was still an attorney at the prior firm. Section 403 of the Revised Uniform Partnership Act (1994) states that the partnership "shall provide former partners and their agents and attorneys access to books and records pertaining to the period during which they were partners."

53. For a description of a horror story in which a lateral partner brought malpractice claims to the new firm, see Anthony E. Davis, *Managing the Risks of Expanding the Firm*, N.Y.L.J., July 6, 1998, at 3. In that case, the lateral hire joined in litigation against a client, while continuing to represent the same client at the prior firm and the new firm. The new firm learned about the litigation and the partner's involvement when the new firm received the client's demand letter.

interest in the lateral may largely stem from the lateral's ability to bring a book of business to the new firm. A Seventh Circuit opinion recognized the likelihood of a lateral bringing clients (and eventually client claims) in stating the following:

Nothing is more common nowadays than for a lawyer to leave one firm for another, carrying his clients from his old firm to the new. Indeed, a lawyer who comes to a new firm without any clients is a much less attractive commodity. (The new firm) might not have hired (the lateral) partner unless he brought his clients with him.⁵⁶

In situations where a lateral lawyer brings business to the new firm, coverage depends on a multiple step analysis. First, you must identify the specific acts or omissions alleged by the malpractice plaintiff. Second, you must discern the firm where those acts and omissions occurred.

This type of analysis was used by the California court in *Taub v. First State Ins. Co.*⁵⁵ That coverage case arose out of a legal malpractice action filed by Client Moore against Lawyer Taub. In 1972 while practicing as a solo law corporation, Lawyer Taub commenced representing Client Moore. In 1981, Lawyer Taub joined the law firm of Hayes & Hume. In 1986 when Moore sued Taub for malpractice, Taub sought coverage under the First State Insurance policy issued to Hayes & Hume. That policy limited coverage to the "professional services" rendered in the conduct of the insured firm's business.⁵⁶ Therefore, the coverage question turned on whether the plaintiff's claims were based on legal services performed in the conduct of Hayes & Hume's business. To answer this question, the court first examined the allegations in the malpractice complaint. This examination revealed that the alleged malpractice occurred in 1972-73. Second, because the 1972-73 malpractice allegedly occurred before Taub joined Hayes & Humes (the insured firm), the court concluded that the malpractice claims were not covered under the First State Policy issued to Hayes & Humes.⁵⁷

The result in the *Taub* case would have been different if the malpractice claims related to professional services rendered at both the prior firm and the new firm.⁵⁸ In that event, the insured may be entitled to a defense under the

54. *Old Republic Ins. Co. v. Chuhak & Tescon, P.C.*, 84 F.3d 993, 1002 (7th Cir. 1996).

55. 44 Cal. App. 4th 811, 52 Cal. Rptr. 2d 1 (Cal. Ct. App. 1995).

56. *Id.* at 818, 5.

57. The court rejected the argument that Attorney Taub was under a continuing duty to cure the problems caused by his negligence that his failure to cure occurred while he was affiliated with Hayes & Hume. The court believed that there was no duty to cure at Hayes & Hume and therefore no coverage because the attorney-client relationship had been terminated before Taub joined Hayes & Hume. *Id.* at 821, 7.

58. See, e.g., *Old Republic Ins. Co. v. Chuhak & Tecson, P.C.*, 84 F.3d 988 (7th Cir. 1996) (where the court declared that the insurer for the new firm would have a duty to defend because the alleged malpractice in failing to file an action on behalf of the malpractice plaintiff occurred when the lateral was at the new firm).

terms of the insurance policy issued to the prior firm, as well as the insurance policy issued to the new firm.

When more than one insurance policy applies, the insurers may agree to share defense costs. If such an agreement cannot be reached, a court might have to resolve the dispute. To do so, the court would compare the allegations in the complaint to the "Other Insurance" provisions in the two policies. If the "Other Insurance" clauses in the policies conflict, the great weight of judicial authority supports the rule disregarding such clauses as "mutually repugnant".⁵⁹ In that event, both policies are treated as primary, requiring some proration of the insurer's liability.⁶⁰

B. PROBLEMS RELATED TO ADJUSTING CLAIMS

Typically, the professional liability policy will state that the insurer has the right and duty to defend any claim covered by the policy, subject to the limits of liability. In discharging the duty to defend, the insurer can encounter conflicts if the interests and preferences of insureds conflict. For example, a conflict can arise between the insured lawyers who are currently partners at the insured firm and former lawyers who are being defended under the firm's policy.⁶¹ In such a situation, the former lawyers may prefer and even demand that the case be settled, while the current partners want to minimize the amount the insurer pays under the firm's policy. While policies have provisions dealing with consent to settlement, they do not address the situation when insureds under the policy do not agree on how settlement should be handled. If there is a material conflict of interest among the insureds, the insurer should provide separate counsel for those insureds who have conflicting interests.⁶²

Conflicts also arise when the insureds must pay the deductible under the policy. Some policies specifically state that the name insured shall pay the deductible amount.⁶³ Who pays the deductible when the insured firm does not have assets to pay the deductible or there otherwise is a dispute on which insureds are responsible for the deductible? Again, courts may have to resolve

59. ROBERT E. KEETON & ALAN I. WIDISS, *INSURANCE LAW: A GUIDE TO FUNDAMENTAL PRINCIPLES, LEGAL DOCTRINES, AND COMMERCIAL PRACTICES* 262-63 (1988) (explaining how a conflict occurs when the applicable "Other Insurance" clause in each policy declares that the policy in which it appears shall be excess insurance).

60. For a discussion of proration rules and the allocation of liability, see *id.* at 265-267.

61. The author thanks Jeff Hanna, Vice-President of Texas Lawyers Insurance Exchange, for identifying this conflict.

62. See Specimen Attorney's Liability Assurance Society, Inc. Professional Indemnity Policy (as amended through Jan. 25, 2000) at 15 (stating that the insurer may withhold its consent to separate defense counsel unless there is "a material actual or potential conflict of interest" among the insureds).

63. For example the Zurich-American Professional Liability Insurance Policy for Lawyers states that the "deductible amount stated in the Declarations shall be paid by the Named Insured."

the matter if the insureds do not reach an agreement on payment of the deductible.⁶⁴

VI. CONCLUSION

Given the risk of Trojan Horse malpractice, the hiring firm and lateral hire should carefully evaluate the professional liability insurance implications of lawyers changing law firms. Because policies vary in handling of claims related to new lawyers and former lawyers, no move should be finalized until the lateral hire and the hiring firm study the policies issued to the firm the lawyer is leaving and the firm the lawyer is joining. The hiring firm should also analyze how the integration of the new lawyer into the firm will affect the future cost and availability of malpractice insurance. As a matter of professional responsibility, firms should include insurance matters in their due diligence review, understanding that insurance protects injured persons as well as insured persons.

64. See, e.g., *American Home Assurance Co. v. Summit, Rovins & Feldseman* (discussed in N.Y.L.J., Feb. 14, 1995, at 3) (holding that individual partners of a dissolved law firm are personally liable if the insured law firm does not have assets to pay the deductible). The court refused to limit liability to the lateral partners who were the targets of the malpractice claim. *Id.*

