



# Lawyers' Professional Liability Claims Trends: 2014

## Insurer Survey

### Introduction & Overview

Malpractice suits against lawyers have become increasingly common in today's legal environment. The potential for severe financial consequences, negative press coverage, and reputational damage makes these cases especially troubling for law firms.

Although the frequency of these claims has begun to level off following a post-recession surge, their severity has continued to increase. In particular, the complexity and longer development pattern of the post-recession claims together with soaring defense costs led law firms to experience a significant uptick in malpractice claim severity in 2013.

During the second quarter of 2014, Ames & Gough, a trusted risk and insurance advisor to law firms, conducted its fourth annual survey of Lawyers' Professional Liability claims. As in our prior surveys, the current study looks at the volume of claims insurers are experiencing as well as specific trends with respect to larger claims. It identifies the types of issues most likely to trigger malpractice claims; practice areas seeing the most significant claims activity; and takes a closer look at risks that have been receiving greater scrutiny, such as those related to lateral hires and cyber security. We also examine how insurers are managing claims, including their use of outside counsel and rates paid for legal defense.

Eight of the leading insurance companies that write Lawyers' Professional Liability Insurance coverage participated in this year's survey, including: AIG/Lexington, AXIS, BRIT, CNA, Catlin, Ironshore, Markel, and Swiss Re Corporate Solutions. Together, they insure approximately 80 percent of the AM Law 100 firms, with six of the eight insurance companies insuring 40 percent or more of both the AM Law 100 and the NLJ 250 firms. We are grateful for their participation in our study and are pleased to present the findings in this report.

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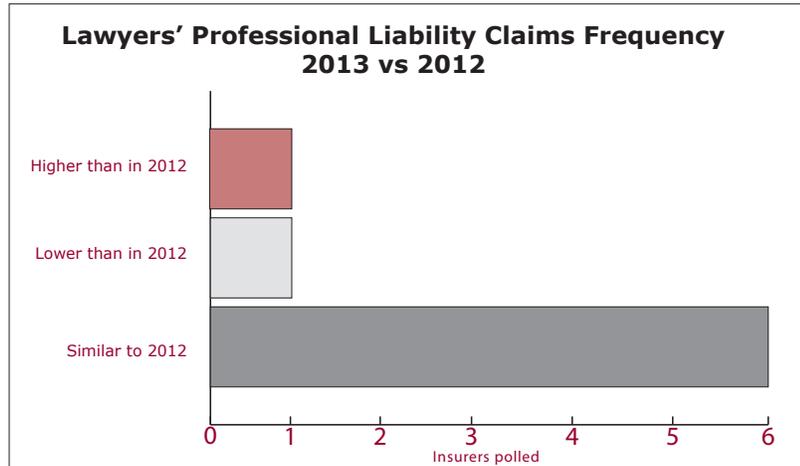
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### Survey Findings

#### 1) Legal malpractice claims frequency levels off.

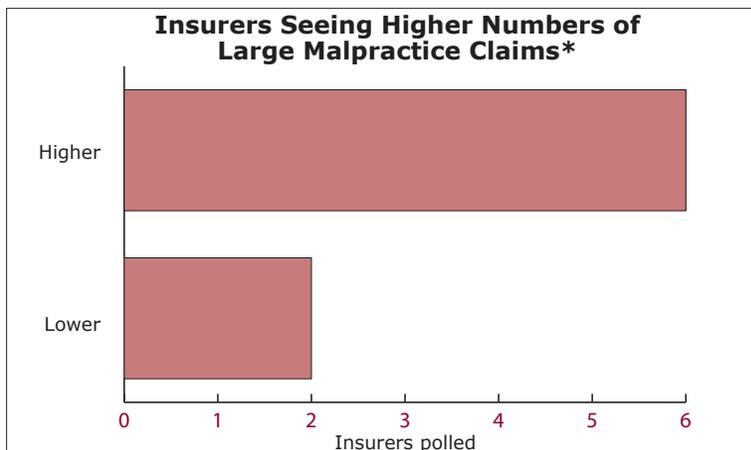
The number of new malpractice claims brought against law firms is flat on a year-over-year basis. Indeed, six of the eight insurers surveyed indicated that the number of claims filed in 2013 was similar to that in 2012. A key reason for this leveling off of claims may be that the claims bubble arising from the 2007 – 2009 recession has worked its way through the judicial system. Keep in mind however, that claims frequency remains higher than it was in the years preceding the recession.



#### 2) Uptick in severity for legal malpractice claims.

Any encouraging trend with respect to data on claims frequency, however, is being offset by the fact that claim severity is increasing. Several insurers attribute this increase to sharply higher defense costs related to the increasing complexity of malpractice claims.

Six of the eight insurers surveyed report they had more claims with reserves of \$500,000 or greater (including loss and expenses) in 2013 than they did in 2012. Of the six, three indicate the number of claims above \$500,000 was up 11 percent or more in 2013 from 2012. The other three indicate increases in the number of large claims were 10 percent or less in 2013 versus the prior year.



\*Note: Large claims defined as claims with reserves of \$500,000 or more.



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

The overall number of malpractice claims resulting in multi-million dollar payouts is continuing to grow.

Four of the eight insurers indicated their company had either paid or participated in paying a claim of \$100 million or greater; two others had a payment between \$50 million - \$100 million.

Although it's possible that some of these insurers were involved with the same claim(s) given quota share coverage arrangements and excess limits, it's clear the number of claims resulting in multi-million dollar payouts is growing.

### 4) Real Estate, Corporate & Securities and Trust, Estates & Probate Law practice areas generating greatest volume of malpractice claims.

Five of the eight insurers surveyed identified Real Estate as the practice area continuing to see the largest number of legal malpractice claims.

However, on a percentage basis, insurers citing this practice area decreased by more than 20 percentage points (to 63 percent in 2013 from 86 percent in 2012). Thus, although the spate of failed real estate deals during the economic downturn had a long tail, many of these claims appear to have worked their way through the system.

Meanwhile, corporate and securities garnered an equal number of responses from insurers in 2013, and rose on a percentage basis from the prior year. When business deals go bad, clients often start looking to their lawyers. While this may be inevitable in many cases, law firms can minimize risk by maintaining a strong conflicts database; clearly identifying who they are (and are not) representing in the transaction; and avoiding serving on their corporate boards.

#### Practice Areas Generating Largest Number of LPL Claims\*

Area of Practice	Responses (by percentage)			
	2013	2012	2011	2010
Real Estate	63	86	67	67
Corporate Business Organization & Securities	63	57	67	33
Trust & Estates	50	57	0	33
Business Transactions - Commercial Law	50	43	67	50
Taxation	25	14	0	0
Personal Injury Plaintiff	13	14	33	17
IP	13	0	0	17
Collection & Bankruptcy	0	14	33	33
Other	0	14	0	0
Family Law	0	0	17	0
General Litigation	0	0	17	0
Litigation Defense	0	0	0	17
Labor & Employment	0	0	0	0
Insurance Defense	0	0	0	0
Criminal/White Collar	0	0	0	0
International Law	0	0	0	0
Personal Injury Defense	0	0	0	0

\*Note: Survey participants provided multiple responses, so the totals for each year sum above 100 percent.



## Insurer Survey

Trust & Estates also continues to be a higher risk area of practice. Often, this is from a lack of clarity as to who is or isn't a client and a failure in lawyer-client communications. When it comes to handling trust and estate cases, which tend to be more personal and emotional, the importance of putting things in writing cannot be overemphasized.

While the failure to have written confirmation of instructions and advice is not negligence in and of itself, such written communication can be extremely helpful in defending the firm when an unhappy client files suit. For example, even taking the time to make a detailed docket notation that you "spoke with the client to review the draft will, including key provisions on beneficiaries, daughter and son," is arguably better than simply noting "conference with client regarding draft will."

Legal malpractice cases arising out of tax issues are also on the increase. Just recently, bankrupt Overseas Shipholding Group (OSG) filed suit against a large U.S. law firm for saddling it with hundreds of millions in "completely avoidable" tax liability. OSG claims that the firm had represented OSG and its subsidiaries for years, but changed the way it advised the company to handle its unsecured credit agreements, not fully recognizing changes to U.S. tax law and therefore greatly increasing OSG's tax liability.

### 5) Most frequent alleged malpractice error: Conflict of interest.

Year over year, conflict of interest is the most common alleged legal malpractice error. This year, six of the eight insurers surveyed cite conflicts as the leading cause of legal malpractice claims. For law firms seeking to remain competitive through mergers or by making lateral hires, this points to the need to continually monitor and improve their ability to identify and manage potential conflicts.

Procedural errors are the second most common cause of malpractice claims, cited as such by four insurers.

Procedural errors can be easily avoided by placing appropriate checks and balances within the calendaring and administrative process. Peer review can also help prevent such errors. Firms must put risk management controls in place to ensure they understand the administrative protocols of each court and case, and that they have the systems in place to comply with these protocols.

### First and Second Most Frequently Alleged Malpractice Errors

Alleged Error	Largest	Second
Conflict of interest	6	1
Procedural Errors	0	4
Failure to know/Inadequate advice	0	1
Failure to file timely	2	0
Inadequate discovery or discovery sanctions	0	0
Failure to calendar/Follow-up	0	1
Drafting/Clerical error	0	1
Breach of fiduciary duty	0	0



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**6) Cyber-related malpractice claims grow more problematic.**

Half the insurers surveyed have had a Lawyers’ Professional Liability Insurance claim arising from a cyber or network security event. Of the four insurers experiencing such claims, three stated the breach was a result of a lost or stolen laptop. The other insurer stated that employee error, a hacker and a disgruntled employee led to a network security breach claim.

The portability of technology has given rise to new issues concerning security breaches. Stolen laptops, smartphones, tablets, or other portable data-bearing devices rank the highest in terms of risk and may provide unauthorized access to your technology systems and confidential information.

Unfortunately, the costs associated with a breach can be enormous. Not only can the reputational risk of a breach potentially destroy a firm, but the repair costs can be substantial. Such costs include satisfying legal requirements associated with notifying affected individuals (estimated at \$200 or more per individual); hiring forensic experts; paying civil fines or penalties; retaining crisis and reputational management consultants; credit monitoring; as well as direct losses incurred by the firm, such as data recovery or business interruption exposures.

The typical Lawyers’ Professional Liability Insurance policy will cover a firm for a breach to a third party’s data if the breach results in a malpractice claim by the client. This is likely to apply as long as the breach occurred during the course of professional services. However, costs to satisfy regulatory reporting requirements, internal costs to repair the firm’s systems, reputational costs, business interruption, and any damage to first-party data would not be covered under a professional liability policy.

**7) Costs rose to defend legal malpractice claims, along with rates insurers paid defense counsel.**

All the insurers surveyed, except one, indicated they saw an increase in the cost to defend legal malpractice claims in 2013. Each year this survey has been conducted has seen an escalation of the cost to defend malpractice cases. Not surprisingly, that cost has tracked closely with the steadily increasing severity of individual claims. Half of those polled increased the rates they paid defense counsel by 2 – 5 percent while two others increased rates by 2 percent or less.

**Average Hourly Rate Insurers Pay Defense Counsel: 2013 vs. Prior Years**

Rate	2013	2012	2011	2010
\$501 or greater	1	-	-	-
\$401 or greater	0	3	2	1
\$301 - \$400	4	1	1	1
\$251 - \$300	3	2	1	1
\$201 - \$250	0	1	2	3



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### **Conclusion: Potential for Large Claims Calls for Sharpened Focus on Critical Risks**

With the U.S. economy continuing its gradual recovery from the financial crisis of 2008, many law firms are aiming to maintain profitability and grow by seeking to expand geographically or by practice area. In light of a steady rise in malpractice claim severity, law firms need to balance their growth initiatives with a heightened focus on risk management.

In this context, pending mergers should be evaluated not only in terms of potential revenue growth and synergies, but with respect to how such combinations might affect a firm's overall risk profile. Potential conflicts of interest and expanded activity in high-risk practice areas should be examined carefully and strategies to minimize related exposures should be developed and implemented on a priority basis.

As law firms evolve, both in terms of their structure and geographic reach, they also need to monitor how their communication with clients is changing as well. They need to assess how they exchange information and review the nature of client data they are handling or maintaining on their own systems. In light of the rash of recent large-scale cyber events, law firms need to understand the nature of their exposures and take appropriate measures to address them. As more claims arise, these issues are receiving greater scrutiny by insurance company underwriters.

Given how rapidly technology is evolving, it's virtually impossible to be completely insulated from cyber and data security risks and other emerging exposures. In this environment, a greater focus on firm-wide risk management remains a key to reducing the potential for large malpractice claims and their costly consequences. A solid risk management program will also go a long way to helping your law firm obtain more favorable pricing, terms and conditions on your professional liability insurance program.

#### **ABOUT AMES & GOUGH**

Ames & Gough, founded in 1992, has established itself as a committed, superior resource for law firms, design professionals, and other consulting firms and professional organizations in need of professional liability insurance and risk management assistance. In recent years, the firm has expanded its capabilities to include management liability, employment practices liability, kidnap & ransom and related insurances; as well as more typical property and casualty insurances. The firm has offices in Boston, Philadelphia, and Washington, DC. Visit the Ames & Gough Website at [www.amesgough.com](http://www.amesgough.com).