

PERSPECTIVES

An attorney's guide to insurance and risk management

MSP L 11/00 "How to Avoid Paying Others' Mistakes"

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How to Avoid Paying for Others' Mistakes

When a law firm considers hiring an attorney from another law firm (a lateral hire), a prime motivator is the potential increase in revenues brought by the new attorney. Specifically, a firm is interested in whether the new attorney will bring new clients and whether the firm will have an opportunity to expand into additional practice areas.

Unfortunately, as the following case demonstrates, law firms often overlook the professional liability baggage that may be associated with the lateral hire.

A sad story – but true

A major East Coast law firm (we'll call it "Jones & Smith") hired two lawyers from a small boutique firm. While at the smaller firm, the lawyers had been involved in the negotiation of a collective bargaining agreement on behalf of their client, an association of distributors. After consulting with these attorneys, the client declared an "impasse" in negotiations and locked out its workers.

Not long after the attorneys joined Jones & Smith, the National Labor Relations Board rendered a decision against the association of distributors in the amount of \$7.3 million, finding that it had committed unfair labor practices. The association later filed a malpractice suit against its two at-

torneys, including the boutique firm and Jones & Smith.

It was the new firm, Jones & Smith, not the boutique firm, that bore the brunt of the expense. The boutique firm went into liquidation, with its policy limits exhausted by other claims, and Jones & Smith became the deep pocket target for the acts the two lawyers had committed, even though it was prior to the time they were hired.

Why? Jones & Smith's professional liability coverage included past acts, and as a result Jones & Smith became responsible for the eventual damages incurred in the malpractice suit. The effect of this litigation on Jones & Smith was that their policy limits were nearly exhausted by a claim unrelated to any work for which they collected fees.

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Consider the consequences

Your firm buys professional liability insurance with limits you think are adequate. Including coverage for the prior acts of a lateral hire exposes your firm to new liabilities, and these liabilities can seriously erode those “adequate” insurance limits. In effect, the exposure that you inherit by buying coverage for a new attorney’s prior acts can waste the insurance limits you bought for your own firm, and reduce the coverage you have available for claims brought by your own clients. Further, you will have to report any “inherited” claims on future legal malpractice applications. Your premiums may very well be adversely impacted, not to mention the cost of any deductible.

‘New hire’ loss prevention steps

Consider these steps you can take to minimize and/or eliminate such losses for your firm.:

Reduce the risk

1. Check the prospect’s background using his/her resume and personal references. Look for obvious problems and characteristics that are incongruous with the standards upheld by your firm.
2. Check the prospect’s personal financial statements for problems that could affect (or may have affected) her/his practice of law.
3. Have the prospect (a) list all claims made against his/her practice in the past, and (b) sign

a statement declaring whether she/he has knowledge of any incidents in which he/she was involved that may give rise to a claim.

4. Find out if the Bar Association has disciplined the prospect.
5. Obtain a detailed list of the prospect’s former and current clients, including a description of the services involved.
6. Put together a synopsis of all the potential liability risks that the prospect would bring to your firm, based on the information gathered in the preceding steps.

Make sure that others insure the risk

How the risk is insured depends on the status of the prior firm.

1. Virtually all legal malpractice policies cover past acts performed for the insured firm that lead to a claim made during the policy period (subject to the retroactive date). Further, the standard policy definition of “insured” includes “any lawyer previously affiliated with the Named Insured as a partner or employee.” Therefore, if the prior firm remains in business and is insured, its insurance should respond to claims arising out of work done prior to the prospective hire’s departure.
2. If the prior firm dissolves, it may purchase “tail” coverage which provides an extended reporting period for claims for past acts that arise within a stated time period (usually one to five years).
3. If taking on this risk makes business sense to you, and you are willing to subject your insur-

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ance limits to the prior acts of lateral hires, then ask your insurance carrier to add specific coverage for those individuals. Be prepared to provide all of the information you have obtained to confirm that there is no other form of coverage, and to pay an additional premium for the additional coverage.

Summary

One law firm estimates that 80% of its current professional liability claims can be attributed to the prior acts of firm lawyers who had been laterally hired into the firm; however, these "lateral" hires represent only 20% of the firm's lawyers. Worse

yet, these claims emanated from matters of which the firm had no knowledge and from which the firm generated no revenue.

Professional liability issues should be one of the most important factors involved in lateral hiring decisions. As insurance professionals specializing in lawyers' liability, we would be happy to familiarize you with the lateral hire coverage problem and help you take the actions necessary to prevent your firm from having to pay for the mistakes of others.

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