Is Notice of a Claim to a Former Partner Notice to the Former Firm?

By Jeffrey P. Lewis

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Most legal professional liability policies are some variety of "claims-made" policies. Some have reporting periods that extend beyond the policy's expiration date. Often an extended reporting period, referred to as a "tail," can be purchased, usually upon the occasion of the insured leaving the practice of law or changing carriers. Often the policy purchased when changing insurance companies will contain a "prior bad act" provision, which excludes coverage for any actionable conduct that occurred before the effective date of the new policy. This is so, notwithstanding that the insured may have had no knowledge of a claim or potential claim when filling out the application for the new policy. The date upon which the insured becomes contractually obligated to report the existence of a claim or potential claim to the carrier is of paramount concern because it triggers which policy, if any, applies to cover the claim.

But who is an "insured" for purposes of imposing a contractual obligation to report a claim or potential claim to the carrier? What about a now former partner who becomes aware of a claim or potential claim arising out of his or her own conduct when he or she was affiliated with his or her former firm, which is the named insured on the policy in question? If the former partner decides, whether out of spite or for other reasons, not to report the matter to his or her former firm so that it can report the matter under its policy then in effect, will that preclude coverage for the firm even though it had not learned of the existence of the claim until much later? Will that preclude coverage under the firm's policy currently in effect? The answer to these questions is seemingly simple — it depends on what the fine print in the policy provides with respect to the triggering of the obligation to report a claim or potential claim. But a recent 10th Circuit decision illustrates what a minefield this issue can be.

In *Berry & Murphy, P.C. v. Carolina Casualty Insurance Company*, 586 F.3d 803 (10th Cir. 2009), it is alleged a shareholder unknowingly committed malpractice in the representation of plaintiffs in a personal injury action while he was with the insured firm. He allegedly had missed certain automatic deadlines for disclosures of such items as identifying non-expert witnesses and for producing expert reports and failed to opt out of a program that simplified procedure but also limited the amount of recoverable damages.

A year later the attorney left the firm and joined another law firm, taking the clients with him. Shortly thereafter he petitioned to withdraw his appearance, allegedly due to his clients' lack of cooperation. The court granted permission to withdraw. But then the court granted a defense motion to dismiss without prejudice because of plaintiffs' failure to prosecute, apparently based upon the failure of the former shareholder to comply with any of the automatic disclosure requirements. The clients hired replacement counsel.

Replacement counsel wrote to the original counsel (the former shareholder) to place him on notice of a legal malpractice claim for conduct found by the court "so egregious and so woefully inadequate that the case was nearly dismissed." The original counsel reported this letter to his current firm, which in turn reported same to its malpractice carrier. But the original counsel did not report this claim to his former law firm, where he was employed when the alleged malpractice had occurred. As a result, the original counsel's former firm was without knowledge of this claim and thus was unable to place its carrier on notice. The malpractice action was commenced in federal district court, based upon diversity jurisdiction, more than a year later, which is when the original counsel's former firm (now actually a successor firm) finally learned of the existence of the claim.

When the successor firm reported the matter to its insurance carrier (which, ironically, was also the carrier for the original counsel's new firm), the carrier denied both a duty to defend and coverage. It noted that the former shareholder met the definition of an "insured" under the policy, which relevant portion included "any individual … who was a … stockholder … of the *Named Insured* or *Predecessor Firm*, but solely while acting within the scope of their duties on behalf of the *Named Insured* or *Predecessor Firm.* …" (Emphasis added.) Therefore, in the carrier's view, the former shareholder was acting within the scope of his duty on behalf of his former firm when he received the letter from replacement counsel, which was his first notice of the claim. That letter was written before the inception of the current policy. Therefore, the carrier contended that this claim qualified as one made before the inception of the current policy and it therefore was not covered. The district court granted summary judgment in the carrier's favor on this basis.

In a 2–1 decision, a 10th Circuit panel affirmed. The majority held that notice to the former shareholder constitutes notice to the former law firm, meaning that the former law firm was denied coverage for its failure to "timely" report this claim to its carrier. The majority, although acknowledging that this ruling "is a harsh result," felt constrained based upon its reading of the relevant policy language. They found compelling that the policy failed to "differentiate between who is an 'Insured' for purposes of 'coverage' and who is an 'Insured' for purposes of 'notice.' " The dissent, in contrast, viewed the relevant policy language as, at the least, ambiguous and, at the most, clearly providing that a former partner is not an "Insured" for notice purposes although an "Insured" for coverage purposes.

What is ironic (or perhaps disturbing) about this decision is not only the apparent injustice (in the eyes of the dissent) to the former law firm but also the potential windfall to the former partner. Depending on whether the policy for his current firm contains exclusions for prior bad acts or other circumstances, the former partner, who did have earlier knowledge of the claim, may end up with coverage under his current firm's policy. In contrast, his former firm, notwithstanding its ignorance of the claim until later, is denied coverage, both under the policy in effect when its former partner learned of the claim and under its current policy, if it is a different policy. This underscores the importance of reviewing one's policy with this issue in mind to ensure that a former disgruntled or irresponsible member of your firm cannot jeopardize your coverage in this manner. If the language of your policy clearly states that the obligation to report can only be triggered by knowledge of a named insured, which would presuppose a current lawyer in the firm, instead of "Insured," that would lessen the likelihood of what occurred in this case happening to you.