Even When Not in Doubt, Always Disclose a Potential Claim

Most if not all legal professional liability policies are “claims made” or “claims made and reported” policies, which means that the policy in effect when the claim is made or when it becomes a potential claim covers the claim — a dicey issue that has spurred much litigation between insurance companies and their insureds. Whether to disclose what may be a potential claim to the professional liability carrier often causes the insured consternation because of a concern that it might prompt an increase in the premium or, even worse, a nonrenewal of the policy. On the other hand, not reporting a potential claim can cause consternation because of the concern that the carrier might later deny coverage based upon untimely reporting should that potential claim later mature into an actual claim. Similar conflicting concerns present themselves when a lawyer fills out an application for a new policy, which always contains questions about potential claims and acts or omissions that could become the basis for a claim. Again, the answers to these questions can result in the carrier setting a higher or lower premium or even refusing to issue the policy. Moreover, this could later prompt the carrier, once it has learned of the information that should have been disclosed on the application, either to cancel the policy or to rescind it, depending on the circumstances. A recent Ohio case illustrates one of the risks of failing to disclose a potential claim to the carrier.

In "Goodman v. Medmarc Insurance, ___ N.E.2d ___, 2012 WL 3861984 (Ohio App., 8 Dist.)," the attorney missed the deadline for filing a brief, which apparently resulted in the court quashing the appeal, which the court later refused to reinstate. The lawyer told his client what had occurred and offered to refund what he had charged in attorney's fees. The attorney and client entered into an agreement titled “Appeal Resolution,” which provided for the refund but did not contain any language providing for the release of the client's malpractice claim. At that time the client “did not express dissatisfaction with [the lawyer's] representation nor did he indicate that he planned to sue.” The client would later give an affidavit in the present case in which he stated that at the time he entered into that agreement it was not his intention to sue. He further stated that he did not decide to sue until later, when he saw a bankruptcy lawyer who referred him to another lawyer to handle this claim.

After entering into that agreement, but before the lawyer learned that his now former client had a change of heart about his potential claim, the lawyer completed an application for an insurance policy with a different carrier than the one that insured him when he had committed the error. That application contained the following question in two parts: “… is (the lawyer) aware of: A professional liability claim made in the past 5 years (either still open or closed)? (or) An act or omission that might reasonably be expected to be the basis of a claim?” In response to both parts the lawyer answered, “No.”

Thereafter the lawyer received a letter from his former client in which for the first time the client expressed his intention to sue, and shortly thereafter the former client did sue. The lawyer then reported the claim to his new carrier, which denied the duty to defend and to indemnify based upon the lawyer's failure to disclose this potential claim in his application. The carrier then filed the present action — a declaratory judgment action — seeking a declaration in support of its position and seeking rescission of the policy. The lawyer filed a counterclaim seeking the opposite declaration, i.e., that the carrier owed a duty both to defend and to indemnify. The trial court granted summary judgment in the lawyer's favor, finding both a duty to defend and to indemnify for the claim. The carrier then appealed to the Court of Appeals of Ohio and a three-judge panel of the appellate court affirmed.

The appellate court found that no “claim” — a defined term under the policy — had arisen when the lawyer had entered into the “Appeal Resolution” agreement. The court noted that the client had made no “demand for money or services” and had brought no suit or other proceeding against the lawyer, any of which would have rendered a “claim.” Therefore the court excused the lawyer for answering “No” to the question of whether he was aware of any claims within the last five years.

The court then rejected the carrier's other argument that the lawyer could not be excused for answering “No” to the question of whether he was aware of “[a]n act or omission that might reasonably be expected to be the basis of a claim.” The court went into an elaborate analysis to determine whether the answer to this question constituted a “representation” or a “warranty.” Under Ohio law a false "representation" by the insured on the application gives the carrier the right to cancel the policy but not to rescind it retroactively to the policy's inception. But if the answer to that question constituted a “warranty,” then the carrier could rescind. To be deemed a “warranty,” the policy must contain language that expressly incorporates the application by reference and clearly state that the information provided on the application will be deemed a “warranty.” In this instance the answer was deemed a “representation,” thus allowing the carrier to cancel but not rescind and thus obligating it to defend and indemnify for the claim because it was made before the policy was cancelled.

What is the lesson from Goodman? First, this whole dispute could have been avoided if the lawyer, when he first discovered the error, had reported the matter as a potential claim to the carrier whose policy was in effect at the time that he missed the appeal. The client had not released him for this potential claim. Therefore there was always the risk that the client would later change his mind, as did happen here, before the claim would expire under the applicable statute of limitations. There is at least one carrier that writes business in Pennsylvania that will excuse its insureds from reporting potential claims so long as a policy is maintained with that carrier without interruption from when the potential claim first arose until it later matured into an actual claim. But that is an exception to the general rule that potential claims must be promptly reported. The insured in Goodman was found to have coverage based upon a technical distinction, which he may not have been able to rely upon had his policy been worded differently. He came uncomfortably close to having no coverage and his close call could have and should have been averted by his reporting the potential claim when it arose.