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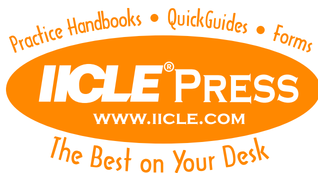

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14 Attorney Liability Insurance

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I. [14.1] SCOPE OF CHAPTER

This chapter makes general observations concerning the legal malpractice insurance marketplace and discusses various provisions in typical legal malpractice insurance policies with regard to their purpose, along with relevant caselaw. Issues pertaining to who is the insured under a legal malpractice policy, what constitutes professional services, notices of claims to insurers, and salient limitations on legal malpractice coverage, such as common exclusions, will be reviewed. However, insurance coverage questions that transcend all lines of professional liability insurance, such as what is a claim, when is a claim made, and what should insureds disclose on an application for insurance, will not be treated in detail. Those issues are sufficiently broad and complex that a proper treatment of them requires a separate discussion.

For a more comprehensive look at errors and omissions (E&O) insurance for all professionals and claims-made issues in professional liability policies, it is suggested that one review Chs. 2 and 3 of COMMERCIAL AND PROFESSIONAL LIABILITY INSURANCE (IICLE®, 2008, Supp. 2010). Those chapters contain a detailed discussion of the various types of E&O policies (including legal malpractice policies) and the issues that arise thereunder, as well as detailed discussions concerning the myriad problems that can arise in applying for claims-made policies in terms of the timing of the claim, knowledge of the insured about circumstances that may give rise to a claim, etc.

Legal malpractice policies are but one example of what is generally known as E&O insurance, also called professional liability insurance. For example, accountants, doctors, insurance agents, architects, and real estate agents typically purchase E&O coverage to provide themselves with protection if they commit an error in the course of their work. As pertains to legal malpractice insurance, the general understanding of the typical purchaser of a legal malpractice policy is that if, in the course of handling a legal matter, the lawyer commits an error, his or her policy will respond by way of defense and protection for damages stemming from the error.

While this chapter will provide a somewhat detailed discussion of general issues of particular import to lawyers with respect to legal malpractice insurance, it is important to bear in mind that every case rises and falls on the facts particular to that case, which means that the practitioner must carefully read the provisions of the malpractice policy that is under review to correctly analyze and evaluate the issues.

II. [14.2] LEGAL MALPRACTICE MARKETPLACE

There are over a dozen insurers providing legal malpractice insurance to lawyers who practice in the State of Illinois. The market has been soft for a number of years, meaning that premiums have been relatively stable and have even sometimes decreased. However, there is a hardening trend underway at this time that augers increasing premiums across the board for law firms of all sizes, from solo practitioners to institutional firms.

It is important to bear in mind that while there are many similarities in the overall design of legal malpractice policies as well as the language therein, there are also differences among policy

forms. As all lawyers know, even a minor variation can make a very substantial difference in outcomes. It goes without saying that absent a studied, side-by-side comparison of policy forms, a law firm purchaser of malpractice insurance or its broker will not be able to make a meaningful comparison between forms. By the same token, however, it is impossible to foresee how minor variations in language might result in different outcomes absent the context of a particular set of facts and circumstances. It is important, therefore, that the purchaser of insurance take the time necessary to at least obtain an informed understanding, with the help of the agent or broker, that the policy form they are purchasing offers the best combination of coverage and price.

III. [14.3] NAMED INSURED — WHO IS COVERED

The day has long since past when a lawyer joined a firm and stayed at that firm for his or her entire career. Whether the motivation is money, opportunity, change of direction, or any of a number of other factors, lawyers frequently stay at one firm for only a portion of their careers and then move on to other practices. In this day of law firms hiring "books" of business, it is not unusual for one or more lawyers from one firm to be cherry-picked and brought over to another firm on the assumption that a substantial quantity of business will accompany the lawyers as they transition from their old firm to the new firm.

In addition, law practices can operate under any number of different legal forms, *e.g.,* they can be professional corporations, partnerships, limited liability partnerships, etc. It is not unusual for a lawyer to incorporate himself or herself as a professional corporation, yet still be a partner in a law partnership.

Faced with the myriad combinations of business organizations as well as the frequent transitioning of attorneys from one firm to another, the insurance industry has no choice but to approach the underwriting of a legal malpractice policy, in terms of who is covered, in as generic a way as possible. Typically, the firm itself will be the "named insured" (which may have special duties to the insurer, in terms of payment of premiums, for example, that are not shared by other insureds), while each individual lawyer is an "insured," covered while providing professional services in his or her capacity as a lawyer in the named insured firm. Usually, if the firm is a partnership, all partners are covered, whereas if the firm is a corporation, the coverage extends to each shareholder lawyer. In addition, each non-partner or nonshareholder employee lawyer is usually covered, along with Of Counsel attorneys and nonlawyer employees such as paralegals and secretaries (for whose errors the law firm is answerable), but only, with respect to all such individuals, while acting within the scope of their employment for the firm.

Problems can arise, as suggested above, when an attorney who was not with a firm at the beginning of a policy becomes associated with the insured firm, but has a claim made against him or her with respect to his or her work at a prior law firm. Various insurers attempt to deal with these and similar issues in one fashion or another, but it is enough to say here that depending on the facts and circumstances, coverage problems can ensue. As mentioned, most typically underwriters attempt to deal with this generically, for example, covering "predecessor" firms. However, the prudent purchaser of legal malpractice insurance will take care to envision the

various derivations related to the coming and going of attorneys, such that for a policy year when a claim might be asserted, the firm itself is covered even if it is sued for acts of a lawyer who was previously, or is subsequently, not associated with the firm.

IV. [14.4] PROFESSIONAL SERVICES

All legal malpractice policies are designed to provide coverage for the lawyer while he or she is acting in a capacity as a lawyer, *i.e.,* as a professional. Thus, a slip and fall in the lawyer's office is not likely to be covered, because that would have little to do with the rendering of professional services. There are two general points that should be born in mind with respect to the extent of coverage provided under legal malpractice policies.

The first is that most malpractice policies cover more than a lawyer simply acting qua lawyer. While there are variations among insurers in terms of particular capacities — other than strictly as a lawyer — in which a lawyer might act, many policies also provide coverage to the lawyer while acting as an administrator, conservator, executor, guardian, notary public, title insurance agent, receiver or trustee, or in a similar fiduciary capacity. Some policies state that such coverage is in addition to the coverage extended to the lawyer while acting as a lawyer, while other policies grant coverage in like capacities but only when such services are performed in the ordinary course of the insured's activities as a lawyer.

In one case, a lawyer had a policy that provided coverage to him as a lawyer as well as in other capacities, such as when he was acting in a fiduciary activity. With respect to an engagement in which he was administering the transition of a health plan from an insurance model to a self-insurance model, the lawyer was sued for alleged fraud and for being personally involved in the transaction without disclosure of his personal interest. Despite the fact that several counts of the complaint alleged common negligence and legal malpractice and despite a very broad grant of coverage, the court determined that the true nature of the breach asserted against the lawyer related to his capacity as an insurance expert and did not involve him acting in a capacity related to his status as an attorney. For that reason (and other reasons, pertaining to particular exclusions), the court determined that the insurance company was under no obligation to defend the lawyer in the case against him. *Illinois State Bar Association Mutual Insurance Co. v. Mondo,* 392 Ill.App.3d 1032, 911 N.E.2d 1144, 331 Ill.Dec. 914 (1st Dist. 2009).

The second point is that questions can arise as to whether the services by the lawyer are really professional legal services. One test for professional services, as articulated by the Supreme Court of Nebraska in *Marx v. Hartford Accident & Indemnity Co.,* 183 Neb. 12, 157 N.W.2d 870 (1968), is whether something involves specialized knowledge, labor, or skills that are predominantly mental or intellectual rather than physical. Another way that courts conceive of professional services involves a test that looks at the course of conduct of the professional. Under this approach, a professional's policy covers routine, nonspecialized conduct as long as it is part of the professional's service to a client. Thus, though dealing with a doctor rather than a law firm, improper physical contact by the doctor with his patient was still deemed to involve professional services since it was intertwined with and inseparable from the service provided. *St. Paul Fire & Marine Insurance Co. v. Asbury,* 149 Ariz. 565, 720 P.2d 540 (App. 1986). *See also Jensen v.*

Snellings, 841 F.2d 600 (5th Cir. 1988), in which the court held that a tax attorney's property-management services and investment advice constituted covered professional services.

Courts are frequently called on to decide whether some particular conduct is or is not "professional" in nature. One rule that seems to come out of the cases is that if there is some doubt about whether the services constitute professional services, if there is a hint of nefarious involvement by the insured, the court is more likely to determine that professional services are not involved. In a case in which an attorney was hired to handle a real estate transaction, and he lent money because insufficient funds were available from his client, which in turn led to a suit by the client's bank against the attorney, the attorney's conduct was deemed to be within the scope of coverage of his malpractice policy. Notwithstanding the argument by the insurer that the attorney was really a creditor and had not been sued for acting as a lawyer, the court determined that even though the insured did not necessarily exercise good judgment, the insured was nevertheless performing a professional service for the client as a lawyer by attempting to complete one of the requirements for the real estate closing. *Regas v. Continental Casualty Co.,* 139 Ill.App.3d 45, 487 N.E.2d 105, 93 Ill.Dec. 661 (1st Dist. 1985).

But in an instance in which an insured was sued by an automobile insurer under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §1961, *et seq.,* and other dishonest conduct related to a fraudulent staged-accident scheme, in addition to determining that coverage was not available because of improper notice to the insurer, the court commented that when an attorney is engaged in fraudulent conduct, he or she is not rendering professional services. *American National Fire Insurance Co. v. Harold R. Abrams, P.C.,* No. 99 C 5807, 2002 WL 243455 (N.D.Ill. Feb. 19, 2002). In reviewing Illinois caselaw, the district judge determined that professional services only involve risks inherent to acting as a professional. The court concluded that conducting business fraudulently was not inherent to the practice of law and thus determined that no coverage was available.

In an Illinois appellate court case, *Continental Casualty Co. v. Donald T. Bertucci, Ltd.,* 399 Ill.App.3d 775, 926 N.E.2d 833, 339 Ill.Dec. 358 (1st Dist. 2010), a former client sued her attorney, alleging that he took more money than he was entitled to under their contingency fee agreement. Citing *Marx, supra,* the court looked at the act of the attorney to determine whether it was professional in character. The court determined that with respect to billing practices (improper billing, really), they did not involve professional services and thus were not covered by the policy.

V. [14.5] DUTY TO DEFEND

The duty to defend has been written on so broadly and is discussed so frequently in insurance coverage cases that the full breadth of the subject, to be truly understood, would require a book unto itself. It is suggested that the practitioner who wants to learn more about the duty to defend under liability insurance policies consult Ch. 6 of COMMERCIAL AND PROFESSIONAL LIABILITY INSURANCE (IICLE®, 2008, Supp. 2010).

In the context of legal malpractice insurance, several general points are worthy of consideration. The first is that it is not inconceivable that a lawyer might be sued for legal

malpractice in the same lawsuit in which he or she is also sued for something having little or nothing to do with legal malpractice. A perfectly good example would be when a client slips and falls in the lawyer's office and sues for bodily injury, but also combines that with a claim for legal malpractice in which the client alleges that the lawyer did not meet the standard of care in the legal matter for which the lawyer was engaged. Naturally, the legal malpractice carrier would be asked to defend the legal malpractice claim, while presumably the office/premises liability carrier would be asked to defend the slip and fall claim. If the lawyer happened to have purchased only one of those two policies, arguably that insurer would, under broad duty to defend principles, have to defend both counts of the complaint (on the basis that an insurer who must defend part of a claim must defend all of the claim). But whether that is a correct answer is not something the Illinois courts have addressed specifically, nor have the courts discussed a related issue: whether the insurer might have a right of recovery of defense costs for that part of the claim it clearly does not cover. That would be worthy of debate, although the Supreme Court of Illinois to some extent closed that door in *General Agents Insurance Company of America, Inc. v. Midwest Sporting Goods Co.,* 215 Ill.2d 146, 828 N.E.2d 1092, 293 Ill.Dec. 594 (2005).

Another common feature of malpractice policies relating to the duty to defend is that most policies explicitly provide for the defense of claims alleging malfeasance, dishonesty, or fraud, but only up to the point that the dishonesty or fraud is proven. That is, once there is a finding of liability predicated on excluded conduct relating to dishonest or fraudulent conduct, the insurer has no ongoing duty to defend thereafter, much less a duty to indemnify. Although this type of provision was not in issue, one court dealing with a legal malpractice policy determined that even though the policy had an exclusion for dishonest acts, and the claim against the lawyer did sound in fraud, subsequent pleadings in the case suggested that simple legal malpractice also afforded the plaintiff alternative grounds for recovery. In this circumstance, the court determined that, notwithstanding the allegation of fraud, other filings clearly predicated liability on simple malpractice, such that the policy was required to respond by way of the provision of a defense. *Maneikis v. St. Paul Insurance Company of Illinois,* 655 F.2d 818 (7th Cir. 1981).

Another point to bear in mind is that it is frequently the case that professional liability policies, including legal malpractice policies, provide for declining limits of coverage with defense fees and costs incurred. In other words, if a policy with a $1 million per claim limit contains a declining limits provision (also called, perhaps improvidently, a wasting limits provision), and if the defense costs associated with defending the insured in a particular claim are $500,000, there remains only $500,000 available to indemnify the insured with respect to that claim. To whatever extent this causes the interests of the defense attorney (whether retained by the insurer or chosen by the insured) to be in conflict with the interests of his or her client and/or the insurer is something that may well be considered by the courts in the future.

Finally, it bears mentioning that some legal malpractice policies contain a separate grant of defense coverage that may be applied with respect to disciplinary proceedings. In many instances, however, the dollars available to defend such a claim are limited to a discrete sum, usually quite small in comparison to the policy limits. And merely because the policy contains such a provision does not mean that in a disciplinary action against its insured, the insurer owes a defense. When the coverage for a disciplinary proceeding still requires the rendering of professional services, to the extent the claim before the Attorney Registration and Disciplinary Commission (ARDC) does

not involve professional services, no duty to defend the ARDC claim exists. *Continental Casualty Co. v. Donald T. Bertucci, Ltd.,* 399 Ill.App.3d 775, 926 N.E.2d 833, 339 Ill.Dec. 358 (1st Dist. 2010).

VI. [14.6] DAMAGES

The grant of coverage in a typical legal malpractice policy will usually state in so many words that the insurer agrees to pay on behalf of the insured that sum for which the insured is liable in damages because of the failure to render professional services. Many policies define the word "damages," and many policies also contain particular restrictions relating to the definition of "damages," including limitations for claims seeking injunctive or declaratory relief, claims seeking punitive or multiplied awards, and claims seeking restitution, disgorgement, or reimbursement of legal fees.

In *Continental Casualty Co. v. Donald T. Bertucci, Ltd.,* 399 Ill.App.3d 775, 926 N.E.2d 833, 339 Ill.Dec. 358 (1st Dist. 2010), the insured lawyer was sued for allegedly keeping more of his fee than he was entitled to under his contingent fee agreement. "Damages" were defined by the policy not to include legal fees, whether related to restitution, forfeiture, set-off, or otherwise. The court had no trouble concluding that the claim against the insured amounted to a claim for legal fees charged (improperly) by the insured.

Other courts have reached contrary conclusions in fee dispute cases. In *Transcontinental Insurance Co. v. Faler,* 9 Wash.App. 610, 513 P.2d 864 (1973), the insured was sued by a client for charging excessive fees. The carrier rejected the claim, but the court held that the claim was one for damages, measured by the amount of excessive fees. And when fees are forfeited to the client by reason of misbehavior of the professional, that can constitute money damages under a malpractice policy. *Perl v. St. Paul Fire & Marine Insurance Co.,* 345 N.W.2d 209 (Minn. 1984).

A decision by a federal district court in Chicago involved an insured lawyer who was sued by the Securities and Exchange Commission relating to materially false and misleading statements about a fund that the lawyer represented. The SEC sought declaratory judgment and injunctive relief, disgorgement of ill-gotten gains, and other remedies. The insured sought coverage under a legal malpractice policy that defined "damages" but, in so doing, explicitly excluded claims for civil or criminal fines, penalties, or forfeitures, as well as injunctive and declaratory relief. In a fairly thorough opinion, the magistrate judge concluded that in effect the SEC was seeking a civil penalty of disgorgement, which was not only excluded by the policy, but uninsurable in the first instance as not constituting a loss within the meaning of a typical insurance contract. *Continental Casualty Co. v. Duckson,* 826 F.Supp.2d 1086 (N.D.Ill. 2011).

VII. [14.7] DEDUCTIBLE/POLICY LIMIT ISSUES

Because legal malpractice policies are written on a claims-made basis, the limits of liability are generally expressed in terms of how many dollars are available per claim and how many dollars are available in the aggregate (meaning more than one claim). One fact pattern (or variation thereof) that arises frequently, whether in claims-made or occurrence-type policies, has

to do with the limits that are available per claim (or per occurrence, in an occurrence contract), when the same facts give rise to repeated or multiple injuries. These issues have vexed insurers and insureds over the years, and in the claims-made context they can be no less difficult than they are in, say, asbestos claims in which hundreds or thousands of people claim damage for exposure at a single site.

For this reason, errors and omissions insurers typically try to telescope all related claims into a single policy by treating them as a single claim. Most legal malpractice policies contain provisions along the lines that claims arising out of related acts or omissions, including those matters that are temporally, logically, or causally connected by some common fact, circumstance, situation, etc., involve only a single claim.

While not illustrative of this exact issue, several cases help demonstrate similar problems. For example, in a case in which an attorney drafted several documents that he knew were not statutorily authorized, a court said he committed separate acts of malpractice, triggering successive policies in effect at the time each document was drafted. *Village of Camp Point, Illinois v. Continental Casualty Co.,* 219 Ill.App.3d 86, 578 N.E.2d 1363, 161 Ill.Dec. 717 (4th Dist. 1991), *appeal denied,* 143 Ill.2d 636 (1992). In a case in which a doctor, insured under successive professional liability policies, negligently prescribed a drug in one policy and negligently monitored the patient's condition related to the taking of that drug in a second policy, the court determined that both policies of professional liability insurance were triggered. *Doe v. Illinois State Medical Inter-Insurance Exchange,* 234 Ill.App.3d 129, 599 N.E.2d 983, 174 Ill.Dec. 899 (1st Dist. 1992).

As stated above, insurers selling claims-made policies, including legal malpractice policies, generally try to treat related claims as a single claim, thereby applying the per claim limit rather than the aggregate limit. For a general illustration of the issue, *see Gregory v. Home Insurance Co.,* 876 F.2d 602 (7th Cir. 1989).

In a decision involving a law firm that employed a nonlawyer who embezzled funds from over a dozen estates that were being probated by the law firm, the issue was whether the per claim limit or the aggregate claim limit applied. That in turn was determined by whether there was a single claim or multiple claims, which in turn was determined by whether the claims were based on related acts or omissions. Per the policy language, "related" was defined to mean any acts or omissions that were temporally, logically, or causally connected by reason of a common fact, circumstance, situation, transaction, event, advice, or decision. In a rather detailed analysis, the court concluded that not only was the policy language not ambiguous, but notwithstanding the fact that numerous separate estates were involved, the conduct giving rise to the different claims was related because the embezzlement scheme had common ties and it involved a single modus operandi. As a result, all of the claims against the insured were to be treated as a single claim, subject to a single limit of $100,000. *Continental Casualty Co. v. Howard Hoffman & Associates,* 2011 IL App (1st) 100957, 955 N.E.2d 151, 325 Ill.Dec. 975.

The main point that the practitioner should keep in mind is that cases dealing with these issues tend to be very fact-specific. The underlying facts and the particular policy language will be very carefully parsed by the court to reach a decision. As a general observation, the cases seem to demonstrate that courts historically tend to favor insureds in these cases, that is, courts tend to

issue decisions that are favorable to the insured rather than the insurer, but at the same time courts are not unmindful of the fact that insurers who are responsible for larger claims payouts end up passing on the cost to the consuming public in the form of higher premiums.

VIII. [14.8] NOTICE TO THE INSURER

As a general proposition of insurance law, notice of a claim must be given by the insured to the insurer within a reasonable period of time. Perhaps representing a minority position among the states, Illinois law still holds the view that notice provisions are valid prerequisites to coverage, and that the insurer need not establish prejudice to avoid coverage, although prejudice is a factor that can be used to determine whether notice was reasonable. *INA Insurance Company of Illinois v. City of Chicago,* 62 Ill.App.3d 80, 379 N.E.2d 34, 19 Ill.Dec. 519 (1st Dist. 1978).

As is true with other liability policies, such as automobile or general liability policies, professional liability policies, including those issued to lawyers, contain notice provisions. But since nearly all legal malpractice policies are claims-made, notice must be understood as being distinct from a claim. A claim is the assertion by a third party of a right against the insured, whereas notice is the insured's communication to the insurer that an occurrence has taken place or that a claim has been asserted. A number of states provide by statute that a late notice defense in the hands of an insurer is obviated in certain circumstances. But since in a pure claims-made policy the notice provision refers only to notice given by the insured to the insurer and does not relate to when the insured knows of a claim being made against it, such a statutory provision is not relevant to the issue of whether a claim was made against (and therefore known by) the insured and reported to the insurer during the policy period. *Stine v. Continental Casualty Co.,* 419 Mich. 89, 349 N.W.2d 127 (1984).

When claims-made policies initially started to be used in the early to mid-1970s, the typical requirement was simply that the claim be made against the insured during the policy period. Policies did not require anything more to trigger coverage, although they still required that reasonable notice of the claim had to be given to the insurance company. But over the past two decades, the claims-made grant of coverage has morphed, such that usually policies now require two elements to be met in order for the claim to be deemed to have been made during the policy period: (a) the claim must be made against the insured during the policy period and (b) the claim must be reported to the insurer during the policy period or within a set time after expiration of the policy, usually 30 days. If either condition is not met, there is no coverage.

Suffice it to say that the courts generally interpret the notice requirements in a claims-made policy as being the sine qua non of a covered claim. That is, as distinct from an occurrence policy in which an occurrence takes place, and notice by the insured is simply to give the insurer information concerning the occurrence so that it may investigate and/or defend, in a claims-made policy the reporting requirement is an element of the grant of coverage that, if not met, means that the claim is ipso facto not covered. *American National Fire Insurance Co. v. Harold R. Abrams, P.C.,* No. 99 C 5807, 2002 WL 243455 (N.D.Ill. Feb. 19, 2002). Therefore, even if the claim is made against the insured during the policy period, if notice is not given by the insured to the

insurer during the policy period, the policy will not apply. In *Abrams,* the court also rejected the proposition that other indirect notice received by the insurer served as a substitute for proper notice.

Interpreting Illinois law, the Seventh Circuit determined that, under a legal malpractice policy that required that the claim be made against the insured during the policy period (which it was), and that the claim be reported to the insurer during the policy (which it was not), a third party with a claim against the insured had no right to the policy proceeds, notwithstanding some Illinois caselaw that suggests that the rights of a third-party claimant cannot be cut off by the insured and the insurer when, pursuant to their own undertaking, they agree no coverage applies. *Home Insurance Company of Illinois v. Adco Oil Co.,* 154 F.3d 739 (7th Cir. 1998).

IX. [14.9] TIMING ISSUES

As suggested in §14.8 above, because one of the critical elements in determining the applicability of coverage under a claims-made policy has to do with when the claim was made against the insured, that issue has been the subject of a very substantial amount of litigation. The cases speak to the timing of the claim, as well as related issues, under not just legal malpractice but all other kinds of errors and omissions policies. Because that subject matter is not legal malpractice policy-specific but rather general to the entire panoply of claims-made policies and because of the breadth of the subject, it is best treated separately. In this respect, see Ch. 3 of COMMERCIAL AND PROFESSIONAL LIABILITY INSURANCE (IICLE®, 2008, Supp. 2010).

It suffices here to note that these types of questions, *e.g.,* when the claim is made (which necessarily requires an analysis of what a claim is), adjunct issues related to timing (such as the application of retroactive dates and prior acts exclusions) and what the insured knew when applying for insurance (because every claims-made application asks if the insured is aware of circumstances that might give rise to a claim), not to mention what an insured can do to protect itself when switching from one claims-made insurer to another (as by invoking the discovery clause) or when retiring (such as by buying a tail policy), must necessarily be dealt with as an area more suited to thorough treatment in a reference book dealing specifically with E&O insurance, as opposed to a chapter in a book discussing only the legal liabilities of attorneys in which but one chapter is devoted to insurance. It is suggested that the practitioner review COMMERCIAL AND PROFESIONAL LIABILITY INSURANCE, *supra*.

X. EXCLUSIONS AND OTHER PROVISIONS

A. [14.10] Services Rendered to Others

As a general matter, legal malpractice liability policies provide coverage when the insured has provided legal services for others. Typically, coverage applies to a client’s malpractice claim against the insured attorney. The claim rests on professional services rendered to another, the client.

An Illinois court has held that malpractice liability coverage is unavailable when the alleged misconduct occurs during the insured's pro se representation. In *Mendelsohn v. CNA Insurance Co.,* 115 Ill.App.3d 964, 451 N.E.2d 919, 71 Ill.Dec. 765 (5th Dist. 1983), the insured attorney represented himself in a marriage dissolution proceeding. After the dissolution, the attorney's former wife sued the attorney, his law firm, and her own attorney for malpractice. Her complaint alleged that all parties knew of her mental exhaustion and susceptibility to emotional distress. It further alleged that, despite this knowledge, all parties negligently acted or failed to act in such a way that the claimant suffered great mental anguish. The insured attorney tendered defense of this action to his malpractice carrier, who took the view that the attorney was not sued for his representation of another.

The *Mendelsohn* court noted that a lawsuit that merely names an attorney in his or her professional capacity is not sufficient to invoke liability coverage. The test is whether the attorney conducted all or part of the underlying action on behalf of another person. The court relied on the Illinois Supreme Court's definition of the "practice of law" as it appears in *People ex rel. Illinois State Bar Ass'n v. People's Stock Yards State Bank,* 344 Ill. 462, 176 N.E. 901 (1931). The definition repeatedly uses the phrase "services rendered in advising a client." 176 N.E. at 907. The *Mendelsohn* court found that the insured attorney acted on his own behalf in the dissolution proceeding. Thus, it held that the attorney's pro se representation was not among his professional services rendered to others.

In *Continental Casualty Co. v. Donald T. Bertucci, Ltd.,* 399 Ill.App.3d 775, 926 N.E.2d 833, 339 Ill.Dec. 358 (1st Dist. 2010), the insured lawyer had withheld a portion of a settlement from his client, claiming that withheld portion as fees. The client sued, claiming the amount withheld was inappropriate and excessive. In the declaratory-judgment action between the lawyer and his malpractice insurer, the court noted the malpractice policy defined "legal services" as "those services performed by an Insured for others as a lawyer, arbitrator, title agent or as a notary public," and held that a lawyer's retention of money as a fee "cannot be construed as the provision of any type of service for another person and is a business practice independent of the lawyer-client relationship." 926 N.E.2d at 842.

B. [14.11] Fiduciary Acts Coverage

Attorney malpractice policies often include a grant of coverage for the insured's negligence while acting in a fiduciary capacity. There are few cases in Illinois addressing this type of coverage, even tangentially.

For example, in *Regas v. Continental Casualty Co.,* 139 Ill.App.3d 45, 487 N.E.2d 105, 93 Ill.Dec. 661 (1st Dist. 1985), a law firm issued a check to a bank on its client's escrow account, even though the client had no funds in the account at the time, to complete a real estate closing for the client. The court noted the law firm's malpractice policy included coverage for "fiduciary activity" by stating that any act or omission committed by them in their fiduciary capacity "shall be deemed to have been committed during the performance of their . . . professional services." 487 N.E.2d at 109. However, in its subsequent analysis, the court did not follow through on the fiduciary activity aspect of the coverage. Instead, the court held the attorney was performing professional services and engaged in the practice of law because "management of all the

requirements and execution of instruments necessary to close a real estate transaction demand legal skill and knowledge as well as professional judgment." 487 N.E.2d at 109. *See also Illinois State Bar Association Mutual Insurance Co. v. Mondo,* 392 Ill.App.3d 1032, 911 N.E.2d 1144, 331 Ill.Dec. 914 (1st Dist. 2009) (applying fiduciary exclusion for role as fiduciary under Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §1001, *et seq.*); *Continental Casualty Co. v. McDowell & Colantoni, Ltd.,* 282 Ill.App.3d 236, 668 N.E.2d 59, 63, 217 Ill.Dec. 874 (1st Dist. 1996) (court found theft of client funds to be "professional negligence," after noting coverage included acts as trustee or "fiduciary activity").

C. [14.12] Dishonest Acts Exclusion

Another common exclusion in legal malpractice policies is the dishonest act exclusion. In *Continental Casualty Co. v. McDowell & Colantoni, Ltd.,* 282 Ill.App.3d 236, 668 N.E.2d 59, 217 Ill.Dec. 874 (1st Dist. 1996), a lawyer in charge of the finances for a law firm transferred funds from a client account to the firm's operating account to pay firm expenses. The client sued the firm, and the firm tendered the suit to its malpractice carrier. The malpractice carrier filed a declaratory-judgment action, arguing the dishonest acts exclusion applied.

The insurer argued the claims clearly "ar[o]se from" the dishonest act of theft, but the court held negligent supervision of client funds was an independent cause of the misappropriation. 668 N.E.2d at 63. Separately, the court held that a "sole allegation" limitation in another exclusion for willful violation of statutes, when read in conjunction with the dishonest acts exclusion, either "demonstrate[d] expanded coverage or, at minimum, reveals an ambiguity" that was construed in favor of coverage. 668 N.E.2d at 66 – 67.

In *Illinois State Bar Association Mutual Insurance Co. v. Mondo,* 392 Ill.App.3d 1032, 911 N.E.2d 1144, 331 Ill.Dec. 914 (1st Dist. 2009), the insured had a consulting firm providing services related to self-insured trusts. He was sued in a multi-count complaint for recommending a self-insured trust arrangement to a client of the consulting firm without disclosing his ties to the proposed trust administrator. After first determining the insured was not being sued in any capacity related to his status as an attorney, the court also held coverage for the claim was barred by various exclusions, including the fraud exclusion and the business enterprise exclusion.

D. [14.13] Business Enterprise Exclusion

In *Continental Casualty Co. v. Flomenhoft,* 263 Ill.App.3d 22, 640 N.E.2d 290, 203 Ill.Dec. 631 (1st Dist. 1994), the insured attorney was a limited partner in a limited partnership he formed and represented. The partnership was intended to take advantage of favorable tax treatment for coal mine investments. The attorney began negotiating to sublease rights to coal mines when the Internal Revenue Service announced it was eliminating the favorable tax treatments for deals that were "in place" on October 28, 1976. 640 N.E.2d at 291. Although an oral agreement on the sublease was reached on October 28, the documents creating the partnership were not signed until afterward. The attorney nonetheless advised others to use the date October 28 as the date the partnership was formed. As general counsel of the partnership, the insured attorney prepared an investment memorandum that gave the formation date as October 28, 1976. The partnership took tax deductions based on the favorable treatment of coal investments. Subsequently, the IRS disallowed those deductions because the partnership was not formed on October 28, 1976.

The attorney was sued by the partners in the limited partnership. The legal malpractice insurer denied coverage based on the business enterprise exclusion, which applied to acts or omissions committed while acting as an attorney for "a business enterprise in which [the insured attorney] is a partner." 640 N.E.2d at 293. The court held the exclusion applied.

See also Illinois State Bar Association Mutual Insurance Co. v. Mondo, 392 Ill.App.3d 1032, 911 N.E.2d 1144, 331 Ill.Dec. 914 (1st Dist. 2009) (finding various exclusions, including business enterprise exclusion, applicable).

E. [14.14] Insured vs. Insured Exclusion

Malpractice policies often exclude claims by one insured against another. In *Andreou & Casson, Ltd. v. Liberty Insurance Underwriters, Inc.,* 377 Ill.App.3d 352, 877 N.E.2d 770, 315 Ill.Dec. 710 (1st Dist. 2007), the insured firm was sued for defamation of a former partner who had been ousted from the firm. She alleged that, after she had been ousted, the firm and its representatives had "publicly disparaged her professionalism and integrity." 877 N.E.2d at 771. Because she still retained her interest in the firm even after her termination, the court held she qualified as an insured, and therefore the insured versus insured exclusion applied.

F. [14.15] Legal Fees and Sanctions Exclusions

Many legal malpractice policies bar coverage for return or restitution of legal fees. This can be done by means of an exclusion or, more frequently, by a definition of "damages" to carve out restitution, unjust enrichment, disgorgement, etc. *See, e.g., Continental Casualty Co. v. Duckson,* 826 F.Supp.2d 1086 (N.D.Ill. 2011). For slightly different reasons, insurers can exclude (or carve out from the definition of "damages") court-imposed sanctions or, more broadly, "civil or criminal fines, sanctions, penalties or forfeitures, whether pursuant to law, statute, regulation or court rule." 826 F.Supp.2d at 1091.

G. [14.16] Innocent Insured Provision

Many legal malpractice policies contain a provision waiving certain exclusions, such as those relating to criminal, dishonest, fraudulent, or malicious acts as to any insured who was not guilty of the crime, dishonesty, fraud, malice, etc. One decision based in Illinois law considered such a provision in the context of a rescission action based on misrepresentations in the application.

In *Home Insurance Co. v. Dunn,* 963 F.2d 1023, 1024 (7th Cir.1992), the court held the misrepresentation by just one attorney (who completed the application for the firm's malpractice insurance coverage) voided the policy ab initio, and therefore it did not matter whether the other insureds were "innocent." *But see Illinois State Bar Association Mutual Insurance Co. v. Coregis Insurance Co.,* 355 Ill.App.3d 156, 821 N.E.2d 706, 290 Ill.Dec. 394 (1st Dist. 2004) (misrepresentation in application made policy voidable, not void, and held right to rescind was waivable if insurer did not act promptly).