



# Legal Malpractice: Coverage Pitfalls in the Real World

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## THE APPLICATION

### IN GENERAL

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Any discussion of a professional liability policy must begin with the application. Whether procuring a new policy or renewing an existing policy, it is inevitable that an insured will have to complete some form of application. The application may take the form of a detailed, multi-page questionnaire (always required for a new policy and often times required in the renewal of an existing policy) or as simple as a certification that the information provided in an earlier application continues to be accurate and that there have been no significant changes in the insured's practice (generally seen with the renewal of an existing policy).

From the insurer's prospective, the application serves two purposes. It allows the insurer to determine whether the prospective insured is a risk it wants to underwrite, and the application also helps to calculate the premium that needs to be charged in order for the insurer to accept the risk.

### COMMON APPLICATION QUESTIONS

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#### **Background Information on the Attorney/Firm**

The number of lawyers;

Whether the firm has attorneys who are "Of Counsel";

The year the firm was established; and

Whether the attorney/firm has an office sharing or expense sharing relationship with any other attorneys.

#### **The Attorney's/Firm's Area of Practice**

Virtually every policy will ask the insured to break down his/her practice area by percentage of time devoted to or revenue generated from a list of practice areas. Professional liability insurers are aware that different practice areas are more likely/less likely to result in claims.

The application may also specifically ask whether, in some set time period, the insured has represented a client with regard to the sale of securities.

#### **Whether Any of the Firm's Attorneys Have Outside Business Interests**

Insurers will want to know whether any of the attorneys working for the firm own, are employed by, or serve as an officer or director of some outside business.

While an attorney may not be acting in his capacity as an “attorney” when participating in these outside interests, it increases the insurer’s risk that the attorney may be sued under a legal malpractice theory.

Whether the insured has ever been rejected for coverage or whether a professional liability policy has been canceled.

### **The Firm’s Office Procedures**

The insurer will likely ask questions regarding the “office procedures” used by the firm such as its diary/docketing system, whether the firm has a computer calendaring system, how conflicts are checked, procedures regarding retainers and “turn-downs.”

### **Prior Claims, Potential Claims and Discipline**

One of the most troublesome areas of the application is the section that asks about claims, potential claims and discipline. The application will likely ask the firm to disclose whether it or any firm member has been the subject of any malpractice claim and, if so, to set forth in detail the nature of the claim and its disposition. The application will also ask whether any firm member has been disbarred, suspended, publicly reprimanded, or privately admonished by the board of professional responsibility.

More difficult, however, are the application questions that ask whether the insured is aware of any potential claim. These questions are, by far, the most likely to result in a coverage dispute.

For the insurer, this is clearly one of the most important questions on the application. An insurer does not want to assume a risk of covering an existing claim and, as such, asks the insured to disclose potential claims.

The wording of the application is all-important. Most applications will broadly ask whether the insured is “aware of any incident that could reasonably result in a claim.” Such language does not simply ask whether the insured is aware that a client or former client has made a “claim” but, rather, whether the insured is aware of any incident or event that could result in a claim.

The issue has arisen as to whether the language in such questions seek a “subjective” or “objective” answer. When a coverage dispute breaks out, an insured may attempt to argue that, despite evidence to the contrary, he/she subjectively thought that no claim existed. Most applications, however, are written in such a way that an “objective” response is required. Under the objective standard, an insured is required to disclose an incident that a “reasonable attorney” thinks could result in a claim. *See Ratcliff v. International Surplus Lines*, 550 N.E.2d 1052 (Ill. Ct. App. 1990) (Objective standard is proper in determining whether insured had notice of potential claim.); *Wittner, Poeger, Rosenblum & Spewak, P.C. v. Bar Plan Mutual Ins. Co.*, 969 S.W.2d 749, 754 (Mo. 1998) (“These known facts supported the court’s implied finding that the Firm knew, or had reason to know, of the possibility Client would file a legal malpractice claim against it.”); *Home Indemnity Co. v. Toombs*, 910 F.Supp. 1569, 174-75 (N.D. Ga. 1995) (In completing application question regarding knowledge of potential claims, the “subjective belief of the insured is not the issue.”).

The application generally concludes by asking the insured to “certify” that the information provided is true and accurate and that a “reasonable inquiry” has been made within the firm to obtain the information requested.

## MISREPRESENTATION IN THE APPLICATION

Alleged misrepresentations in applications for professional liability policies have resulted in significant coverage disputes.

Most professional liability policies incorporate the application into the policy itself. For example, the policy may provide:

By acceptance of this policy the insured agrees:

The statements in the application are his or her representations;

This policy is issued in reliance upon the truth of such representations; and

This policy embodies all of the agreements between the insured, us and/or our agents.

Minn. Stat. § 60A.08, subd. 9 provides:

No oral or written misrepresentation made by the assured, or in the assured's behalf, in the negotiation of insurance, shall be deemed material, or defeat or avoid the policy, or prevent its attaching, unless made with intent to deceive and defraud, or unless the matter misrepresented increases the risk of loss.

Accordingly, an insurer can void coverage in two circumstances. First, if the insured intended to defraud the insurer, coverage can be voided. If, however, the misrepresentation not fraudulent, insurer can void coverage if the misrepresentation materially increases the “risk of loss” to the insurer. See *Transamerican Ins. Co. v. Austin Farm Center, Inc.*, (Minn. Ct. App. 1984).

The term “risk of loss” refers to the likelihood that the insurer will be liable in the future. *Proprietors Ins. Co v. Northwestern National Bank of Minneapolis*, 374 N.W.2d 772, 777 (Minn. Ct. App. 1985).

In professional liability policies, the failure to disclose a potential claim in the application has been said to increase the risk of loss as a matter of law. *Continental Insurance Co. v. Maxwell*, 799 S.W.2d 882 (Mo. Ct. App. 1990)(“When an attorney-litigant, sued by counterclaim in a dispute arising out of an attorney-client relationship, inaccurately represents on an application for professional liability insurance the non-existence of circumstances which could result in a malpractice claim, the inaccuracy of that answer is material to the issuance of the policy as a matter of law.”); *TIG Ins. v. Blacker*, 767 N.E.2d 598 (Mass. Ct. App. 2002) (“[A]ccurate information about an applicant's exposure to potential claims is so fundamental to claims-made underwriting, that a misrepresentation on this score may be said to increase the risk of loss as a matter of law, without proof of subjective reliance by the insurer.”).

Where there is a misrepresentation that increases the risk of loss, the insurer can seek to void the entire policy or seek to void coverage for that particular claim. See Howard v. Aid Ass'n. for Lutherans, 272 N.W.2d 910, 912-13 (Minn. 1978) (Material misrepresentation of a required disclosure on an application allows an insurer to void a life insurance policy, whether or not the misrepresentation relates to the cause of death of the insured.); Wittner, Poger, Rosenblum & Spewak v. Bar Plan Mutual Insurance, Ct. File No. 70655 (Mo. Ct. App. filed Sept. 16, 1997)(unpublished)(Professional liability insurer denied coverage for particular claim based on misrepresentation in application.)(aff'd. on other grounds, 969 S.W.2d 749 (Mo. 1998)); Gurstel v. St. Paul Fire & Marine Ins. Co., Ct. File No. C1-90-896 (Minn. Ct. App. filed Aug. 21, 1990)(unpublished).

Where the policy is voided in its entirety, the insurer must return the premium.

## INSURING GRANT

### POLICY LANGUAGE

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The most common form of claims-made professional liability coverage provides that an insurer will "pay on behalf of the insured *damages arising out of* the rendering or failing to render *professional services* for others." From a coverage aspect there are several legal issues that result from the above language.

#### **Interpreting "Damages"**

The above insurance grant limits recovery in that a suit must allege or seek "damages." In this regard, "damages" refers to the payment of money, and accordingly, some claims do not meet the "damage" predicate for coverage:

- Claims seeking injunctive relief or specific performance;
- A criminal proceeding;
- Representation in a Disciplinary Action; and
- Claims for restitution.

Some policies expressly exclude from the definition of "damage" the following:

- Any fine or penalty imposed by law or otherwise assessed against an insured;
- Punitive or exemplary damages; and
- Legal fees, costs or disbursements paid or owed to the insured or paid or owed by the insured.

Removal of these "damages" from the policy definition can preclude indemnification for such things as treble damages pursuant to Minn. Stat. §§ 481.07, 481.071.

#### **"Damages" v. "Loss"**

Although the more common policy indemnifies for "damage," other policies exist that have more restrictive insuring grant language. For example, instead of indemnifying for "damage," some policies instead provide coverage only for "loss." This distinction is

significant. In particular, the Supreme Court of Minnesota has held that a return of attorney's fees for a breach of fiduciary duty is not restitution, but rather covered "damage" in a policy that, by its express language, indemnifies for "money damages." In that case, *Perl v. St. Paul Fire & Marine Ins. Co.*, 345 N.W.2d 209 (Minn. 1984), the court noted that "[t]he injury lies in the client's justifiable perception that he or she has or may have received less than honest advice in zealous performance to which a client is entitled." The court continued:

The law treats a client's right to an attorney's loyalty as a kind of "absolute" right in the sense that if the attorney breaches his or her fiduciary duty to the client, the client is deemed injured if no actual loss results. But instead of awarding the injured client nominal money damages for the breach, the law, in this instance, says that the attorney is not entitled to compensation for services rendered and the client is entitled to recover, as damages, the compensation paid. Consequently, when St. Paul Fire & Marine uses the unqualified term "money damages" in its policy, we think it refers to all money damages whether or not awarded to compensate for actual harm. 345 N.W.2d at 212 (citation omitted).

As the *Perl* decision notes, when a client seeks a return of legal fees paid as a result of a lawyer's breach of fiduciary duty, the conduct may not result in actual loss. If there is no "loss," then there is no coverage under a policy that only indemnifies for "loss."

### **Interpreting "Arising Out Of"**

Courts have almost uniformly defined the phrase "arising out of" in a very broad context to mean conduct "originating from," "growing out of" or having a "substantial nexus" with the activity for which coverage is provided. There does not need to be proximate cause between damages and professional services under this language. See *County of Hudson v. Selective Ins. Co.*, 332 N.J.Super. 107, 114, 752 A.2d 849, 852 (App.Div. 2000).

### **"Arising Out Of" v. "Resulting From"**

Instead of the broad language "arising out of," some policies provide coverage for claims "resulting from" the rendering or failing to render professional services for others. Courts have interpreted the later in a more narrow sense, stating that damage "results from" professional services only if a strict causal relationship exists between the services and damage. See *Westchester Fire Ins. Co. v. Continental Ins. Co.*, 126 N.J.Super. 29, 37, 312 A.2d 664, 669 (App. Div. 1973).

In Minnesota, however, the Minnesota Court of Appeals stated, using the American Heritage College Dictionary as support, that "resulting from" has the same and ordinary meaning as "arising out of." *Mork Clinic v. Fireman's Fund Ins. Co.*, 575 N.W.2d 598, 602 (Minn. Ct. App. 1998).

### **Interpreting "Professional Services."**

Most policies require that the covered services be "professional." Sometimes the term "professional" is defined in the policy, other times it is not. Even when defined, it can become substantially difficult to determine whether the insured was acting in a professional capacity as a lawyer when the services were rendered.

Case law offers some assistance in defining "professional." The leading case which articulates such a definition, although it deals in terms of the medical profession, is Marx v. Hartford Accident & Indemnity Co., 183 Neb. 12, 157 N.W.2d 870 (1968). In Marx, the court provided an often-cited definition of professional services:

Something more than an act flowing from mere employment or vocation is essential. The act or service must be such as exacts the use or application of special learning or attainments of some kind. The term "professional" in the context used in the policy provision means something more than proficiency in the performance of a task and implies intellectual skill as contrasted with that used in an occupation for production or sale of commodities. A "professional" act or service is one arising out of a vocation, calling, occupation or employment involving specialized knowledge, labor or skill, and the labor or skill involved is predominantly mental or intellectual, rather than physical or manual. 157 N.W.2d at 871-72 (citations omitted).

Despite being a good starting point, the Marx definition is sometimes difficult to apply in the legal context, as lawyers often perform a wide variety of tasks, some of which are commonly performed by non-lawyers. Therefore, courts have also looked to define professional services by asking whether the particular services were "legal." This inquiry focuses on whether the retention was for legal services or skills that do not ordinarily constitute the practice of law. The crux of the determination centers on the purpose of the retention rather than the title, capacity, or activity of the lawyer. If the lawyer is retained principally for legal services wherein he or she must use his or her experience in the law, then the performance of non-legal services incidental to that representation is generally covered. If, however, the retention is non-legal, then the performance of incidental services that could otherwise be considered legal is nonetheless excluded. See Morris v. Valley Forge Ins. Co., 305 Ark. 25, 805 S.W.2d 948 (1991) (whether purchase of motel owned by lawyer resulted from advice while representing client in a divorce).

Some decisions have focused on whether the lawyer acted in a personal rather than professional capacity. This distinction can be significant in a claim for defamation. In that regard, the focus will be on whether the defamatory statement was made in a personal capacity out of ill will or spite, as compared to whether the statement was part of a lawyer's professional advice to a client. The latter should be covered, the former should not. See Gerol v. Arena, 127 Wis.2d 1, 377 N.W.2d 618 (App. 1985) (A defamatory letter written to physician on behalf of a neurosurgeon friend did not involve the use of any legal expertise and was done in a personal rather than professional capacity. It is important to note that the lawyer was seeking coverage under an umbrella policy, which excluded coverage for professional services.).

## CLAIMS MADE POLICY

### GIVING NOTICE OF CLAIM DURING THE POLICY PERIOD

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With very few exceptions, professional liability policies are "claims-made and reported" policies. A claims-made policy is fundamentally different than an occurrence policy. Under an occurrence policy, a claim will be covered if the loss occurred during the policy

period, regardless of when a claim is made. A claims-made policy, however, will cover a claim only if the claim is made and reported during the policy period.

While early attorney's professional liability policies were written as occurrence policies, insurers moved toward claims-made forms for a number of reasons. Because the occurrence policy covers a risk that "occurred" during the policy, regardless of when the claim is eventually brought, the insurer may carry a risk for years or decades after the policy. As such, underwriting is much more difficult. With a claims-made form, the premium is more closely timed with the risk. With a claims-made form, the insurer is able to "close the books" at the end of the policy period. As such, underwriting claims-made policies is much easier and is generally much less expensive for the insured.

Under a typical claims-made-and-reported policy, however, a claim will be covered only if the "act, error or omission" occurred during the policy period AND is reported to the insurer during the policy period.

With respect to the first condition, that the claim be based upon an act or omission that occurred during the policy period, most policies extend coverage to claims that occurred prior to the policy period so long as the insured had no knowledge of facts that could support a claim as of the effective date of the policy.

Reporting the claim during the policy period is a condition precedent to coverage. As noted in *Northwest Airlines, Inc. v. Federal Insurance Co.*, Ct. File No 3-91-0228 (D. Minn. filed 1/13/93) (unpublished) ("to grant an insured coverage under a claims-made-and-reported policy for a claim reported after the expiration of the policy period would alter a basic term of the insurance contract by forcing the insurer to insure a risk it had not agreed to cover.").

With an occurrence policy, an insurer can void coverage based upon late notice only if it can show that it was prejudiced because of the late reporting. *Reliance Insurance Company v. St. Paul Insurance Co.*, 307 Minn. 338, 239 N.W.2d 922 (1976).

With a claims-made policy, however, failure to report the claim during the policy is fatal to coverage. Prejudice to the insurer is not a necessary element. *Northwest Airlines, Inc. v. Federal Insurance Co.*, Ct. File No 3-91-0228 (D. Minn. filed 1/13/93) (unpublished); *Esmailzadeh v. Johnson and Speakman*, 869 F.2d 422 (8th Cir. 1989).

Under a pure claims-made-and-reported policy, an insured would have no coverage if the act, error or omission occurred prior to the issuance of the policy. Most policies, however, will extend coverage for "prior acts," that is acts that took place prior to the policy period, so long as the insured was not aware of facts that could support a claim as of the effective date of the policy.

Clearly, an insurer has no desire to insure a known claim. Accordingly, if the insured knows or has reason to know that a potential claim exists at the time the policy is issued, the prior acts language will not extend coverage for that claim.

A coverage defense under the prior acts provision usually goes hand in hand with a defense of misrepresentation in the application.

Additionally, if one of the attorneys knows of the claim, that knowledge is generally imputed to the law firm so as to foreclose coverage for the firm. This is particularly true if the attorney is an officer or partner in the law firm. Sunrise Properties, Inc. v. Bacon, Wilson, Ratner, Cohen, Salvage, Fialky & Fitzgerald, P.C., 425 Mass. 63, 679 N.E.2d 540 (Mass. 1997); Greenberg & Kovitz v. National Union Fire Ins. Co. of Pittsburgh, P.A., 312 N.J. Super. 251, 711 A.2d 909 (N.J. 1998); Gurstel v. St. Paul Fire & Marine Ins. Co., Court File No. C1-90-896 (Minn. Ct. App. filed August 21, 1990) (unpublished).

Like misrepresentations in the application, the “knowledge” of the insured is viewed objectively.

The prior acts provision is not an “exclusion” but, rather, simply an extension of the insuring grant.

## **DEFENSE, COOPERATION AND SETTLEMENT**

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### **CONTROL OF THE DEFENSE**

Professional liability policies, like most other policies, give the insurer the right to control the defense. Unless there is an actual conflict of interest, the insurer has the right to select the attorney to defend the insured. Mutual Serv. Cas. Ins. Co. v. Luetmer, 474 N.W.2d 365, 368 (Minn. Ct. App. 1991).

This is true even where the insurer is defending the claim under a reservation of rights. Mutual Serv. Cas. Ins. Co., 474 N.W.2d 365.

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### **COOPERATION**

An insured has an obligation to cooperate with an insurer in defending the claim. Generally, the cooperation clause requires that the insured assist the insurance company in its preparation for settlement or trial. An insured's responsibilities under the cooperation clause of an insurance policy involve attending hearings and trials, assisting in effecting settlement, securing and giving evidence, and obtaining the attendance of witnesses. Indiana Ins. Co. v. Williams, 448 N.E.2d 1233, 1237 (Ind. Ct. App. 1983).

In order for an insurer to deny coverage based on a breach of the cooperation clause, the insurer has the burden of proving a substantial and material lack of cooperation resulting in substantial prejudice to its position. White v. Boulton, 259 Minn. 325, 107 N.W.2d 370 (1961).

The cooperation clause has become an issue where the insured has attempted to voluntarily “settle” the case before tendering the claim to the insurer.

Insurers have also attempted to rely on the cooperation clause where there was a significant delay in tendering the claim. See Felive v. St. Paul Fire & Marine Ins. Co., 711 P.2d 1066 (Wa. Ct. App. 1986).

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### **SETTLEMENT**

One difference in professional liability policies, however, is that the policy usually provides that an insurer will not settle a malpractice claim unless the insured consents.

If, however, the insured refuses to consent to a settlement recommended and requests that the insurer continue to defend the claim, most policies provide that the insurer's liability for the claim is capped at the amount of the recommended settlement and the risk of any liability above and beyond that sum is shifted to the insured.

## EXCLUSIONS

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### GENERALLY

All professional malpractice policies contain clauses that delete or limit coverage under certain circumstances. These clauses appear in the policy under the "Exclusions" heading. An exclusion itself may be modified to give back to the policy a right that was taken away by the exclusion; such a provision is called an "exception."

An exclusion only becomes an issue if the claim first meets the requirements of the insuring grant. For example, if a lawyer was not performing "professional services," the claim would not be covered and the applicability of an exclusion is irrelevant.

There are three general categories of exclusions: (1) exclusions eliminating damages not typically included in a professional liability policy (bodily injury, property damage, other business pursuits, officer/director liability incurred from a non-insured company); (2) exclusions eliminating an extremely large financial risk (Securities, ERISA); and (2) exclusions eliminating a "moral" risk (dishonest and/or fraudulent acts; discrimination, sexual harassment).

## COMMON EXCLUSIONS

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### BODILY INJURY

If a policy defines the phrase "bodily injury," that definition is usually limited to "bodily injury, sickness or death." Thus, a claim alleging this type of injury would be excluded from coverage.

Minnesota courts have held that a claim for emotional harm without attendant physical manifestations, is not "bodily injury" within the meaning of a general liability policy. *Garvis v. Employers Mut. Cas. Co.*, 497 N.W.2d 254, 257-58 (Minn. 1993); *Hamlin v. Western Nat. Mut. Ins. Co.*, 461 N.W.2d 395, 397 (Minn. Ct. App. 1990). This holding should be equally applicable to an exclusion for bodily injury in a professional liability policy. Therefore, a claim for negligent infliction of emotional distress, standing alone, should not be excluded from professional liability coverage via a bodily injury exclusion unless the policy has a materially different definition of "bodily injury" than the one articulated above, or contains a separate exclusion for these damages.

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### PROPERTY DAMAGE

The policy exclusion will generally remove from coverage a claim for damages based upon the loss of tangible property. See McAlear v. St. Paul Ins. Co., 158 Mont. 452, 493 P.2d 331 (1972).

### **Other Business Pursuits/Insured as an Officer or Director of a Non-Insured Company**

As a general proposition, professional liability insurers do not insure against any business activity of the insured outside of the attorney's business interests in his or her law firm. The purpose of a business exclusion is twofold: (1) to prevent the shifting of an outside business loss to a professional liability policy; and (2) to avoid the increased risk of such a loss when the lines between the practice of law and other business pursuits become blurred.

As it pertains to the "Other Business Pursuits" exclusion, typical policies will only preclude coverage if an insured has a specified level of financial interest, i.e. ownership interest, in the non-insured company. (For example, a policy may only preclude coverage for legal negligence claims concerning a non-insured company in which a lawyer has an ownership interest exceeding 10%. The exclusion would not apply to an ownership percentage interest under that amount.) See Senger v. Minnesota Lawyers Mutual Ins. Co., 415 N.W.2d 364 (Minn. Ct. App. 1987) (No coverage where attorneys admitted they were sued in their capacity as owners of a franchise).

As it pertains to the Officer/Director exclusion, coverage is generally excluded for claims arising out of the lawyer's activity as an officer or director of a company other than the insured law firm. If you are an attorney who holds an officer or director position in a business outside of the insured law firm, the best practice to ensure liability coverage is to make certain your outside business interest has you insured under a directors' and officers' liability (D & O) policy.

In a separate exclusion that is based upon the same considerations as stated above, professional liability policies sometimes do not cover liability incurred from the acts of a lawyer with whom the insured attorney shares office space and facilities. This exclusion will not apply, of course, if the office-share attorney is also an insured under the policy.

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## **SECURITIES**

This exclusion is of particular significance to insurers, as claims based upon securities transactions can involve several millions of dollars for each claim, including but not limited to the defense of such an action. Thus, most professional liability policies exclude coverage for "securities."

The scope of a securities exclusion, like other exclusions, depends upon the breadth of the language used in the policy. For example, some policies may preclude coverage arising out of the promotion, solicitation or sale of securities, or the performance of such securities. With this language, the most significant determination is whether the claim arose out of a "security." In that regard, it is prudent to turn to the definition of the term "security" as used in both federal and state securities law. See Securities Act of 1933, § 2(a)(1); Securities and Exchange Act of 1934, § 3(a)(10); Minn. Stat. § 80A.14, subd.

18(a). Due to the exhaustive definition of that term, further clarification of a particular transaction may be needed with the assistance of federal and state case law.

Although the term "security" is defined broadly under federal and state law, the scope of the definition may not encompass every type of investment scheme. In recognition of this fact, some professional liability policies not only exclude "securities," but in addition "other investments" as well. Since the latter is more broad than the former, a policy containing "other investment" language will exclude a claim that, although it may not concern a "security," does concern an investment transaction.

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## ACTIVITIES UNDER ERISA

Generally, this exclusion precludes recovery for claims arising out of an insured's capacity as a fiduciary under the Employee Retirement Income Security Act of 1974. This exclusion should only concern the insured's capacity as a fiduciary, and does not apply to an insured as a fiduciary solely by reason of legal advice rendered with respect to an employee benefit plan.

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## DISHONEST/FRAUDULENT ACTS

Typical policy language will state that the policy is inapplicable "to any dishonest, fraudulent, criminal or malicious act or omission of the insured." Perhaps the most relied-upon exclusion, the basis for not insuring this type of conduct stems from public policy considerations against insuring willful acts.

In *Perl*, the court differentiated between the types of fraud covered under this exclusion:

Fraudulent acts are recognizable under the well-established rules defining fraud, but should not include constructive fraud, or acts or omissions which are deemed fraudulent only because they constitute a breach of the fiduciary obligations. 345 N.W.2d at 213 (citation omitted). Therefore, the rule of law in Minnesota is that "the policy exclusion for 'fraudulent' acts or omissions does not encompass constructive fraud for breach of fiduciary duty." *Id.*

As noted above, some policies contain "exceptions" to exclusions. As this relates to the Fraudulent/Dishonest Acts exclusion, the typical policy will cover insureds who did not participate in, acquiesce in or fail to take appropriate action after having personal knowledge of the such Fraudulent/Dishonest Acts. This exception is sometimes referred to as "Innocent Insured Protection." As to a law firm that is a corporation, however, it should be remembered that such an entity could only act through its officers and directors. As such, any fraudulent/dishonest conduct of an officer/director would be imputed to the corporation, negating application of the Innocent Insured Protection exception as to the law firm. *See Sunrise Properties, Inc. v. Bacon, Wilson, Ratner, Kohen, Salvage, Fialky and Fitzgerald, P.C.*, 679 N.E.2d 540 (Mass. 1997).

As a note of mention, other typical moral-based exclusions consist of claims for discrimination (based upon race, creed, age, sex, marital status or sexual preference) and sexual harassment.

## LIMITS OF LIABILITY/DEDUCTIBLE

### LIMITS OF LIABILITY/DEDUCTIBLE EXPLAINED

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Most professional liability policies have two policy limits: a “per claim” limit (the insurer’s policy limit for a single claim) and an annual aggregate (the most the insurer will pay for all claims under a particular policy period).

Similarly, most professional liability policies have a “deductible.” Like with the limit of liability, the insured is generally responsible for a deductible “per claim.”

Again, the specific language used in the policy is key. The “per claim” language focuses not on the event or cause of the loss but, rather, on the number of third parties injured by the insured’s conduct. See *Atlas Underwriters, Ltd. v. Meredith-Burda*, 343 S.E.2d 65 (Va. 1986) (where, in the course of spray painting a water tower, insured damaged forty vehicles, “per claim” deductible clause required that \$250.00 deductible be applied to each damaged car); *Burlington County Abstract v. QMA Associates Inc.*, 400 A.2d 1211 (N.J. Ct. App. 1979) (where abstracter failed to ascertain taxes due with regard to the sale of 84 condominium units, “per claim” deductible clause required that \$500 deductible be applied to each); *Capitol Indemnity Corp. v. Miles*, 978 F.2d 437 (8th Cir. 1992) (deductible applied to each claimant suffering damage from single incident).

The language can be both a boon and a problem for the insured. If there are multiple claimants in a single lawsuit, the insured has the benefit of multiple limits of liability. The insured, however, must pay a deductible on each claim. If, in an effort to avoid paying multiple deductibles, the insured tries to cast multiple claimants into a single claim for deductible purposes, he/she runs the risk of having the claim be subject to a single limit of liability.

It is also important for an insured to determine whether “defense costs” are included in the limits. Beginning in the 1980’s, some insurers have modified the policies to provide that the cost incurred in defending the insured reduce the limits. In many cases, this is not a significant issue. If, however, the litigation is complex, the cost of defense may take up a significant portion of the limits of liability leaving less to settle the claim.