TRANSACTIONAL LAWYERS UNDER FIRE: A LOOK AT COVERAGE QUESTIONS ARISING IN THE CONTEXT OF SECURITIES CLASS ACTION SUITS AGAINST LEGAL PROFESSIONALS

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I. INTRODUCTION

With the demise of Enron, politicians are debating the proper role of accountants, the Securities Exchange Commission[1] has undertaken an "unusual volume of enforcement activity,"[2] and bankruptcy creditors are arguing that Enron's Directors & Officers liability policies should be preserved as assets of the bankruptcy estate rather than be used to provide a defense to directors or officers named as defendants in the securities class action.[3] This article, however, speaks of another development that has received significant exposure: the inclusion of Enron's transactional attorneys as defendants.[4] Although the Enron implosion is not the first time that transactional lawyers have been sued in securities matters, the publicity surrounding the Enron litigation is likely to encourage additional actions.[5]

Traditionally, securities class actions have focused on the issuing company, its directors and officers, and, in some instances, its accountants. The inclusion of law firms engaged in Enron's transactional work as defendants to securities class action litigation naturally raises the general question of law firms' ability and willingness to pay damages for securities law violations should such liability be imposed or incurred through judgment or settlement[6] and, in particular, the extent to which the insurance

1. Hereinafter SEC.

2. Otis Bilodeau, *Rising Stock*, Legal Times, Apr. 29, 2002, at 1, 21. The SEC reports thirty-six matters involving emergency relief over the past six months as compared to forty-three such matters during 2001. *Id*.

3. *See Enron Directors Say Creditors Committee Is Holding D. O. Policy Hostage*, 12 Andrews Ins. Coverage Litig. Rep., Apr. 5, 2002, at 11, (discussing proceedings in before the United States Bankruptcy Court for the Southern District of New York).

4. *See* Newby v. Enron Corp., Case No. H-01–3624 (S.D. Tex. filed Apr. 18, 2002) (naming Vinson & Elkins and Kirkland & Ellis) *available at* http://www.enronfraud.com; Tittle v. Enron Corp. No. 4:01–3913 (S.D. Tex. filed 2002) (naming Vinson & Elkins).

5. A few years ago, plaintiffs, for instance, named Mayer, Brown, Rowe & Maw (then Mayer Brown & Platt) as a defendant to securities litigation arising out of transactions by Commercial Financial Services, Inc., in the case of *Pioneer Insurance Co. v. Chase Securities, Inc.*, No. 99-CV-919-K(J) (N.D. Okla. filed 1999). *See* Otis Bilodeau, *Mayer, Brown's Echoes of Enron*, Legal Times, May 6, 2002, at 18.

6. Firms argue they have no liability because, at worst and even assuming the factual allegations are true (which law firms usually do not concede), they have acted in the capacity of an aider and abettor for which they are not liable under section 10(b) of the Securities Exchange Act of 1934. *See* Cent. Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994). Holding aside the merits of the claim against the insured law firm, policies apply to the defense of claims, typically even if the claims against the insured are groundless, false, or fraudulent.

policies typically purchased by law firms will apply to these types of claims.[7]

Law firms typically purchase professional liability insurance to cover the cost of third-party claims for economic damages allegedly resulting from their provision of professional services (in the securities context, either the provision of legal advice and opinions concerning the structure of a transaction or the public reporting of the transaction). Depending on the nature of the allegations against a law firm, the law firm likely will be greeted by its insurer citing a number of provisions and exclusions that may affect whether or the extent to which the insurer will be obligated to pay. Nevertheless, a law firm may possess insurance coverage that is responsive to securities-types claims alleging unintentional violations of securities laws.

II. PROFESSIONAL LIABILITY COVERAGE AND COMMON COVERAGE DEFENSES WHERE THE INSURED IS ALLEGED TO HAVE VIOLATED SECURITIES LAWS

Most lawyers reasonably regard their professional liability insurance policies as their front-line defense to claims that their actions or inaction somehow caused economic damage to a claimant. Professional liability insurance policies typically provide coverage for "claims" for "damages" by reason of an "act" "arising out of the performance of professional legal services." And unlike general liability policies, which focus on damages arising out of physical injury, either to property or an individual,[8] insurers sell profes-

7. As one example, an insurer is paying $21 million, less deductible and defense costs, on behalf of Jennings, Strouss & Salmon, a law firm involved in the litigation surrounding the failed Baptist Foundation of Arizona. *Law Firm to Settle BFA Investor Claims*, Bus. Ins., May 20, 2002, at 2.

8. *E.g.*, Travelers Ins. Cos. v. Penda Corp., 974 F.2d 823, 829 (7th Cir. 1992) (economic damages not "property damage" for purposes of general liability policy); National Cas. Co. v. Great Southwest Fire Ins. Co., 833 P.2d 741, 747 (Colo. 1992) (no coverage for emotional distress because in absence of physical manifestations, emotional distress not "bodily injury"); State Farm Lloyd's v. Kessler, 932 S.W.2d 732, 737 (Tex. App. 1996) (same). *Compare, e.g.*, Waller v. Truck Ins. Exch., Inc., 900 P.2d 619, 629 (Cal. 1995) (affirming appellate court decision that where gravamen of complaint is economic loss, no CGL coverage even though claimant demonstrated related bodily injury and emotional distress) *with* Allstate Ins. Co. v. Interbank Fin. Servs., 264 Cal. Rptr. 25, 28 (Cal. Ct. App. 1989) (suggesting that insured should have pursued claim related to its professional services under a professional liability policy because "an insurer would not reasonably expect that a [CGL] policy would cover claims for securities fraud"). That said, *Waller* cannot be read as precluding coverage of all contract-based claims; where the gravamen of the underlying claim involves covered injury, there is coverage even if the theory of recovery sounds in contract rather than tort. Vandenberg v. Superior Court (Centennial Ins. Co.), 982 P.2d 229 (Cal. 1999). Furthermore, general liability policies may include supplemental coverage for what is defined in insurance parlance as "personal injury" (known as PIL coverage) that for primary policies typically extends coverage to an insured for damage it pays as a result of some torts, such as trespass, slander, or malicious prosecution, that need not involve physical injury to a person.

sional liability policies to provide coverage for damages resulting from a claimant's nonphysical, economic injury.[9]

Nonetheless, both the insuring agreement and the exclusions contain limitations that can restrict an insured's recovery. Insureds should be aware of these limitations when considering how best to respond to the underlying securities claim—and when purchasing and negotiating the terms of new coverage.

A. *Professional Liability Policies Do Not Cover Proven Intentional Harm*

Insurance policies typically exclude coverage for identified forms of intentional harm. Policies covering an insured's liability for "wrongful acts" will, for example, define the term to mean acts that are negligent (in various degrees of ordinary and gross negligence), i.e., those acts that, although they may be intentionally performed, have adverse consequences to a third party that were unintended or unexpected by the actor. Thus, where the insured acted with an intent to cause harm instead of negligently,[10] insurers

9. *See* Prisco Serena Sturm Architects, Ltd. v. Liberty Mut. Ins. Co., 126 F.3d 886, 893 (7th Cir. 1997) (evaluating negligent certification claim against architect and stating that professional services policy "'designed to insure members of a particular professional group from the liability arising out of a special risk . . . inherent in the practice of the profession'") (quoting Mgmt. Support Assocs. v. Union Indem. Ins. Co., 473 N.E.2d 405, 409 (Ill. App. Ct. 1984)).

10. Some states have gone so far as to enact statutes precluding insurance coverage for willfully, as compared to negligently, causing harm. *See, e.g.*, CAL. INS. CODE § 533 (West 2002); N.D. CENT. CODE § 9–08–02 (2002). Whether "recklessly" caused harm—something perhaps greater than gross negligence but less than willful conduct—is covered turns on the policy language and the precise articulation of public policy. *See* note 13 *infra*.

Sometimes, an insurer that can establish that the insured intended to act but cannot establish that the insured intended harm will argue that there is a public policy against coverage on grounds of moral hazard. Moral hazard exists when an insured acts in a manner to produce a loss precisely because it has insurance, as for example where an insured creates a loss by destroying property in order to collect pursuant to the insurance contract. *See* BLACK'S LAW DICTIONARY 723 (7th ed. 1999). In the context of third-party liability policies, insurers' moral hazard arguments suffer two critical infirmities. First, any public policy concerning any perceived increase in risky behavior as the result of insurance is counterbalanced by the public policy interest in ensuring that injured parties be compensated for their injuries. *See, e.g.*, Skidmore v. Throgmorton, 751 N.E.2d 637, 641 (Ill. App. Ct. 2001) ("The risk-spreading theories of liability insurance policies mandate that affected members of the public should be afforded the maximum protection possible in accord with fairness to the insurer."). Second, it is empirically doubtful that moral hazard is even relevant in the liability context as compared to the first-party-loss context. *See* Jerrold I. Ehrlich & Epstein Becker, *Market Insurance, Self-Insurance, and Self-Protection*, J. POL. ECON. 623, 641 (1972) ("no one has shown rigorously why, or under what conditions, market insurance reduces self-protection"); B. BERLINER, LIMITS OF INSURABILITY OF RISKS 72–74 (1982) (liability policies create little if any moral hazard); Moorehouse, *Pricing Insurance with Costly Information*, 19 ATLANTIC ECON. J. 41, 41 (1991) ("It is well known that a risk averse individual, who purchases actuarially fair [liability] insurance, will choose full coverage and exercise optimal care.") (footnote omitted). In any event, it is inappropriate to read into a policy a limitation of coverage on this ground. *E.g.*, Edward Stern & Co. v. Liberty Mut. Ins. Co., 112 A. 865, 867 (Pa. 1921) ("[N]or did the existence of the policy lead to, aid or encourage an infringement of the law. . . . To refuse to sustain

argue that the acts do not fall within the coverage grant.[11] Similarly, professional liability policies commonly exclude coverage where the insured's act, error, or omission was "illegal,[12] dishonest, fraudulent, criminal or malicious."

The difficulty for a law firm subject to a claim that it caused harm by violating securities laws is that the claimant, in proving the law firm's liability, may well establish that the law firm's actions were intended to cause the harm complained of by the claimant or were somehow "illegal, dishonest, fraudulent, criminal or malicious," thereby defeating coverage. For instance, for a private party to prove a violation of section 10b of the Securities Exchange Act of 1934, the party must prove that the alleged violator, the insured, acted with the requisite scienter—a knowing or intentional practice to deceive, manipulate, or defraud—in making the false statement, although a plaintiff can meet that standard by proving the defendant's recklessness.[13] Of course, if the insured made a false statement with the intent to deceive, the insurer is likely to assert the exclusion for dishonest or fraudulent acts.[14] An insured would fare better should the civil

the contract would be to read into it an exception not contained therein nor thought of at its inception."). *Cf.* Ohio Casualty Ins. Co. v. Hubbard, 208 Cal. Rptr. 806 (Cal. Ct. App. 1984) (refusing to treat public policy prohibition on indemnification of punitive damages as an exclusionary term applicable to insurer's defense obligation; requiring insurer to defend punitive damages claims).

11. *E.g.*, Transamerica Ins. Group v. Meere, 694 P.2d 181, 186, 189 (Ariz. 1984) (finding that if insured acted, albeit intentionally, in self-defense, insured did not intend to injure attacker and thus coverage would exist; "intent" argument relevant to prevent insured from acting wrongfully with security that insurance company "will 'pay the piper' for the damages").

12. The California Supreme Court has refused to enforce an exclusion of "illegal" conduct on the ground that the exclusion is unenforceably overbroad and so vague as to make coverage illusory. Safeco Ins. Co. of Am. v. Robert S., 28 P.3d 889, 894 (Cal. 2001). As the court noted, an insured would never have liability as a result of a "legal" act, only as a result of an "illegal" one, so an illegal-act exclusion would destroy all coverage.

13. A prima facie showing under section 10(b) requires (1) misrepresentations or omissions of material facts or acts that operated as a fraud or deceit, (2) causation, (3) damages, and (4) fraudulent activity in connection with the purchase and sale of a security. Alpern v. UtiliCorp United, Inc., 84 F.3d 1525, 1533–34 (8th Cir. 1996). A section 10(b) suit requires "proof of knowing or intentional practices to deceive, manipulate, or defraud" on the part of the defendant. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976) (defining "scienter" as a "mental state embracing intent to deceive, manipulate or defraud"). That said, the majority of the circuits also hold that the scienter requirement is satisfied if the defendant stated facts with reckless disregard for their truth or falsity. *See Alpern*, 84 F.3d at 1534; SEC v. Infinity Group Co., 212 F.3d 180, 191 nn.11–13 (3d Cir. 2000). An individual cannot maintain a civil action by alleging "aiding and abetting" liability against a defendant, *see* Central Bank of Denver v. First Interstate Bank of Denver, 511 U.S. 164 (1994), but some recent legislative proposals would amend statutes to allow such liability. Otis Bilodeu, *Senate Puts Corporate Bar in Its Sights*, Legal Times, July 15, 2002, at 1, 12.

14. For the insured to have coverage, it must be in a jurisdiction in which recklessness is insurable and face a claimant who proves only that the insured was reckless. *Compare* California Amplifier, Inc. v. RLI Ins. Co., 113 Cal. Rptr. 2d 915, 923, 926 (Cal. Ct. App. 2001) (California Insurance Code section 533 bars coverage for violation under California Corporation Code section 25500 because to prove a violation requires claimant to demonstrate

claimant include allegations of a violation of section 11 of the 1933 Securities Act, which provides relief to purchasers of registered securities who rely upon false or misleading information in a registration statement.[15] A plaintiff bringing a section 11 claim need prove only that the material he or she relied upon was false or misleading, and that the plaintiff suffered damages as a result; the plaintiff need not show reliance, scienter, or even causation.[16]

The presence of any potentially covered cause of action within any claim or suit against a law firm is critical to defense coverage. An insurer typically is required to defend the entirety of the action against the insured even if all causes of action turn out to be uncovered at the time of resolution, if, prior to resolution, at least one cause of action had the potential to be within coverage.[17]

Law firms that perform corporate securities work therefore will need to consider the likelihood of their being pursued for causes of action grounded

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that violator acted with intent to defraud through a false statement) *with* Raychem Corp. v. Federal Ins. Co., 853 F. Supp. 1170, 1180 (N.D. Cal. 1994) (California Insurance Code section 533 no categorical bar to Rule 10b-5 action as long as claimant's proof of scienter did not rise above level of recklessness).

15. 15 U.S.C. § 77k(a) (2003). A law firm can violate section 11, although it can defend itself by showing that its participation was other than as an expert. *See* Seidel v. Public Service Co. of New Hampshire, 616 F. Supp. 1342, 1362 (D.N.H. 1985).

16. *Alpern*, 84 F.3d at 1541. That said, a section 11 defendant may escape what otherwise would appear to be strict liability by showing that any failure to uncover the false or misleading information was not negligence, making the standard under section 11 one of negligence from the point of view of a defendant. *See generally* Michael P. Dooley, Fundamentals of Corporation Law 916–19 (1995).

17. For many years, policies had no language concerning whether, in an action involving covered and uncovered causes of action, the insurer could refuse to pay some portion of defense costs as a result of the existence of an "uncovered" cause of action or claim as part of the otherwise-covered proceedings against the insured. Jurisdictions generally agree that insurers are required to defend the entirety of a lawsuit in the presence of even just one potentially covered cause of action, *see generally* Marc S. Mayerson, *Insurance Recovery of Litigation Costs: A Primer for Policyholders and Their Counsel*, 30 Tort & Ins. L.J. 997, 1,000 (1995), but they disagree as to whether or in what circumstances the insurer can later recoup defense costs confined solely to the uncovered cause or causes of action. For instance, in California, an insurer can recover defense costs it advanced with respect to amounts solely for the not-even-potentially covered cause of action. *See* Buss v. Superior Court, 939 P.2d 766, 775–78 (Cal. 1997). *See generally* Donald R. McMinn, *The Duty to Defend Following* Buss *and* Domtar*: Restrictions on Insurance Carriers' Ability to Avoid Defense Costs Through Allocation*, 11 Mealey's Litig. Rep. (Ins.) 15 (Oct. 21, 1997). By contrast, in many jurisdictions where an insurer has a contractual obligation to defend an entire lawsuit in the presence of a potentially covered cause of action, an insurer has no right to recoup any part of the defense costs. *See* Blackhawk-Central City Sanitation Dist. v. American Guarantee & Liab. Ins. Co., 214 F.3d 1183, 1189 (10th Cir. 2000); International Ins. Co. v. Rollprint Packaging Prods., 728 N.E.2d 680 (Ill. App. Ct. 2000); Schultze v. Continental Ins. Co., 619 N.W.2d 510 (N.D. 2001). Insurers now are drafting language addressing the issue, with some expressly permitting the insurer to allocate defense costs between covered and uncovered causes of action and still others offering language that expressly provides defense coverage for uncovered causes of action so long as there is a potentially covered cause of action that triggers the defense obligation.

on negligence or strict liability, and whether the coverage they have purchased is sufficiently broad to cover such claims.

B. *Professional Liability Insurers May Argue Coverage Limitations in an Insuring Agreement's Use of the Terms "Loss" or "Damages"*

The indemnification obligation in the typical insuring agreement of a professional liability policy is phrased in terms of covering either the insured's "loss" or amounts the insured pays as "damages." The terms "loss" and "damages" do not immediately appear restrictive, but insurers argue that they serve to preclude coverage for some liabilities of an insured.[18]

Many policies have insuring agreements offering to indemnify the insured for "'Loss' . . . sustained by the Insured by reason of liability imposed by law," but some policies thereafter define the term "loss" in a manner that restricts the extent of its application, particularly for an insured facing securities-related claims. Insurers often define "loss" to exclude, among other things, "fines, sanctions, taxes or penalties," equitable remedies such as restitution or disgorgement, "matters deemed uninsurable by law,"[19] and punitive or exemplary damages. Insurers argue that policies offering coverage for amounts the insured is "legally obligated to pay *as damages*" are not necessarily significantly broader; they contend that the reference to payment "as damages" limits the policy's application to amounts paid to compensate the claimant for covered injury and that amounts paid for penalties or fines or as part of an equitable remedy (the return of ill-gotten gains) are not "damages."[20] These policies also often contain express exclusions for fines and penalties or punitive or exemplary damages awards.

Particularly with respect to enforcement proceedings initiated by the SEC, law firms should expect that insurers likely will contend that the terms

18. Because the coverage clauses generally are construed broadly in favor of coverage, the Washington Supreme Court has explained that "the general coverage provisions of a policyholders' insurance contract . . . is an odd place to look for exclusions of coverage." Boeing Corp. v. Aetna Cas. & Sur. Co., 784 P.2d 507, 511 (Wash. 1990).

19. *See* note 10 *supra*.

20. In the absence of any policy exclusion on point, courts often reject the argument that punitive damages are not "damages" within the meaning of an insurer's promise to indemnify its insured for its liability to pay "damages." *See, e.g.*, New South Ins. Co. v. Kidd, 443 S.E.2d 85, 88 (N.C. Ct. App. 1994); State v. Glens Falls Ins. Co, 404 A.2d 101, 105 (Vt. 1979); Brown v. Maxey, 369 N.W.2d 677, 686 (Wis. 1985). In the environmental context, insurers have had relatively little success in arguing that the phrase "as damages" does not extend to equitable remedies sought in a lawsuit. *See, e.g.*, Avondale Indust. Inc. v. Travelers Indemnity Co., 887 F.2d 1200, 1207 (2d Cir. 1989); Certain Underwriters at Lloyd's of London v. Superior Court, 16 P.3d 94, 107 (Cal. 2001) (equitable remedies ordered pursuant to CERCLA within coverage as long as subject to court judgment); Outboard Marine Corp. v. Liberty Mut. Ins. Co., 607 N.E.2d 1204, 1215 (Ill. 1992); Farmland Indus., Inc. v. Republic Ins. Co., 941 S.W.2d 505 (Mo. 1997); Morton Int'l, Inc. v. General Accident Ins. Co., 629 A.2d 831, 845 (N.J. 1993), *cert. denied*, 512 U.S. 1245 (1994).

"loss" and "damages" preclude coverage for some or all of the amounts to which an insured is exposed, such as statutorily authorized fines or penalties or disgorgement of improper gains.[21] When faced with such a claim, the insured should stand ready to identify its exposure to "loss" or "damages" to its insurer if it wants the insurer to assume its defense. In the absence of potential liability that would qualify as "loss" or "damages," the insured may be hard-pressed to identify a claim that potentially would fall within coverage, and the insurer will argue it has no obligation to defend the insured.

That insurers often seek to construe "loss" and "damages" restrictively highlights the importance of the form and documentation surrounding any settlement with the claimant. In order for the insured to seek indemnification from the insurer for amounts paid to a claimant in settlement, the insured should structure any settlement to preclude any argument that settlement payments were not within coverage.[22]

C. *The Insured Must Establish a Connection Between Its Alleged Liability and Its Professional Services*

Not surprisingly, professional liability insurers seemingly try at times to constrict coverage to liability resulting only from technical legal errors performed by the insured even though the actual policy language reflects the intent to cover a lawyer's liability in his or her capacity as a professional providing services to clients.[23] The insuring agreement typically links cov-

21. *See*, *e.g.*, Level 3 Communications, Inc. v. Federal Ins. Co., 272 F.3d 908, 909–10 (7th Cir. 2001) (disgorgement an effort to deprive defendant of net benefit of unlawful act, not a "loss" within meaning of Directors' & Officers' Policy). Even *Level 3 Communications* and other cases that turn on the formalistic absence of compensation to the underlying claimant, however, suggest that "loss" or "damages" exist where the insured's payment *is* intended to compensate the claimant for injury or harm rather than merely stripping the defendant of allegedly ill-gotten gain. *See id.* at 912 (in dicta, suggesting coverage where payment to claimant required in absence of any measurable benefit to insured); Jaffe v. Cranford Ins. Co., 214 Cal. Rptr. 567 (Ct. App. 1985) (distinguishing between returning amounts wrongfully received and compensating plaintiff). *See also* AIU Ins. Co. v. Superior Court, 799 P.2d 1253, 1274 (Cal. 1990) ("Whatever technical distinctions we and other courts have drawn between restitution and compensatory damages in other contexts, in ordinary terms both concepts are within the definition of 'damages.'").

22. Where the insurer cannot prove that the settlement payments were attributable only to uncovered causes of actions, insureds should recover. *Cf.*, Weyerhaeuser v. Commercial Union Ins. Co., 15 P.3d 115, 126–27 (Wash. 2001) (insurer not allowed a credit against coverage obligation because unable to prove that funds insured received from other carriers were allocated to loss at issue).

23. This intent is reflected, albeit in different policy wording. Some policies manifest this intent through insuring agreements expressly extending coverage to professional legal services performed by insureds acting in the capacity not only of lawyer, but also other capacities, including those of arbitrator, mediator, notary public, title agent, or various fiduciary capac-

erage to acts "arising out of the performance of professional legal services" or "in professional services rendered."[24] The professional services requirement should not challenge an insured facing a securities claim involving a publicly traded security because the insured's liability likely will arise directly out of legal work performed by the insured.[25]

ities (e.g., administrator, conservator, receiver, executor, and the like). Alternatively, other policies manifest the intent by using a definition of "legal services" that includes services performed by the insured "as a lawyer, arbitrator, mediator, title agent, or as a notary public" and "as an administrator, conservator, receiver, executor, guardian, trustee or in any other fiduciary capacity."

24. The term "professional services" serves as a marker differentiating professional liability policies from Commercial General Liability [hereinafter CGL] policies; CGL policies usually exclude "bodily injury or property damage arising out of the failure to render any professional services." *E.g.*, Thermo Terratech v. GDC Enviro-Solutions, Inc., 265 F.3d 329 (5th Cir. 2001). Insureds should remember, however, that a professional services exclusion should exclude a narrower range of activities than is encompassed by use of the phrase "professional services" in a professional liability policy's insuring agreement because of the effect of the standard rules of policy construction—insurance policy exclusions are read narrowly and insuring agreements broadly. *Compare* State Farm Mut. Auto. Ins. Co. v. Partridge, 514 P.2d 123, 128 (Cal. 1973) (insuring agreement broadly construed) *with* Blaylock v. American Guarantee Bank Liab. Ins. Co., 632 S.W.2d 719, 721 (Tex. 1982) (policy exceptions and limitations construed narrowly against insurer). As a result, there may be a narrow band of overlapping coverage under CGL and professional liability policies. *Cf.* Kitsap County v. Allstate Ins. Co., 964 P.2d 1173, 1180 (Wash. 1988) (court rejected insurers' arguments that an insurance policy with multiple coverage grants should not be interpreted in a manner that would allow coverage grants to overlap; allowed overlapping coverage).

25. Some policies specify that coverage is not provided for liability claims against a covered lawyer that arise out of his or her acting as an official of another entity, whether as a partner, officer, director, employee or some role other than as attorney or legal counselor, in which case the professional liability policy may not apply if the insured lawyer is sued in the capacity of a board member or partner of the entity that issued the securities giving rise to the securities claim. *See, e.g.*, Coregis Ins. Co. v. LaRocca, 80 F. Supp. 2d 452, 460 (E.D. Pa. 1999) (no coverage for attorney who was partner in business outside his law practice); Coregis Ins. Co. v. Bartos, Broughal, & Devito, LLP, 37 F. Supp. 2d 391, 393 (E.D. Pa. 1999) (same). The lawyer's professional liability insurer will expect the lawyer to seek coverage from the directors and officers liability insurer of the issuing entity, and a related interinsurer dispute centering on the role of the lawyer and other-insurance clauses may arise (assuming the potential applicability of the professional liability policy). Although such clauses do not excuse each insurer's nonpayment of the insured even if mutually repugnant, the other-insurance clause does not limit a carrier's obligation to perform vis-à-vis its insured in the first instance. *See* Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co., 52 Cal. Rptr. 2d 690, 742–43 (Cal. Ct. App. 1996). *See also* Dayton Indep. School Dist. v. National Gypsum Co., 682 F. Supp. 1403, 1411 n.21 (E.D. Tex. 1988), *rev'd on other grounds*, 896 F.2d 865 (5th Cir. 1990); American Nurses Assoc. v. Passaic Gen. Hosp., 484 A.2d 670, 673 (N.J. 1984). Courts uniformly interpret these clauses in a manner to ensure that the insured is not deprived of the coverage that would exist repetitively under each policy as if the other policy did not exist. *See Armstrong*, 52 Cal. Rptr. 2d at 743; Shade Foods, Inc. v. Innovative Prods. Sales & Mktg., Inc., 93 Cal. Rptr. 2d 364, 407 (Cal. Ct. App. 2000) (bad faith denial of coverage on other-insurance grounds). The other-insurance dispute should be an interinsurance company dispute with the insured being fully defended and/or indemnified as long as any applicable policy has available

The term "professional services" may not be defined within the policy, leaving the evaluation to a commonsense meaning, with nods to the insured's reasonable understanding of the role it was playing vis-à-vis the claimant, as well as, potentially, the claimant's understanding.[26] Courts also look to whether the services in question, even if capable of being performed by one other than a lawyer, are those "routinely rendered for others by an attorney in a legal practice of [that] type, in which case they qualify as covered professional services."[27] That said, some courts have erroneously found that the "professional services" requirement is not met when an insured allegedly provided such services in a fraudulent manner.[28] This construction of the "professional services" qualification bootstraps a sub silentio fraud exclusion,[29] which a court ought not read into a policy that otherwise does not contain such an exclusion.[30] And even where a policy might have a fraud exclusion, the mere allegation of fraud should not be sufficient ground to disclaim coverage where the facts alleged also would support a claim based on negligence.[31]

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limits. *See, e.g.*, Scottsdale Ins. Co. v. National Union Fire Ins. Co., 116 Cal. Rptr. 2d 174 (Ct. App. 2002) (reiterating importance that other-insurance clause enforced "without prejudicing" insured).

26. *See, e.g.*, Westport Ins. Corp. v. Bayer, 284 F.3d 489, 497 (3d Cir. 2002) (affirming trial court's finding looking to insured's understanding of role and claimant's understanding of role); Toms v. Lawyers Mut. Liab. Ins. Co., 408 S.E.2d 206, 210 (N.C. Ct. App. 1991) ("The controlling circumstance is whether the attorney was in fact engaged for the purpose of obtaining his legal services," in which case coverage extends to services beyond the strict legal role undertaken.) (quoting Ellenstein v. Herman Body Co., 129 A.2d 268, 270 (N.J. 1957)).

27. Jensen v. Snellings, 841 F.2d 600, 613 (5th Cir. 1988).

28. *See* Krasner v. Professionals Prototype I Ins. Co. Ltd., 983 F.2d 1076 (9th Cir. 1993) (unpublished table decision) (finding "professional services" requirement not met where an insured, a member of the insurance defense bar, engaged in scheme to defraud insurers by billing fraudulently). By contrast, another court found that a claim against an insured accountant arose out of professional services to the extent the insured created fraudulent financial documents to hide insured's conversion of claimant's assets. North River Ins. Co. v. M.M. Winkler & Assocs., No. 1:92cv366, 1994 U.S. Dist. LEXIS 21153, at *12-*13 (N.D. Miss. Oct. 12, 1994). *See also Westport Ins. Corp.*, 284 F.3d at 497–98 (attorney involved in alleged Ponzi scheme by which claimants were defrauded performed professional services).

29. *See, e.g.*, American Nat'l Fire Ins. Co. v. Abrams, No. 99C5807, 2002 U.S. Dist. LEXIS 2577, at *22 (N.D. Ill. Feb. 19, 2002) ("an attorney engaging in fraudulent conduct is not rendering professional services in his or her capacity as an attorney").

30. In *Fluke Corporation v. Hartford Accident & Indemnity Co.*, the Washington Supreme Court denied an insurer's argument that public policy precluded an insured's coverage; the court announced that Washington courts did not use public policy to invalidate coverage, at least not unless the policy was "convincingly expressed" in state statute. *See* 34 P.3d 809, 812–13 (Wash. 2001). The court further made clear its opposition to those public policy arguments not grounded in a convincing expression of state interest, observing that "[t]he paramount public policy here is the commitment to upholding the plain language of contracts." *Id.* at 814.

31. *Jensen*, 841 F.2d at 615 (in complaint alleging fraud, noting possibility that claimants could "recover under their complaint by proof of improper but nonfraudulent conduct").

D. *Professional Liability Policies' Use of a Claims-Made Trigger Allows for Coverage Disputes*

One of the more important questions affecting coverage for any claim under a professional liability policy is the insured's knowledge of the acts or omissions that led to the claim and when the insured gained awareness of the possibility that those acts or omissions would produce a claim. The state of the insured's knowledge may be relevant to, among other things, the trigger of coverage, any retroactive date restriction in the policy, and an insurer's ability to raise misrepresentation or concealment defenses against one or more insureds. Once an insured presents a claim, it should consider carefully the coverage implications of its responses to any questions that its insurer asks concerning the timing and extent of the insured's knowledge.

1. The Requirement of a "Claim" in the Policy Period

The timing of a claim is important because professional liability policies typically are written on a "claims-made" or "claims-made and reported" basis. Put simply, the policy responds, respectively, when an insured receives a claim during the policy period or when an insured receives a claim *and reports it* to its insurer, *both* of which must occur during the policy period.[32] Either way, for coverage to respond, the insured must be the subject of a claim during the policy period.[33] Furthermore, the language used in policies requires that the claim against the insured be "first made" during the policy period; consequently, a carrier sometimes will argue that, if a related claim had been asserted in a prior policy period, no claim was "first made" during its policy period. In the absence of some form of exclusion for prior-and-pending claims, many courts have rejected the notion that a "prior claim" exclusion inheres in claim-first-made coverage so as to preclude coverage in the event of a prior or pending claim.[34]

Although a "claim" is necessary to trigger the insuring agreement, most professional liability policies include supplemental provisions extending

32. Some policies permit a brief grace period to address the unreportable "December 31" claim problem. This is different from an optional "discovery period" or "extended reporting period," which is optional "tail" coverage that becomes available for purchase on certain conditions, generally the cancellation or nonrenewal of the policy. If there is a "discovery period" or "extended reporting period, an insurer will allow the insured to report claims made arising during a defined period after policy expiration provided those claims arise out of an act or omission occurring prior to the end of the policy period.

33. When policies are canceled or not renewed, insureds may have an option to purchase "discovery periods" that provide coverage for claims made against the insured for a set time period following the termination of the policy.

34. Attorneys Ins. Mut. of Alabama, Inc. v. Smith, Blocker & Lowther, 703 So. 2d 866, 869 (Ala. 1996); Homestead Ins. Co. v. American Empire Surplus Lines Ins. Co., 52 Cal. Rptr. 2d 268, 273 (Cal. Ct. App. 1996); Edward J. Beder, *Triggering Coverage for Related Claims Under Claims-Made Coverage*, 9 Coverage 19 (Jan./Feb. 1999).

coverage to an insured law firm should it, during the policy period, have knowledge of circumstances that could reasonably be expected to result in a claim that might arise after the policy period.[35] In order to avail itself of this option, the insured law firm or lawyer must provide the insurer with written notice detailing the potential claim or claims.[36] As a result, some insureds provide their insurers with extensive written notices, called "laundry lists,"[37] as policy periods draw to a close in an effort to secure the broadest possible coverage under an existing policy. Should subsequent out-of-period claims eventually arise, however, the insurer that had received the laundry list might argue against coverage on the ground that the insured's notice was speculative and did not describe circumstances that "could reasonably be expected to result in or lead to a 'Claim'" with sufficient specificity. Whether this test is satisfied in any given instance is grist for the insurance-dispute mill.[38]

2. Insurers Will Deny Coverage If The Insured Concealed Claims That It Expected Prior to Policy Inception

Depending on the policy language, the insured's coverage can be threatened if the insurer is able to establish that the insured expected a claim prior to policy inception. Policies typically have exclusions, or limitations in the insuring agreement, precluding coverage for claims noticed to prior insurers and, more significantly, circumstances reasonably expected to be

35. For example, a policy might state: "If during the policy period the Insured shall become aware of any act or omission that may reasonably be expected to be the basis of a claim against the Insured and gives written notice to the [Insurer] of such act or omission and the reasons for anticipating a claim, with full particulars . . . then any such claim that is subsequently made against the Insured and reported to the [Insurer] shall be deemed to have been made at the time such written notice was given to the [Insurer]." Knowledge of circumstances that may give rise to a claim differs from a claim itself because a claim requires a demand on the insured by a third party seeking recovery as a matter of right. *E.g.*, City of Marion v. Nat'l Cas. Co., 431 N.W.2d 370, 373 (Iowa 1988) (defining "claim").

36. *See generally* Edward J. Beder Jr. et al., *It is a Mistake to View Insurance Policies as Self-Executing*, NAT'L L.J., Nov. 4, 1996 at B5.

37. *See, e.g.*, Continental Ins. Co. v. Metro-Goldwyn Mayer, Inc., 107 F.3d 1344, 1345 (9th Cir. 1997). Insureds have a particular incentive to provide broad notice if, as one policy comes to an end, they are considering purchasing coverage from a different insurer—and therefore facing inquiry into these matters by the underwriters—because the new insurer likely will exclude coverage for potential claims identified during underwriting.

38. *E.g.*, *Continental Ins. Co.*, 107 F.3d at 1347–48 (insured's notice sufficiently detailed; included documents indicating dates and nature of wrongful acts); FDIC v. Alexander, 78 F.3d 1103, 1108 (6th Cir. 1996); McCullough v. Fid. & Deposit Co., 2 F.3d 110, 113 (5th Cir. 1993) (notice of financial institution's worsening condition not sufficient notice of wrongful act leading to claim); FDIC v. St. Paul Fire & Marine Ins. Co., No. 91–4035, 1991 U.S. App. LEXIS 30668, at *7 (10th Cir. Dec. 24, 1991); Slaughter v. American Cas. Co., 842 F. Supp. 376 (E.D. Ark. 1993) (notice generally referring to certain losses without more detail sufficient because policy did not require more detail), *rev'd on other grounds*, 37 F.3d 385 (8th Cir. 1994); Continental Ins. Co. v. Superior Court, 43 Cal. Rptr. 2d 374, 380 (Cal. Ct. App. 1995) (notice sufficient).

the basis of a claim if the circumstances were known by the insured prior to policy inception.[39] Of course, in the absence of such an express exclusion, nothing bars a law firm from obtaining insurance against the risk that known circumstances will provide a claim in the particular policy period.[40]

In the absence of a prior act or prior claim exclusion, insurers can seek to defeat coverage on the ground that, during the policy application process, the insured concealed information material to policy formation.[41] If a law firm expected a claim at the time of underwriting and did not disclose its concerns about an imminent loss,[42] insurers will argue that the insured withheld material information at the time of contracting, justifying a coverage denial. Insurers lay groundwork for these arguments by asking the insured in the underwriting materials to identify any claims made against the insured and any circumstances that may result in a claim being made against the insured. Insurers sometimes attempt to bolster their ability to rely on concealment defenses by including in the policy an express declaration that the policy was issued in reliance on the statements in the policy application, an effort to create a presumption that any question on the application involved material information.[43] Nonetheless, there are various

39. *See, e.g.*, Low v. Golden Eagle Ins. Co., No. A094961, 2002 Cal. App. LEXIS 4549, at *11 (Cal. Ct. App. Jan. 25, 2002) (unpublished) (insured ousted from coverage where court found insured "knew that its acts or omissions 'might reasonably be expected to give rise to a claim'" in violation of a prior-acts exclusion).

As an incentive to renew, some insurers tie the insured's knowledge of circumstances potentially leading to claims back to the insured's knowledge at the time it purchased its first policy from the insurer; this precludes the insurer from seeking to exclude coverage on the ground of any knowledge gained by the insured after inception of the first policy, even if it has been several years since that first policy was issued. If an insured switches insurers, therefore, it increases the risk that in the event of a claim, the insurer will be able to discover prepolicy circumstances that arguably should have alerted the insured to the potential for a claim.

40. *E.g.*, Pittston Co. Ultramar Am. Ltd. v. Allianz Ins. Co., 124 F.3d 508, 518 (3d Cir. 1997) (no bar to coverage if insured has knowledge of property damage that may result in claim; known-loss doctrine bars coverage "only when the legal liability of the insured is a certainty")*;* Montrose Chem. Corp. v. Admiral Ins. Co., 913 P.2d 878, 904–06 (Cal. 1995) (insurability requires fortuity, but fortuity exists in third-party context after damage is discovered as long as imposition of liability for damage is uncertain). *Cf.* Attorneys Ins. Mut. of Alabama, Inc. v. Smith, Blocker & Lowther, P.C., 703 So. 2d 866, 870 (Ala. 1996) (refusing insurance company's effort to deny coverage on the basis that earlier claim had been made but not reported).

41. S*ee, e.g.*, Thompson v. Occidental Life Ins. Co., 513 P.2d 353, 360 (Cal. 1973); Mass. Mut. Life Ins. Co. v. Nicholson, 775 F. Supp. 954, 959 (N.D. Miss. 1991).

42. Of course, if the insured does disclose a potential claim during the underwriting process, it faces the distinct likelihood that the matter will be expressly excluded from the policy. That said, the insured's current insurer might not consider any identification to be sufficient for triggering the existing policy.

43. *E.g.*, *In re* Jasmine, Ltd., 258 B.R. 119, 125–26 (D.N.J. 1999) (misrepresentations material as matter of law because policy incorporated policy application). This argument has limitations. First, the presumption of materiality may be rebuttable. Old Line Life Ins. Co. of Am. v. Superior Court, 281 Cal. Rptr. 15, 17 (Cal. Ct. App. 1991). Second, in certain jurisdictions, an insurer cannot bring a concealment defense based on statements in a policy

state statutory, regulatory, and decisional hurdles for an insurer to overcome before it can successfully refuse to pay on the ground that its own customer defrauded it.[44]

3. Retroactive Date Limitations Can Limit Available Coverage

Policies triggered by a claim being made against the insured can be viewed as retrospective in that they provide coverage as a result of acts or omissions that predate the claim, sometimes significantly. In order to limit the extent of coverage for past actions and omissions, many carriers include a retroactive-date provision in their policies.[45] These provisions preclude coverage for claims arising out of acts or omissions that took place prior to a date certain, whether that date is the policy's inception or some earlier date.

Insureds should consider the impact of a proposed policy's retroactive date at the time coverage is arranged, particularly in the securities context where a complaint could allege a lengthy pattern of misconduct on the part of the legal professionals. Retroactive dates are negotiable; some insurers will issue policies that use the retroactive date of expiring coverage written by a different insurance company. When considering the terms of claims-made coverage, an insured should explore the carrier's willingness to negotiate a retroactive date sufficiently far in the past to afford appropriate coverage.

E. *Professional Liability Policies Provide Important Defense Benefits*

Even if the insurer has recognized that it owes the insured a defense against a claim, there is room for friction over the subject of defense costs. The insurer must consider issues including control over the choice of counsel (and the rates paid to that counsel), payment of in-house defense costs, and payment of prenotice defense costs.

One of the first subjects likely to cause tension between the insured and its insurer involves the choice of counsel to defend the insured against the claim. Law firms are likely to be particular about the lawyers representing them and may feel that the choice of defense counsel should remain in their hands. A problem arises when, as is typical, the standard contract

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application unless the insurer physically has attached the application to the policy. *See* 215 ILCS 5/359a (2003).

44. *E.g.*, Imperial Cas. & Indem. Co. v. Sogomonian, 243 Cal. Rptr. 639, 644 (Cal. Ct. App. 1988) (rejecting the proposition that "a mere incorrect answer on an insurance application will give rise to a defense of fraud, where the true facts, if known, would not have made the contract less desirable to the insurer"); Commercial Underwriters Ins. Co. v. Hunt & Calderone, P.C., 540 S.E.2d 491, 493 (Va. 2001) (rejecting as "boilerplate" language in application claiming insured's representations to be material to contract).

45. For example, the insuring agreement of one policy provides that "the 'Claim' must result from a 'Wrongful Act' which occurred on or after the 'Retroactive Date.'"

language imposing a duty to defend on the insurer provides the insurer with the power to select defense counsel. If a law firm-insured believes that the choice of counsel is going to be of particular importance, the firm should eliminate the possibility of a dispute over counsel with its insurer by purchasing a policy that expressly provides the right to select counsel; although this right may be tempered by the insurer's right to provide consent of the chosen counsel[46] or the requirement that the insured choose from a list of counsel preapproved by the insurer (and sometimes attached to the policy when issued). In the absence of a provision giving the insured the right to select counsel, the insured's only opportunity to control the counsel selection arises if the insurer's control and handling of the defense could affect the insurer's obligation to provide coverage to the insured such that the insurer defending a case could, as a strategic matter, lose the case on a basis falling outside coverage rather than on an alternative basis that would be within coverage. In that case, the insured and insurer have a conflict of interest in the manner in which the defense proceeds, and most jurisdictions find that the conflict of interest precludes the insurer's control over the defense.[47]

Once the counsel is selected, an insured must remain vigilant in ensuring that it receives a complete defense. This means the insurer must provide counsel appropriate to the task, counsel with the experience necessary to provide an effective defense, and if a matter is sufficiently complex, an insurer can be required to provide local and national defense counsel and to pay for defense costs incurred in responding to matters across a constellation of claims.[48] Furthermore, if the law firm uses its lawyers in place of hiring outside counsel, either in whole or in part, the law firm should be able to recover such in-house defense costs.[49] (Because

46. An insurer's right to provide consent is bounded by the implied covenant of good faith and fair dealing inherent in all contracts. Therefore, the insurer cannot unreasonably refuse to consent to an insured's choice of counsel.

47. *See, e.g.*, Howard v. Russell Stover Candies, Inc., 649 F.2d 620, 625 (8th Cir. 1981) (insurer may provide independent attorney or pay costs of insured's chosen counsel); San Diego Fed. Credit Union v. Cumis Ins. Soc'y, Inc., 208 Cal. Rptr. 494 (Cal. Ct. App. 1984), *superseded by* Cal. Civ. Code § 2860 (West 2002); Thorton v. Paul, 384 N.E.2d 335 (Ill. 1978) (insurer facing conflict owes duty to reimburse insured's defense costs). The Florida Supreme Court now requires insurer-provided attorneys to make a mandatory disclosure concerning possible conflicts of interest. Fla. Bar Rules of Prof. Conduct R. 4–18(j), *available at* 2002 WL 716773.

48. *See* Marc S. Mayerson, *Insurance Recovery of Litigation Costs: A Primer for Policyholders and Their Counsel*, 30 Tort & Ins. L.J. 997, 1005 (1995). An insurer does not comply with its contractual obligation to defend if it provides counsel without sufficient familiarity with the legal issues or skill in their handling arising out of the claim against the insured.

49. *See id.* at 1006–07. *See also* Continental Cas. Co. v. Pittsburgh Corning Corp., 917 F.2d 297, 299 (7th Cir. 1990); Pittsburgh Plate Glass Co. v. Fidelity & Cas. Co. of N.Y., 281 F.2d 538, 542 (3d Cir. 1960); V. Van Dyke Trucking Inc. v. "The Seven Provinces" Ins., Ltd., 406 P.2d 584, 589 (Wash. 1965). Courts have granted recovery for in-house defense costs even

costs incurred in lieu of paying outside counsel to perform work are recoverable but the in-house costs of traditional oversight of outside counsel are not, insured law firms should take care to document both the decision to use their own lawyers in place of outside counsel and the time spent by in-house counsel on advancing the defense of the matter.) Finally, the insured should remember that its right to a defense stretches beyond the initial judgment to include the costs of appeal where reasonable grounds for appeal exist.[50]

In certain instances, an insured will find that it has incurred costs in advance of providing notice to its insurer. In those instances, the insurer may argue that it has no obligation to pay "prenotice" defense costs, generally contending either that a duty to defend does not arise until notice has been given and thus that prenotice defense costs fall outside the scope of the contractual obligation, or that prenotice defense costs are voluntary payments that are excluded in the absence of the insurer's consent.[51] Although insurers have had some success with these arguments (mainly at the trial court level), the appellate case law generally rejects the notion of an additional exclusion to the notice provision and requires instead the insurer to show it was substantially prejudiced in fact by the insured's having spent money to defend itself prior to giving notice before it will find such costs excluded.[52]

F. *Professional Liability Policies Provide Varying Levels of Protection for the Innocent Insured*

Few securities lawyers are sole practioners. The question therefore becomes how insurers apply the conduct- or knowledge-based coverage lim-

where policies define covered "costs" to exclude employee salaries. *See*, *e.g.*, Pacific Gas & Elec. Co. v. Lexington Ins. Co., No. 948209, slip op. at 31 *et seq.* (Cal. Super. Ct. Apr. 13, 2000) *reprinted in* 14 Mealey's Litig. Rep. (Ins.) at A1, A11-A31 (May 23, 2000).

50. *See* Cathay Mortuary (Wah Sang) Inc. v. United Pac. Ins. Co., 582 F. Supp. 650, 657–58 (N.D. Cal. 1984); Delmonte v. State Farm Fire & Cas. Co., 975 P.2d 1159, 1169 (Haw. 1999); Davis v. Allstate Ins. Co., 747 N.E.2d 141, 146 (Mass. 2001); Goddard v. Farmers Ins. Co. of Or., 22 P.3d 1224, 1229 (Or. Ct. App. 2001).

51. Certain policies may impose an express obligation on insureds to seek consent before incurring defense costs, which, given the implied covenant of good faith and fair dealing requiring the insurer not to withhold consent unreasonably, is, in effect, an obligation to provide notification prior to making the expenditure. *See*, *e.g.*, Coastal Iron Works, Inc. v. Petty Ray Geophysical, 783 F.2d 577, 585 (5th Cir. 1986).

52. Griffin v. Allstate Ins. Co., 29 P.3d 777, 779, 781 (Wash. Ct. App. 2001) (Unless the insurer is prejudiced by the absence of notice, it "is liable for fees and costs incurred before the insured tenders defense of a covered claim."). *See also*, *e.g.*, TPLC, Inc. v. United Nat'l Ins. Co., 44 F.3d 1484, 1492 (10th Cir. 1995); Sherwood Brands, Inc. v. Hartford Accident & Indem. Co., 698 A.2d 1078 (Md. 1997); Roberts Oil Co. v. Transamerica Ins. Co., 833 P.2d 222 (N.M. 1992). *See generally* Stephen A. Klein, *Insurance Recovery of Prenotice Defense Costs*, 34 Tort & Ins. L.J. 1103 (1999).

itations to law firms when only a subset of the insured lawyers at the firm may have knowledge or engaged in conduct justifying a limitation on coverage. Examples of potential limitations include, for example, a denial on the ground that the insured had knowledge of a claim at the time of underwriting or on the ground that the claim arises out of the insured's fraudulent or criminal conduct. Usually, however, form policies include some form of an "innocent insured" provision that preserves coverage for some insureds while allowing the insurer to deny coverage to other insureds, and where a policy has no such provision, the law may imply one.[53] These provisions provide coverage to insureds who did not commit or have knowledge of the other insured's wrongful acts—though often requiring the innocent insureds to blow the whistle on the conduct by notifying the insurer of the wrongful acts or conduct at the time the innocent insureds first learn of them.

When negotiating coverage, insureds should consider the breadth of the proposed innocent-insured provision. Some innocent-insured provisions apply when coverage otherwise would be excluded because of "criminal, dishonest, fraudulent, or malicious conduct," while others apply "because of concealment of a 'Claim' by any insured." The latter is arguably broader, as can be illustrated by the example of one insured member of a firm knowing of a potential claim at the time of underwriting. Given that, as discussed above, policies typically preclude coverage for a claim if the claim was reasonably expected by *any* insured at the time of policy inception, the latter version of the innocent-insured provision would allow coverage to those insureds who, at the time of policy inception, had no knowledge or expectation of a potential claim. The former provision, by contrast, would not allow coverage for innocent insureds for potential claims arising out of any negligent conduct, only those claims involving alleged "criminal, dishonest, fraudulent, or malicious conduct."

G. *Professional Liability Policies Differ in Their Treatment of Lawyers Who Change Their Association from One Firm or Practice to Another*

Gone are the days when lawyers' associations with one another changed only because a newly minted lawyer joined a firm or practice or an older one retired. Now lateral moves between law firms or practices are routine. With the increase in lawyer mobility, however, come new challenges for managing professional liability insurance assets.

53. In certain jurisdictions, there is a presumption of severability that functions in much the same way as an innocent-insured provision in the absence of any such provision. *E.g.*, McGory v. Allstate Ins. Co., 527 So. 2d 632, 638 (Miss. 1988) (in absence of innocent-insured clause, innocent partners may recover under the policy for the deliberate wrongful acts of other insured).

One challenge, of course, is sorting out the responsible carriers should a lawyer change affiliation between the time of performing a service and the time the claimant asserts a claim arising out of the service.[54] In such a situation, both the lawyer's prior firm and the current firm are likely to have professional liability policies, and, depending on the language of the various policies involved and the application of any retroactive dates, the individual lawyer may have overlapping coverage for the claim.[55] Typically the lawyer will be covered by the prior firm's current policy, subject to any applicable exclusions for the claim; the policy of the lawyer's prior firm is likely to define the term "insured" to include lawyers formerly affiliated with the named insured to the extent the lawyer performed legal services either on behalf of the named insured or within the scope of a lawyer's employment by the named insured. The potential for overlap will depend on the current firm's policy. If the current firm's policy does not limit coverage for insureds (which will be defined to include a firm's current lawyers) to liability arising out of legal services performed on behalf of the named insured (generally the law firm), the lawyer can fit within the coverage grant. Of course, if the lawyer wants to call upon both policies, it is imperative that the lawyer provide timely notice of the claim to each insurer.

III. CONCLUSION

Class action litigation alleging violations of the laws governing securities usually involves demands for significant damages awards. The potential exposure faced by a law-firm defendant may cause it to look at its professional liability policy for protection, but the size of the exposure provides the insurer with an incentive to "scrutinize" the insured's coverage claim.[56]

54. Other challenges arise as a result of the information that the lawyer brings to the new firm. For instance, the newly arrived lawyer will bring client confidences from the prior firm that will complicate the conflict-check process and potentially expose the firm to disqualification efforts. *See generally* Donald R. McMinn, *ABA Formal Opinion 88–356: New Justification for Increased Use of Screening Devices to Avert Attorney Disqualification*, 65 N.Y.U. L. Rev. 1231, 1236–55 (1990) (discussing conflict issues and imputed disqualification).

55. Of course, the claimant is likely to assert the claim not only against the individual lawyer, but also against either the prior or the current firm (or both). Should each firm be found liable as a result of the actions or omissions of the lawyer, each should have coverage in the absence of other applicable exclusions or conditions. As a general rule, policies will cover the prior firm for the acts and omissions of its former lawyers as long as they were performed on the firm's behalf. The current firm, which will have defense unavailable to the prior firm, will be able to argue for coverage for itself on the ground of language in the insuring agreement extending coverage to the insured for the acts or omissions of those for whom it is liable.

56. Richard E. Stewart & Barbara D. Stewart, *The Loss of the Certainty Effect*, 4 Risk Mgmt. and Ins. Rev. 29–49 (2001).

This means that a law firm seeking recovery from a professional liability policy for an alleged securities-law violation will need to approach its insurer carefully, ready to address the various coverage roadblocks—most particularly, how the claim against the law firm fits within the terms of the insuring agreement, the law firm's provision of timely notice, and the facts known to the law firm at the time the policy was underwritten.