



LPLI 2022 Claims Survey: Malpractice Claim Severity Hits All-Time High as Law Firms Face Rapid Change

Insurer Survey

I. Introduction & Overview

As the legal industry continues to undergo a rapidly evolving operating environment, many leaders of U.S. law firms are adopting more rigorous management approaches to running their firms, including a strong focus on cutting expenses, implementing more flexible work arrangements, and expanding their use of technology.

Furthermore, as law firms compete more aggressively for both business and talent, the move toward a hybrid work model together with continued reliance on lateral hires has triggered a corresponding increase in larger claims. These matters are arising primarily from conflicts of interest and lack of quality of work review.

Even though the frequency of legal malpractice claims remains relatively flat, claim severity continues to spike. Among other factors, elevated claim costs have been driven by an increase in legal defense costs due to court delays arising from the impact of COVID-19, aggressive tactics deployed by plaintiffs' counsel, and the overall increasing complexity of cases. As a result, some firms now rush to settle large claims – often before litigation is filed – to avoid escalating costs.

In light of these developments, knowing more about how legal malpractice claims come about, their typical causes, and how to prevent them can provide valuable insights for a firm's management team. Ames & Gough, a trusted insurance and risk advisor to law firms, conducted its 12th annual survey of Lawyers' Professional Liability Insurance (LPLI) claims results.

As in our prior surveys, the current study looks at the volume of claims insurers are experiencing as well as specific trends with respect to larger claims. We identify practice areas and types of errors most likely to trigger malpractice claims; and look at issues keeping insurers up at night, such as those related to lateral hiring and remote work, silent cyber, and Russian aggression. We also examine the rising cost to defend and manage legal malpractice claims.

Eleven of the leading insurance companies that write Lawyers' Professional Liability Insurance coverage participated in this year's survey. They include ARGO, Crum & Forster, BRIT, Everest, Ironshore, Markel, ProSight Specialty, Sompo, Travelers, QBE, and Swiss Re Corporate Solutions. Together, they insure approximately 80 percent of the *AM Law 100* firms. We are grateful for their participation in our study and are pleased to present the findings in this report.

II. Survey Findings

1) Legal malpractice claim frequency remained flat to somewhat higher in 2021, after reaching a high in 2019.

Seven of the 11 insurers surveyed experienced claims frequency similar to 2020. Of the four insurers who saw claim frequency rise last year, one indicated it increased by less than 5%; one reported a 6-10% increase; another, an increase of 11-20%, and one reported an increase of more than 21%.

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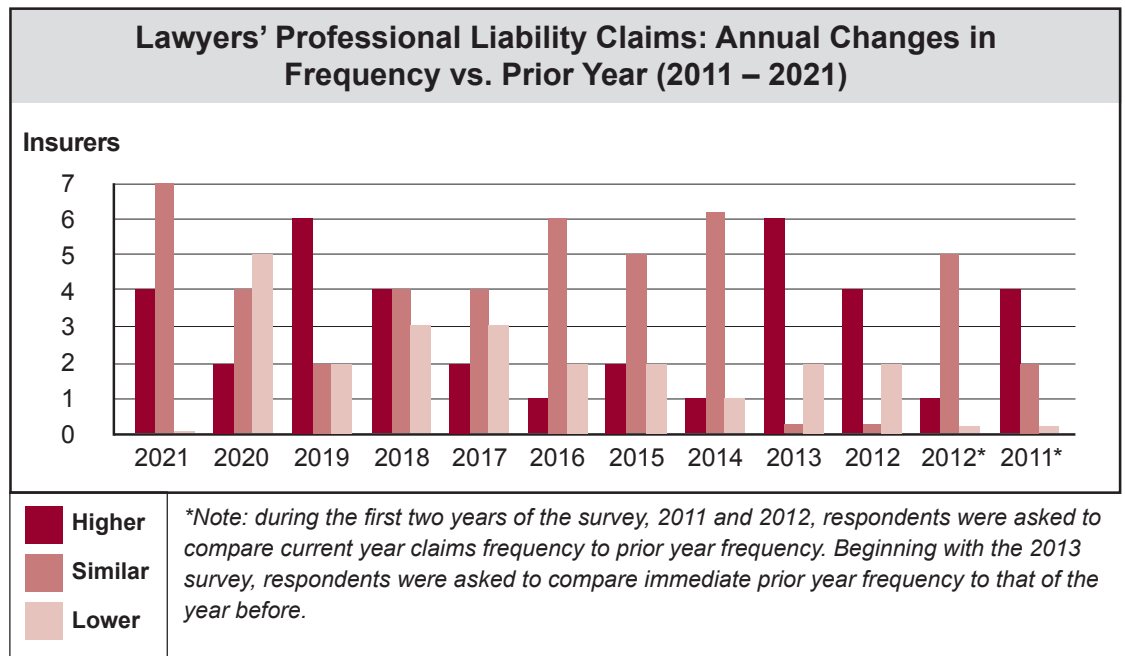
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2) Legal malpractice claim severity continues upward trend; mistakes are costlier.

The last several years have been the worst on record for legal malpractice claim payouts. In the last two years alone, the insurance market (including mutual insurance companies; Lloyds of London; and commercial market insurers) has seen at least five claims settle for over nine figures.

Anne Keiser Brenner, the Head Lawyers Director at Swiss Re Corporate Solutions, stated: “The market has experienced a twin track dynamic to claims payouts. Some severe claims from older years develop beyond the normal development patterns and take longer to conclude (notably financial crisis related claims up to 8-10 years), while in parallel other claims experience a shortened development tail, where firms are paying sizeable settlements involving primary and excess insurers within 6 to 18 months of notice. This creates pressure for primary and excess insurers who are faced with both types of claims payouts in the same financial year.”

- **Claims with reserves over \$500,000:** As one indication of how insurers are grappling with claim severity, all 11 insurers polled had claims reserved over \$500,000 (combined indemnity and defense costs). Six had 21 or more claims reserved above this amount; four had between 11-20 claims reserved over \$500,000; and one had between 6-10 claims reserved over \$500,000.
- **Claims paid over \$50 million:** Ten of the 11 insurers (90 percent) have participated in a claim payout in excess of \$50 million in the last two years. More significantly, three paid a claim between \$150 million - \$300 million.
- **Claims paid over \$300 million:** Four of the 11 insurers (36 percent) have paid a claim over \$300 million. Anecdotally, at least one claim settled for over \$400 million and five cases settled for over nine figures.

Although some of these insurers with large claim payouts likely were involved with the same claim(s) given quota-share coverage arrangements and excess limits, it's clear that the number of claims resulting in multimillion dollar payouts has continued to increase on a year-over-year basis.

The potential for a large legal malpractice claim coupled with the exorbitant cost to defend it underscores the need for law firms to carefully consider the amount of limits they purchase. Firms should ensure they have adequate financial protection.

3) Largest number of claims stems from three key practice areas.

Trust & Estates; Business Transactions, and Corporate & Securities have seen the most claims for the last several years. It's also worth taking note of the growing number of legal malpractice claims in the areas of *Insurance Defense* and *Taxation*.

Practice Areas Generating Largest Number of LPL Claims*												
Area of Practice	Responses by Percentage											
	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
Bus.Transactions/Commercial	63	73	70	63	56	67	67	56	50	43	67	50
Trust & Estates	73	82	60	55	56	56	56	67	50	57	0	33
Real Estate	9	18	30	45	67	44	56	44	63	86	67	67
Corporate & Securities	45	45	50	45	56	56	33	56	63	57	67	33
Personal Injury Plaintiff	9	18	20	27	11	22	22	0	13	14	33	17
Collection & Bankruptcy	9	9	10	0	22	11	0	11	0	14	33	33
General Litigation	9	18	10	0	11	11	11	11	0	0	17	0
Taxation	27	27	0	0	0	0	11	0	25	14	0	0
IP	9	9	20	0	0	0	0	0	13	0	0	17
Family Law	0	0	0	0	0	0	0	0	0	0	17	0
Labor & Employment	0	0	0	0	0	0	0	0	0	0	0	0
Insurance Defense	18	0	0	0	0	0	0	0	0	0	0	0

Rising number of legal malpractice claims against insurance defense lawyers:

Although legal malpractice claims have existed for over a century, the large volume of these claims made by an insurer (primary or excess) against counsel retained to defend its insured is relatively new. If an insurer believes malpractice has occurred due to defense counsel's mishandling of a claim, the insurer often has the ability to bring a lawsuit against defense counsel.

However, an insurer's ability to sue defense counsel varies by state. In some states, the law is still uncertain while other states permit an insurer to bring a legal malpractice claim against defense counsel under one or more of several theories: (1) *Tripartite Relationship Theory*; (2) *Equitable Subrogation Theory*; (3) *Third Party Beneficiary Theory*; or (4) *The Restatement of Law Governing Lawyers Theory*.

1. ***Tripartite Relationship Theory***: This theory states that the lawyer has two clients: the insurance company and the insured. This is because both the insured and the insurer are beneficiaries of the insurance company's exclusive control over the litigation. As a result, if the proximate cause of damages to the insurer are a result of the defense attorneys' malpractice, then the interests of the insurer and the insured are aligned, and the insurer can sue defense counsel for legal malpractice.
2. ***Equitable Subrogation Theory***: This theory is more of a limited exception to the privity of contract requirement (where normally the insured has direct privity of contract and an attorney-client relationship with defense counsel assigned to represent them). This is because it allows insurance companies hiring defense counsel to assert claims for malpractice on the insured's behalf. In other words, similar to the doctrine of subrogation, it allows an insurance company to step into the insured (client) position and pursue a full recovery from the defense counsel responsible for the loss.

3. **Third Party Beneficiary Theory:** According to this theory, because the insured has a contractual duty to the insurance company to cooperate in the defense of a lawsuit – and, likewise, the retained counsel has agreed (through the insurer’s defense counsel guidelines) to defend the insured – there is a shared intent to help or benefit the insured/client, thus making the insurance company a beneficiary of the attorney’s services to the insured (client).

4. **The Restatement of Law Governing Lawyers Theory:** This theory states the lawyer designated by an insurance company to defend an insured owes a duty of care to the insurance company for matters where the interests of the insurance company and insured are not in conflict, whether or not the insurance company is held to be a co-client of the lawyer.

Best Practice Tip!

Increasingly, insurance companies are holding defense counsel accountable for legal malpractice where they have breached the standard of care. So, it is imperative that defense lawyers have sound risk management practices in place. Defense firms should know and adhere to the outside counsel guidelines they have agreed upon with the insurance companies that hire them. They should also use clear and regular communication with both the insurers and insured clients relying on their advice.

Rising legal malpractice claims against tax lawyers. Similar to trends associated with previous periods of economic downturn or uncertainty, legal malpractice claims against tax lawyers again are on the rise. In the current environment, issues have surfaced related to the changes to the tax laws during the pandemic, including: the Families First Act; The Covid Tax Relief Act; The America Cares Act; the Child Tax Credit; etc. Given the rapid change in laws, some lawyers who lacked expertise to handle these matters dabbled in an area of practice outside of their capability while other attorneys failed to effectively communicate the changes with their clients.

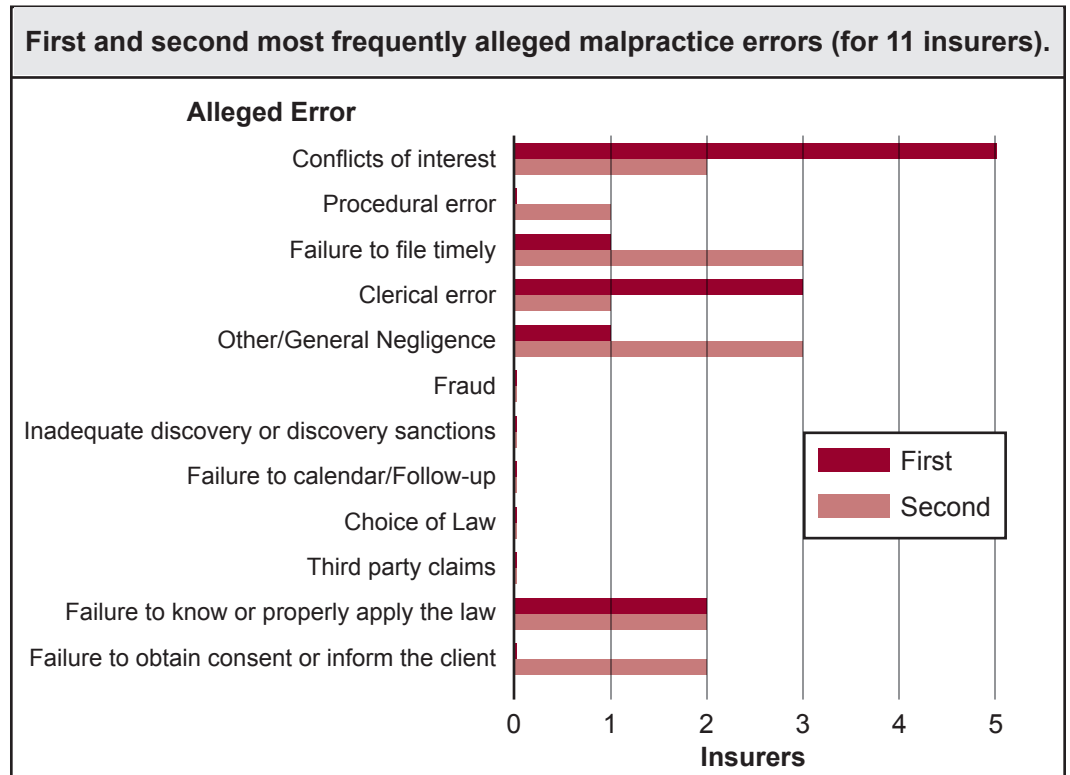
Best Practice Tip!

Tax lawyers seeking to prevent or avoid malpractice should start with the basics of *careful client screening*; *clear and copious communication*; and *conscientious calendaring*.

- **Careful client screening:** In screening a client, the lawyer should try to ensure there are no red flags; no conflicts of interest; or problems with the client’s ability to pay the attorney’s fees. In effect, the firm wants to make sure it is not taking on the wrong client for its practice.
- **Clear and copious communication:** The lawyer should also provide proficient documentation of all dealings with the client. This starts with a well-crafted engagement agreement letter signed by all the parties. The engagement agreement should provide details on whom the lawyer represents and whom they do not; the scope of the intended representation (what work the lawyer will be doing for the client and what work they will not be doing for the client); any fee arrangements; how the files will be handled; and expectations on communication and cooperation between the client, the firm and the attorney.
- **Conscientious calendaring:** Tax matters should be carefully calendared to avoid missing deadlines and to schedule regular communications with the client, as failure to know or ascertain deadline correctly is the top substantive error for tax lawyers. At the same time, as the business environment becomes increasingly global, clients and attorneys are no longer constrained to geographical locations. This comes with additional risks as statutes of limitations vary by jurisdiction. Additionally, a number of events can even toll the statute of limitations in civil tax matters, including: collection due process hearing requests; offers in compromise; and innocent spouse relief requests.

4) Most common legal malpractice errors.

Conflicts of Interest continue to be the most frequent malpractice error; clerical errors ranked as the second most common error leading to malpractice claims this year.



Conflicts of interest has been the leading cause of malpractice claims year over year. Five of the insurers ranked it the most frequently alleged error and two ranked it second.

Clerical/scrivener’s errors were ranked the second leading cause of malpractice claims; four of the 11 insurers ranked it as either the leading cause or second leading cause of a malpractice claim.

Clerical/scrivener’s errors are simple or minor mistakes, such as writing the wrong numbers down during a settlement negotiation that changes the meaning of a letter, paper or document. It is not one that occurs from judicial reasoning or determination.

Given the larger size and increasing complexity of some business transactions, even an otherwise “simple mistake” can lead to a large legal malpractice payout. Firms should be double- and triple-checking their work; with multiple eyes on the same document to ensure accuracy.

5) What keeps insurers up at night?

This year, legal malpractice insurers were asked what was keeping them up at night and why? Their responses contained several recurring themes, including: lateral hires and attorney migration; work practices/supervision related to Covid-19; and silent cyber exposure. Since the polling of the insurers, we can anecdotally add Russian aggression in Ukraine to this list.

Lateral hire and attorney migration risk: Today, law firms must continue to operate in an intensely competitive landscape. The imperative for survival and the drive for growth are leading to more firm mergers and the hiring of attorneys from other firms. In fact, nearly all law firms say inorganic growth or lateral hiring is part of their strategy going forward. Unfortunately, these initiatives often bring greater risks.



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According to Michael Ellenhorn, founder and CEO, Decipher Investigative Intelligence (an advisory firm that uses investigative intelligence to help law firms reduce lateral hire risk), lateral hiring [of partners and associates] increased by 45 percent since 2019, jumping from 13,621 to 19,786.

He warns: “While there were more than 5,000 lateral partner moves in 2021, nearly 50 percent of all lateral partner hires fail.”

More concerning for law firms, according to Mr. Ellenhorn, should be that 35 percent of firms experience a malpractice issue arising from a lateral partner and that the average cost (in paid claims) is eight times greater for a lateral hire than for an incumbent attorney.

The risk of a malpractice claim; of losing a client; and the incalculable cost of bringing in a culturally incompatible attorney often might be avoided with a minimum amount of due diligence. As currently reported in *The American Lawyer* – “Lateral Hazard: Legal Malpractice Claims Rise With New Hires”¹ and “Hiring Misfires Show Need for Tougher Law Firm Vetting”² – law firm lateral hiring is proceeding at a faster pace than ever. Despite the need for a vigilant hiring and selection process, attorney candidates that previously took four to six months to hire are now being hired in four to six weeks.

Mr. Ellenhorn noted: “One out of every three laterals has a serious red flag.”

Specifically, red flags in these recruitment efforts may include: an overstated book of business; questionable legal skills and exaggerated credentials; conflicts and outside business interests; unethical behavior; malpractice claims; and significant tax liens or bankruptcies. Although recruiting attractive lateral hires is part of most firm’s strategy going forward, it is important that firms balance their desire for recruiting with the need to engage in a thorough vetting process.

Work practices related to Covid-19/supervision of staff: Timothy Loyal, Claims E&O manager at AXA XL, observed: “Tight oversight of attorney/staff is needed in order to reduce legal malpractice risk.”

Rule 5.1 of the ABA Model Rules requires a lawyer having direct supervisory authority over another lawyer to make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.

However, when a law firm’s employees are dispersed in different locations, as they have been throughout the pandemic, it is arguably more difficult to supervise. Indeed, it is harder to know if attorneys are managing their caseloads; how they are doing mentally and physically; what errors might have been made.

Best Practice Tip!

Law firms need to find ways to promote a culture that encourages communication, openness, access and collaboration. They should maintain regular and predictable communication with their lawyers and staff members, so that they notice if someone has the capacity and skills to handle their work or if they drop off the radar. Practice group leaders should also be tasked with keeping track of staff.

Meanwhile, law firm employees should also know about resources – both within and outside the firm – that may be available to them if they feel overwhelmed, anxious or depressed. For instance, an excellent place to start might be the resources page on the American Bar Association website at www.americanbar.org/groups/lawyer_assistance/resources/covid-19--mental-health-resources-.

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Silent cyber exposure: From the perspective of lawyers’ professional liability insurers, “silent cyber exposure” refers to potential cyber-related losses on the legal malpractice insurance policy that were not specifically designed to cover cyber risk. In other words, in most instances, lawyers’ professional liability insurers have not expressly stated their policy excludes cyber-related exposure.

However, by not making the language certain, they don’t deny it either. Law firms need to be sure they understand whether or not their legal malpractice insurance will cover a cyber-related breach – and if so, whether or not their cyber policy will respond first.

Some cyber policies state they are excess to any other available insurance. So, a firm’s lawyers’ professional liability insurance policy limit and deductible could be at risk if cyber-related losses are not specifically excluded.

Russian aggression in Ukraine: Anecdotally, we know that insurers are concerned that financial transactions in and out of Russia may become difficult for law firms and insurers will be looking to see how law firms disentangle themselves. This is also causing some insurers to re-evaluate their market participation and either reduce capacity, cease writing certain firms or attempt to add exclusionary language.

6) Continued increase in cost to defend legal malpractice claims.

Not surprisingly, the survey found the cost of defending malpractice claims continues to increase. Among the insurers surveyed, nine of 11 indicated defense costs increased in 2021 over the prior year.

- Two insurers stated the average cost to defend a claim exceeded \$500,000;
- Five stated their average defense costs were between \$100,000 and \$500,000; and
- Four insurers indicated the average cost of defense was between \$10,000 and \$100,000

At the same time, the rates insurers pay defense counsel are also climbing. Among insurers surveyed, 81 percent reported an increase in rates paid to defense counsel during the past year. Specifically, 18 percent saw an increase in rates the insurance company paid defense counsel by 2% or less. More than half (55%) saw an increase in rates of 2-5%; and 9 percent saw an increase of 5-10%.

Average Hourly Rate Insurers Pay Defense Counsel												
Hourly Rate	2021	2020	2019	2018	2017	2016	2015	2014	2013	2012	2011	2010
\$550 or greater ¹	2	2	2	2	2	2	-	-	-	-	-	-
\$501 - \$550 ¹	1	0	1	1	0	0	-	-	-	-	-	-
\$501 or greater ²	-	-	-	-	-	-	3	2	1	-	-	-
\$401 - \$500	1	1	0	0	0	1	1	1	0	3	2	1
\$301 - \$400	2	3	4	2	2	1	0	2	4	1	1	1
\$251 - \$300	3	3	1	4	5	3	4	4	3	2	1	1
\$201 - \$250	2	2	2	2	0	2	1	0	0	1	2	3

1. New category introduced in 2017 survey.

2. For 2013 - 2015, the category was defined as “greater than \$500.”



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7) Insurers plan rate increases.

Increases in malpractice claim severity and the cost to pay defense counsel are factors leading insurers to project premium increases in 2022. All but one of the insurers polled indicated they were planning rate increases for 2022 to keep up with the increased severity of legal malpractice claim payouts.

- Two insurers project rate increases of 0-2%;
- Four are planning rate increases between 3-5%;
- Three are projecting rate increases of 6-10%; and
- One is projecting rate increases between 11-20%.

III. Conclusion:

As law firms look to address key challenges and maintain their culture in a changing legal market, robust risk management; strong vetting; and fervent oversight remain key. Firms need to continually re-evaluate their practices and procedure – and, potentially, even their business strategy – to achieve the proper risk-reward balance.

At the same time, understanding the frequency and severity of legal malpractice claims; how errors occur and the practice areas that typically cause them can provide invaluable insights into where to invest limited time and resources.

Building and maintaining a solid risk management program requires ongoing focus and attention. However, this investment, experience shows, can pay dividends in terms of financial results, as well as in better pricing and coverage terms for the firm's Lawyers' Professional Liability Insurance program.

Notes:

1. Strom, R. (2017). Lateral Hazard: Legal Malpractice Claims Rise With New Hires. *The American Lawyer*. June 30, 2017.
2. Flaherty, S. (2017). Hiring Misfires Show Need for Tougher Law Firm Vetting. *The AM Law Daily*. June 22, 2017.

ABOUT AMES & GOUGH

Ames & Gough, founded in 1992, has established itself as a committed, superior resource for law firms, as well as consulting firms, professional organizations, associations, and design professionals, in need of insurance and risk management assistance. The firm has offices in Boston, Orlando, Philadelphia, and Washington, DC.

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