Getting Paid and Staying Covered

The Importance of Reviewing Your Professional Liability Policy Before Filing a Suit for Fees

by Diana C. Manning and Gregory J. Cannon

It happens to every lawyer in private practice: The attorney is retained by a client and puts time and effort into handling a matter, only to have the client fail to pay the attorney's fees. In tough economic times, this scenario seems to occur more frequently.

A few years ago, the only considerations might have been the amount owed and whether it was worth the time and effort to file a suit for fees. Today, the analysis goes beyond the time and aggravation. Filing a suit for fees may impact the firm's professional liability insurance coverage, and potentially increase future premiums, even if the attorney succeeds in obtaining a judgment. The easiest way to avoid professional liability insurance pitfalls is to never file a suit for fees. That answer, however, is not always practical.

Before filing an action though, the firm's professional liability insurance policy and application should be carefully reviewed to accurately assess the pros and cons of bringing suit. There are many carriers writing professional liability policies in New Jersey, and although numerous provisions generally deal with the same coverage issues, every policy is written differently. To accurately manage risk, many malpractice carriers specifically exclude certain actions from coverage under their policies. Before filing any complaint for attorneys' fees and costs, the relevant provisions in the policy should be reviewed.

Carriers want to know if a lawyer or law firm files suits for fees because of the very real risk that the client will counterclaim for legal malpractice under the theory that the best defense is a good offense. This strategy is even more attractive in New Jersey, as the state Supreme Court has held that "an attorney may not collect attorney fees for services negligently performed."[1] The Court further held that successful claimants in legal malpractice actions are entitled to recover the reasonable attorneys' fees and costs incurred in prosecuting such an action.[2] This means that a client can seek both disgorgement of the attorneys' fees already paid, as well as attorneys' fees and costs for prosecuting a counterclaim. In addition to trying to eliminate liability on the claim for fees, these are big incentives to file a counterclaim for malpractice.

Of course, just because a counterclaim can be filed does not mean that it will be successful. Nonetheless, getting to the resolution may be expensive, as well as time consuming, and may impact the firm's future coverage.

What to Look for in a Policy Before Filing Suit

The first consideration when contemplating a suit for fees is whether the policy contains a fee dispute exclusion. Although it is not common, there are policies that exclude any claim arising, either in whole or in part, from professional services that resulted in a lawsuit or other legal action to recover legal fees. In other words, any claim resulting from or connected to a complaint for fees may be excluded.

This is the type of exclusion that at least one carrier has included in a New Jersey policy:

This policy excludes any claim arising in whole or in part from professional services in which the firm instituted a lawsuit or other legal action to collect unpaid legal fees owed or claimed to be owed to the firm for such professional services. Specifically, the Insurer will have no duty to defend against any counter-complaints or counter-claims alleging malpractice or professional negligence for such professional services in any lawsuit or other legal action.

With this type of exclusion, the lawyer bears the risks of a counterclaim for malpractice, which include defense costs if outside counsel is retained, time if the matter is defended *pro se*, and an adverse judgment if the counterclaimant is successful.

The second consideration is the policy's deductible. What is the amount of the deductible? And importantly, does it apply to claims expenses in addition to loss (also sometimes defined as damages) or to loss only? Claims expenses generally include all reasonable and necessary fees, costs and expenses resulting from the investigation, defense and appeal of a claim. For example, if the attorney has a $20,000 deductible that applies to claims expenses, the lawyer is obligated to pay the first $20,000 of attorneys' fees and costs incurred by counsel retained to defend the counterclaim.

A deductible that is limited to loss or damages generally requires payment of the deductible only when the attorney becomes legally obligated to pay a judgment, award or settlement. Defense costs are not included. If the deductible applies to claims expenses and a counterclaim is filed, depending on the amount sought and the amount of the deductible, more could be spent defending the counterclaim than is being sought in fees.

Another factor to consider is how much the client has already paid in fees. There is much debate among the legal malpractice bar about the breadth and interpretation of the Court's statement in *Saffer v. Willoughby*[3] that an attorney may not collect fees for services negligently performed. Most carriers, however, exclude claims for disgorgement, or the return or reimbursement of fees for professional services. Either a return of fees is specifically excluded or the term damages is defined to exclude restitution, reduction or set-off of fees charged by the attorney for legal services.

The policy should also be reviewed to determine whether the limits of liability are reduced by claims expenses. If the litigation becomes long and complicated, or involves a significant claim for damages, it may be time-consuming and expensive to oppose the counterclaim, even if it would ultimately be successful. If claims expenses reduce the limits of liability, defending a counterclaim reduces coverage and could, in certain circumstances, create the potential for an excess verdict. It could also impact coverage available for any additional claim made during the policy period.

The last consideration is the effect filing a claim may have on insurability in the future and an increase in premiums. Without a crystal ball, it is difficult to determine the answers to these questions with any accuracy. Underwriting is not an exact science, and each carrier analyzes risk differently. The professional liability insurance application and the language of the existing policy, however, offer some clues regarding how filing a complaint for fees might be viewed.

The insurer uses the application questions to gauge risk, but few lawyers give them much thought once they receive their policy. The most recent application submitted to the attorney's professional liability insurance company most likely asked at least one question, or maybe more, about suits for fees. Giving the application a second glance can provide insight into the insurer's concerns. If looking to switch carriers, the application can be an early indicator of what terms will ultimately appear in the policy. With certain carriers, the application is a warranty or a representation to the contract, and may become a part of the insurance contract itself.

In most applications, the question of whether or not a firm has filed a suit for fees is as important as whether or not the firm has a conflict of interest system or uses engagement letters. This is a common series of questions:

- *Does the applicant firm use engagement/disengagement/non-engagement letters?*
- *Does the applicant firm maintain a system to avoid conflicts of interest?*
- *How many suits for collection of fees have been filed by the applicant firm during the past two years?*

Filing a suit for fees may not be excluded from the current policy, but may impact future policies. How many years forward will the fact that a suit for fees was filed have to be identified? What impact will an affirmative answer have on the underwriter's assessment of risk? These questions are further complicated if a counterclaim is filed. The counterclaim becomes part of the firm's claims history. The firm may be required to report the claim on future applications for years after it was resolved. Questions about claims history and pending claims are included in every application, no matter which carrier is involved. A five-year look-back period or longer is not unusual:

During the last 5 years, has any professional liability claim or suit been made against the firm or any predecessor in business, or any past or present lawyers in the firm? If "Yes," provide full details on a supplemental sheet.

Moreover, successfully defeating the counterclaim does not necessarily insulate the firm from potentially adverse effects on rates and policy terms. Carriers can evaluate the costs of defense in addition to the outcome of the claim. If the successful defense of the counterclaim requires years and thousands of dollars, there may still be an adverse impact on the firm in the form of increased premiums.

Tips to Avoid Trouble

Given the potentially broad implications a suit for fees may have on a firm's professional liability policy, avoiding

having to file such a claim is preferable. Although it is easier said than done, the primary way to avoid this type of situation is to insist that clients keep current on their bills. If the client is unable or unwilling to keep current, then the firm should terminate the representation or request to be relieved as counsel, if required, to avoid being trapped in the representation.

There are also some steps a firm can take prior to the representation to avoid potential problems:

1. Do not be afraid to go on instinct. Turn away representation if it seems appropriate.
2. Evaluate whether the client can afford the entire representation, not just the retainer.
3. If the client can afford the representation, enter into a written fee arrangement that is plainly written and unambiguous. Tailor the retainer agreement to the specific client and representation.
4. Ask for and collect a sufficient retainer. If the client is unwilling to pay a reasonable retainer, then there is a good chance they could become a future problem client.
5. Do not modify the fee arrangement once representation has commenced.
6. Review bills in draft not only for errors, but to confirm that the fees incurred were necessary and reasonable. This is especially important if other individuals bill time to the matter.
7. Advise the client that the firm bills on a monthly basis and expects to be paid on a monthly basis.
8. Act promptly if the bills are not paid. Confirm any conversations with clients about payment in writing.

Conclusion

There is no way to completely avoid a client falling behind. There is also no surefire formula to preclude a claim for malpractice. Prudent client selection goes a long way to helping to circumvent both situations. Prompt action to end the representation when a client is not paying the firm's bills can also go a long way toward minimizing lost receivables and avoiding a suit for fees. In those instances where a client has fallen significantly behind, it is critical to properly evaluate the true cost of bringing a suit for fees. That evaluation is incomplete if the terms of the professional liability insurance policy are not reviewed and the potential of long-term impact is not considered. If, upon review, the attorney is unhappy or surprised by the terms of the policy, the issues should be considered at renewal. ⚖

Endnotes

1. *Saffer v. Willoughby*, 143 N.J. 256 (1996).
2. *Id.*
3. *Supra*, note 1.

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