Does Your Firm Have Adequate Insurance Limits?

The recession of the last few years has caused many law firms to reevaluate their expenses. While thoughtful frugality can help keep a firm on solid financial footing, too much cost-cutting could put a firm in jeopardy.

Insufficient liability insurance threatens your firm's viability

Rutter Hobbs & Davidoff is one firm that unfortunately learned this important lesson the hard way. In 2010, a jury decided against this Los Angeles firm in a malpractice suit, reaching a verdict of $10 million. Published reports indicated that the firm, which at its peak had 30 attorneys, did not have adequate limits of professional liability insurance in place in order to satisfy the judgment, and as a result, was forced to dissolve.

The firm's dissolution (and resulting dislocation and potential personal liability for the individual partners) appears to have been a potentially avoidable outcome if the firm had purchased enough insurance to cover a loss this large. This unfortunate outcome should serve as a wake-up call to law firms that have not recently evaluated the amount of malpractice insurance that they purchase.

Evaluating the right amount of malpractice insurance for your firm

While there is no hard-and-fast formula to limit selection, the following factors should be considered:

- A minimum of $1 million is advisable – for even the smallest of firms. Claims involving matters in dispute for even relatively small amounts can still easily generate defense costs and fees well into six figures. It is important to remember that the limits of liability for these policies include defense costs (although additional limits devoted solely to defense costs are sometimes available).

- The value of the matters your firm routinely handles should set a rough benchmark for how much insurance you should have. A firm should put itself in the shoes of a potentially dissatisfied client, and make a good faith estimate of what the realistic damage demand would be in a malpractice suit.

- Benchmark the coverage that other similarly situated firms purchase. An insurance broker that has a broad client base is of significant value for this exercise. Such a broker should be able to easily provide a number of "comparables" on an anonymous basis, in order to provide a good idea of what other firms with similar practice profiles deem to be proper limits.

Cost/benefit analysis will prove value

Professional liability insurance for law firms is, on a historical basis, currently inexpensive. A clear-eyed cost/benefit analysis should lead a firm to conclude that it would be pennywise and pound foolish to run the risk of catastrophic loss (and potential firm dissolution), in order to save a few thousand dollars in insurance premiums.

RIAN JORGENSEN, JD, is Senior Vice President of Ahern Insurance Brokerage, one of the largest independently owned insurance brokerage firms specializing in the insurance needs for law firms.