

The Consequences of Failing to Disclose a Potential Claim to Your Insurer

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The D.C. Circuit recently held in *Chicago Insurance Co. v. Paulson & Nace, PLLC et al.* that Chicago Insurance Company was justified in denying a \$1.75 million legal malpractice award because the policyholder had failed to inform it of the potential malpractice claim when he applied for coverage.

According to the April 21, 2015 ruling, 15-year-old Sarah Gilbert became paralyzed after a spinal surgery in July 2004. Ms. Gilbert retained the Washington-based law firm of Paulson & Nace, PLLC to bring a medical malpractice action on her behalf. In July 2006, Paulson & Nace filed a medical malpractice complaint in Virginia state court, four days before the statute of limitations expired on Ms. Gilbert's claims. The complaint was improperly captioned, and when the defendant moved to dismiss based on this error, Paulson & Nace filed a properly captioned complaint in a separate civil action. In February 2007, the court dismissed the claims in the first case without prejudice, and during a hearing in June 2007, the same court stated that it would dismiss the second complaint with prejudice on statute of limitations grounds. Paulson & Nace appealed the trial court's decision but was unsuccessful.

In July 2007, while the state court appeal was still pending, Paulson & Nace applied for a new legal malpractice insurance policy with Chicago Insurance Company. At the time, the firm's sole member, Barry J. Nace, indicated on the application that there were no circumstances under which a claim could be made against his firm. Chicago Insurance subsequently issued a claims-made liability insurance policy. The policy included a standard known risk exclusion, which provided that any pre-policy conduct would not be covered if the firm had a reasonable basis to believe that it had breached a professional duty prior to the policy's issuance.

Ms. Gilbert eventually filed a legal malpractice against the law firm in March 2012 and was awarded \$1.75 million by a Virginia court in 2013. Chicago Insurance brought a declaratory judgment action contending that Paulson & Nace should have known of the potential claim when it applied for the insurance policy and that the known risk exclusion therefore applied. The District Court in Washington, D.C. granted Chicago Insurance summary judgment, and a three-judge appeals court panel unanimously upheld the ruling.

According to the ruling, the principal question in the case was "whether a reasonable attorney in Paulson & Nace's position would have been on notice by July 2007 of a possible breach of professional duty or a potential malpractice claim such that there was an obligation to disclose the underlying incident to the insurer." The D.C. Circuit agreed with the District Court that "no reasonable jury could have found against Chicago Insurance on this question." "Under such circumstances—that is, where an attorney is aware that he committed a procedural error that resulted in an unfavorable outcome—there is no triable question with respect to a lawyer's duty to inform his insurer of the potential claim."