WRNewswire

An AALU Washington Report

WRNewswire #16.8.11 was written by ***Steve Leimberg,*** co-author with **Howard Zaritsky,** of Tax Planning With Life Insurance, Publisher of Leimberg Information Services, Inc. (LISI) and Creator of NumberCruncher Software.

The AALU WRNewswire and WRMarketplace are published by the Association for Advanced Life Underwriting® as part of the Essential Wisdom Series, the trusted source of actionable technical and marketplace knowledge for AALU members—the nation's most advanced life insurance professionals.

Tuesday, 23 August 2016 WRN 16.08.23

TOPIC: Malpractice Suit Against Trustee Who Failed to Inform Beneficiaries of Potential Policy Lapse

CITATION: *John N. Thomson, v. Hartford Casualty Insurance Company*, 2016 WL 4036403, No. 15-1501 (6th Cir. July 28, 2016).

SUMMARY: The successor trustees and beneficiaries of the Vitello family trust sued Kathleen King O'Brien, a Michigan lawyer, for malpractice in her handling of a policy owned by the trust when she was the trustee. O'Brien sought coverage from her malpractice insurer, Hartford Casualty. But it denied her claim because she had failed to timely notify it of the reasonably foreseeable possibility that the Vitello trust would pursue a malpractice claim against her.

The successor trustees and beneficiaries later won a state-court judgment against O'Brien. They filed a writ of garnishment against the malpractice insurer (O'Brien had assigned her indemnity claim against the insurer to the plaintiffs) to recover money (almost $800,000) the court had awarded them. The malpractice insurer moved for summary judgment, arguing that it had no contractual obligation to cover the trust's malpractice claim. The district court granted the insurer's motion. This appeals court affirmed the lower court's judgement in favor of the insurer.

RELEVANCE: This is a malpractice coverage case where the attorney agreed to act as the trustee of a life insurance trust she had drafted. The facts of this case do not disclose why the drafting attorney was named trustee or why she accepted that role. But it will seldom make sense for the lawyer who drafts a will or trust to be the trustee of that trust (or for the agent involved in the case). In fact, many firms discourage or even prohibit their attorneys from doing so, except where the clients are closely related to the attorney (e.g. family members); among other reasons, many legal malpractice policies do not provide coverage for an attorney to act as a fiduciary, since it is not the "practice of law." Furthermore, it's almost impossible for a non-corporate trustee to cost efficiently balance the possible fees that can be charged with the liability risk involved. This case points out the importance of a careful, complete, and thoughtful process in selecting a trustee and the danger for any non-professional trustee to accept such a position. It also highlights several major advantages of a professional corporate trustee – which will certainly have an organized process and organized infrastructure for payment of life insurance premiums and warning procedures in the case of impending policy lapses (See *WRMarketplace 16-25: Who Can You Trust with Your Policy? Finding the Right Fiduciaries for Insurance Trusts*).

This case also provides an important lesson about malpractice coverage – emphasizing both the importance of having it and the importance of honestly and fully answering the questions in the application and completing any policy requirements in a timely manner. The best practice is for every estate and business planning professional to have adequate malpractice coverage and to understand its limitations and exclusions, including any exclusion for acting as a fiduciary.

Life insurance agents in particular should avoid acting as trustees of their clients' trusts because:

- Their contracts with their life carriers may prohibit acting in such capacity,

- It is unlikely that an agent's standard professional responsibility insurance coverage will indemnify them for liability in relationship to trustee conduct, and

- The inherent conflict of interest between fiduciary responsibility and compensation for sales to the trust increase the likelihood of a strained relationship with the client and family.

FACTS: In 1998, Silverio and Anna Vitello hired Kathleen King O'Brien, a trusts-and-estates lawyer, to establish a family trust for the benefit of the Vitellos' four children. The trust agreement named O'Brien as independent trustee. As trustee, she was responsible for managing the trust's sole asset, a $1,000,000 joint life policy payable on the death of Silverio or Anna, whoever died later. The annual premium was $25,000.

When Silverio died in 2001, his widow Anna could not afford the annual premium. The insurer agreed to modify the policy so that Anna would pay only $7,800 per year and make up the difference in premium from the equity in the policy. O'Brien established an automatic monthly electronic funds transfer from Anna's bank account to pay the modified premium.

Eventually, the policy equity was exhausted. The insurer sent the trustee, O'Brien, a notice that the policy would lapse unless her monthly payments were tripled. O'Brien did not act on the notice.

The insurer sent O'Brien another notice, informing her that the policy would lapse unless Anna made an $8,684.30 payment by December 12, 2008. O'Brien informed neither Anna nor the Vitello children of the pending lapse, and otherwise failed to act on the notice, despite her express responsibility under the trust agreement to "promptly notify the Vitellos, in writing, of the amount necessary to pay the balance" of any outstanding obligation to the insurer.

The policy lapsed. The insurer denied O'Brien's belated efforts to reinstate it. Several months later, in May 2009, Anna filed a petition in state probate court to remove O'Brien as trustee. In her petition, Anna complained that "O'Brien has refused to provide Anna Vitello with a copy of the Trust Agreement," and that O'Brien had "not conveyed sufficient information to [Anna] for [Anna] to determine the status of the [life insurance] policy and what options may be available to prevent any lapse."

O'Brien resigned later that month, and Michigan lawyer John Thomson (one of the plaintiffs in this case) replaced her as independent trustee. The trust eventually obtained another, more expensive life-insurance policy that carried a lower face value.

In June 2010, O'Brien—who had maintained continuous malpractice insurance coverage through Hartford Casualty Insurance Company since 1994—applied to renew her malpractice insurance policy. O'Brien herself specified in the application that the "retroactive date" of the policy was September 3, 1994, and that the "proposed coverage effective date" of the new policy was September 3, 2010. In a section labeled "underwriting questions," the application asked O'Brien whether she was "aware of any act, error or omission that could result in a professional liability claim being made[.]" O'Brien answered "no [.]"

Finally, the application carried a disclaimer—marked "IMPORTANT"—warning O'Brien that, "[t]o avoid loss of coverage, it is imperative that all known circumstances, acts, errors, omissions, or personal injuries which could result in a professional liability claim against you ... be reported to your present insurer within the time period specified in your present policy. All known claims and/or circumstances are specifically excluded by The Hartford, should coverage become effective."

Hartford thereafter renewed O'Brien's policy for a "policy period" running from an "effective date" of September 3, 2010 until an end date of September 3, 2011, and with a "retroactive date" of September 3, 1994. Per the terms of the policy, Hartford promised to indemnify O'Brien for "damages" arising out of "any act, error, or omission ... committed or alleged to have been committed prior to the end of the 'policy period' and subsequent to the 'retroactive date; provided always that: ... [s]uch 'damages' result from a 'claim' that is first made against the 'insured' during the 'policy period' and is reported in writing to [Hartford] immediately but in no event later than sixty (60) days after the expiration of the 'policy period';

... [and a]s of the effective date of this Coverage Form, no 'insured' knew or could have foreseen that such act, error, [or] omission ... could result in a 'claim[.]" '

In May 2011, Thomson and the Vitello trust's beneficiaries sued O'Brien in Michigan probate court for malpractice and breach of fiduciary duties. O'Brien faxed the complaint to Hartford, which declined to indemnify her after concluding that, as of the effective date of her insurance policy (September 3, 2010), O'Brien could have foreseen (and did not disclose on her application form) that she would be subject to a malpractice claim for her performance as independent trustee of the Vitello trust. O'Brien and the plaintiffs later agreed that O'Brien would assign her indemnity claim against Hartford to the plaintiffs and would "not oppose" the plaintiffs' case in state probate court; in exchange, the plaintiffs promised to seek collection of any state-court judgment *only* from the malpractice carrier. The Michigan probate court entered a $770,065.42 judgment for the plaintiffs – who attempted to collect the judgment by filing a writ of garnishment against the malpractice carrier in state court.

In this appeal, the court noted that the terms of O'Brien's malpractice insurance policy were straightforward: The insurer agreed to indemnify O'Brien for any "damages" stemming from a "claim first made against" O'Brien "during the 'policy period' and ... reported in writing to the insurer immediately." Under the facts in this case, in May 2011, the plaintiffs asserted against O'Brien a claim that fell in the middle of the contract's "policy period," which ran from September 2010 to September 2011. O'Brien then timely reported the claim in writing to the malpractice insurer for indemnification.

But the malpractice contract expressly disavowed indemnification for claims arising from an act or omission where the insured, "[a]s of the effective date of [the contract], ... knew or could have foreseen that such act, error, [or] omission ... could result in a 'claim[.]" ' And when the contract took effect in September 2010, O'Brien had every reason to foresee that her nonfeasance as trustee of the Vitello trust—nonfeasance that resulted in her forced resignation in May 2009—might give rise to a malpractice claim against her. Thus, in accordance with the plain terms of the contract, the insurer denied coverage.

The district court read the contract the same way the insurer did – and the appeals court agreed with both. The contract's key proviso excludes from coverage any claims that the insured *could have foreseen* at the start of the "policy period" (September 3, 2010).

O'Brien was denied coverage because she failed to report her nonfeasance. When Anna Vitello petitioned the state probate court to remove O'Brien, she specifically asserted that O'Brien had failed to provide Anna with "sufficient information ... to determine the status of the [life-insurance] policy and what options may be available to prevent any lapse." The petition also made clear that any "lapse of the policy" would result in a "tremendous loss of value to the Trust and its beneficiaries." These allegations "formed the basis" for the successful malpractice claims that the plaintiffs later filed in state court. Soon after the Vitellos presented these allegations to the probate court, O'Brien resigned her position as trustee. In the court's words, "Any reasonable lawyer would have known that this course of events bore the seeds of a malpractice claim."
