

Errors and Omissions Insurance: Assuming the Risk of Professional Liability

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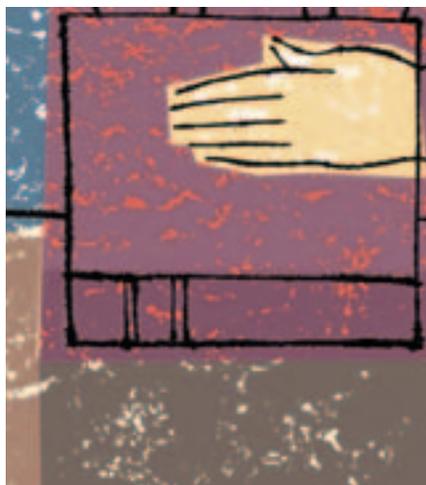
Picture this: You've decided to strike out on your own and start a consulting practice. The list of tasks you need to accomplish grows each day, from getting new telephone service to buying that new notebook computer you've been eyeing since last fall. Oh, and then there's marketing, networking, and of course, finding time to actually do billable work for your clients. As you address the myriad details of setting up and running a new business, it is crucial that you consider whether you need to obtain errors and omissions (E&O) insurance.

What Errors and Omissions Insurance Does

So what, exactly, is E&O insurance (also known as professional liability insurance), and what does it do? Ask an economist or insurance agent this question and he or she is likely to explain that E&O insurance, like all insurance, "is a risk management mechanism used to allocate loss across an adequate and acceptable risk pool." For the rest of us, suffice to say that E&O insurance helps protect our business and personal assets from the costs of litigation and monetary damage awards when others say we've "done them wrong."

E&O insurance does for businesses and independent consultants what malpractice insurance does for doctors and lawyers, providing coverage for the "acts, errors, and omissions" related to the conduct of your business. While the "rising tide of litigation" is, to some extent, less extreme than the picture that has been painted by politicians and the media, professionals sometimes are sued for their acts. When they are, the costs can be substantial—win or lose. Indeed, the most crippling aspect of being sued can be the costs related to mounting a credible defense—the legal fees. A simple "fishing expedition" brought by a plaintiff can cost a defendant thousands of dollars. Many E&O policies provide what is called "first dollar defense," whereby the insurance company pays your lawyer from day one and lifts an enormous financial burden from your shoulders.

E&O insurance works much like your auto insurance, covering acts on a “claims made” basis. If a claim is brought while the policy is in force, it is covered (subject, of course, to policy exclusions, which are discussed a bit later). Unlike auto insurance, however, the policy can specify a retroactive date to cover claims for acts before the policy was issued. For example, you might wish to have the policy include all of your work since January 1, 1999, even though you’re just now buying the policy. A good E&O carrier will usually agree to this, although the additional liability might make the policy premiums higher.



What E&O Insurance Costs

Before you run out and purchase an E&O policy, it’s important to weigh the costs and benefits. After all, the cost of E&O insurance will probably come out of your pocket, not your client’s, and while this may be a cost of doing business, you’ll need to charge higher rates or accept a lower profit margin from your business to cover it.

As with everything, the cost of E&O coverage depends on what you want and from whom you buy. A bare-bones policy with a “no-name” carrier might cost as little as \$500 per year for up to \$500,000 of coverage. More coverage with a “name

Shopping for E&O Insurance

BY CHRISTOPHER JUILLET

Let’s say you’ve done your research and decided that, for your business, E&O is the way to go. Here are a few shopping tips.

Where to Obtain It

In these days of the “wired world,” the first answer to the question of where to obtain E&O insurance is likely to be “On the Internet, of course.” Certainly, there is no dearth of information about E&O insurance on the Web, much of it offered by companies that also offer E&O insurance policies and are only too happy to sell to you. I prefer to deal with a local independent agency that specializes in small-business insurance. It’s never a bad idea to work with someone you can meet with and talk to face to face.

If you decide to go that route, check with the local Better Business Bureau, as well as with the insurance regulatory body in your state. Make sure the agency stands behind its customers and resolves disputes in a just and honorable manner. Arrange a face-to-face meeting with the agent to see how the agency operates. Be sure to ask about the companies the agency represents. Make sure the company the agency recommends is an “A-rated” insurance underwriter—the industry designation for the best, most reputable, and most solvent carriers. You may be able to get cheaper coverage on the Internet or with a carrier that is not A-rated, but the policy may not provide the level of coverage you need when you need it most.

What to Watch Out for

Like all insurance policies, E&O policies are legal agreements: contracts containing numerous terms, clauses, and exclusions. Some are written in something approaching plain English, while others are rife with legal jargon. Policy terms you should note and ask questions about include the following:

Covered Acts—Be sure the policy explicitly states that it will pay for your “acts, errors, and omissions” and for those of your employees and subcontractors, if applicable, including any negligent act, error, or omission relating to your providing—or failing to provide—professional services.

First Named Insured—This should be your company name

(if you are incorporated or organized as a limited liability company), the corporation stockholders or LLC members, and their spouses. If you are organized as a partnership or sole proprietor, include your spouse and the spouses of your partners, if applicable, among the named insured. Finally, list all former employees and partners as named insured if they were involved in any of the work covered by your E&O policy.

Exclusions—These are events that are excluded from coverage. Common policy exclusions include death, bodily injury, and criminal acts. However, many policies also exclude contractual liability, such as indemnification clauses. That is, if you agree to indemnify a client for the cost of legal action brought by, for example, one of your client’s customers, you may have promised to pay for your client’s legal costs on your own, with no help from your E&O insurance carrier.

Deductible—This is the amount you have to pay before the policy begins to cover the claim. Some policies require you to pay for legal costs up to the deductible, while others cover legal defense beginning with the first dollar spent. Lower deductibles mean higher premiums, and vice versa. Be sure you can afford the coverage you obtain and that it provides adequate coverage for your business.

Policy Limits—This is the maximum amount the insurance carrier pays to satisfy a claim. Check to see whether this ceiling amount includes the cost of legal defense. If it does, less money is available to cover the payment of the claim. As with deductibles, higher policy limits translate into higher premiums.

Retroactive Date—Most policies provide coverage for claims made after the policy date. You can often negotiate for an earlier retroactive date to cover earlier projects. If you do, the policy cost will almost certainly be higher due to the increased number of potential claims.

Read the policy carefully before signing it, even if you’re being pressed to finalize the agreement. You might even want to have it reviewed by an attorney who specializes in insurance and business matters. That way, you’ll know you have done all you can to make an informed and considered decision about this important aspect of your business.

brand” carrier can cost \$5,000 per year or more. Some factors that affect premium costs include the following:

- **The kind of work you do**—Higher risk means higher premiums, so if you write, for example, procedures for the transportation of hazardous materials through large cities, your premiums may be higher than if you develop and maintain a Web site for your local humane society.
- **How long you’ve been doing this work**—More experience often translates into lower risk of error, so more experience can mean lower premiums. However, if you want the carrier to date coverage back to a time prior to the policy date, expect the cost to increase, due to your lower level of experience at that time and the larger number of potential claims.
- **How many employees are covered**—If you have employees or subcontractors you want to cover, the added risk of insuring their potential errors and omissions translates into higher premiums.
- **Whether prior claims have been made against you**—“Where there’s smoke, there’s fire,” or so insurance carriers tend to believe. If there have been prior claims against you, even if they were resolved in your favor, you can expect higher premiums.

In short, we get what we pay for. Greater coverage, reduced risk, a lower deductible, and a better insurance carrier each play a part in increasing the cost of E&O insurance, but each provides an attendant peace of mind that can offset the expense.

If You’re Asked to Have E&O Coverage

Considering the significant cost of obtaining E&O insurance, what do you say to a prospective client who asks whether you have (or are willing to obtain) this sort of coverage? Your best course is to start asking some questions in turn:

- Why is this important to the client in the first place? Is the client trying to shift liability onto you, or is this simply company policy? It’s not unreasonable for large companies to shoulder the



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responsibility for injuries related to their products. After all, they’re the ones designing, producing, and, ideally, making a profit from selling the products. In fact, very large companies should be willing to indemnify and defend *you* in the event of legal action, as it will be in their best interest to ensure that you have the best legal counsel available.

- Is the client willing to help you absorb the cost of obtaining E&O insurance? Companies that always require contractors to have E&O coverage are probably accustomed to paying more for technical communication services. If this is new for them (possibly at the advice of their new corporate attorney), they may not understand that you’ll need to recover the added cost of procuring E&O coverage by charging more for the project.
- Is there some special set of risks inherent in the project that make potential liability more likely and, thus, E&O coverage more advisable? If so, the benefits of E&O insurance may outweigh the cost, but remember—you can often negotiate things like the cost of E&O insurance, with a prospective client for a project you really want.

It’s important to consider carefully whether your business is one in which the inherent risks are sufficient to warrant the not insignificant cost of E&O insurance. If you decide to obtain E&O coverage, take the time to find an agent and a carrier you can work with and in whom you have complete confidence—to get the insurance you need at a price you can afford. (The sidebar “Shopping for E&O Insurance” offers some advice on where to find E&O insurance and what to look for when evaluating the carrier and policy.) 

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