

PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Professional

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Understanding “Claims-Made” Insurance

Assume for a moment that a Summons and Complaint arrives at your office. After an unpleasant exchange with the process server, you close your office door, shut off your phone, and begin reading through the numerous allegations. As you plow through the legal jargon, you find you are being sued for alleged negligence that occurred as part of services rendered more than 5 years ago. You remember the difficulties you and your staff encountered dealing with this client and completing your assignment.

You need to report the claim. However, you've switched insurers four times in the past five years, and achieved dramatic reductions in your premium costs. Which of the four companies will respond to defend and settle this claim? What factors determine insurance coverage in a situation where a claim is made many years after the project is completed? Were you careful to preserve coverage for prior acts each time you changed insurers? Who can you turn to for help to untangle this mess?

Claims-Made or Occurrence Form?

Two widely differing approaches are used by insurers to determine coverage when writing liability insurance. The difference centers upon the event that triggers coverage, and is known as the “coverage trigger.” The two approaches are known as “claims-made and reported” (“claims made”) and “occurrence.”

A review of your present liability insurance program will reveal both claims made and occurrence policy forms as part of your risk management program. For example, your business package policy may include commercial general liability insurance written on an occurrence basis. Your employee benefits liability, professional liability and employment practices liability insurance will use the claims-made coverage trigger.

The differences between claims-made and occurrence forms

The occurrence policy's coverage trigger is tied to the date of the event or accident giving rise to the claim. Under an occurrence contract, the ***policy in force on the date of the event causing the loss*** must respond with both defense and indemnity. The claim may arise years after the policy has expired, and the occurrence coverage trigger places little or no importance on the date the insured receives notice of the claim.

In the case of a claims-made policy, however, determination of coverage is triggered by ***the date you first became aware and notify the insurer of a claim or potential claim.*** The insurer's policy in force on the date you became aware and give notice is the insurer who must defend and settle the claim.

Prior acts coverage

Occurrence policies do not provide coverage for prior acts. They do remain available for claims that arise years after they have expired. If an accident or event occurs during the term of an occurrence policy, that policy must respond to any future claim.

A claims-made policy may reach backwards in time and provide coverage for claims made today from negligent acts, errors or omissions that occurred years before the policy was purchased. As outlined later, several conditions must be met before prior acts coverage is granted.

Advantages to the insurance company

Claims-made insurance allows for a close match between premium dollars and claims. Shortly after the expiration of a claims-made policy, an insurer can close its books and determine its profit or loss. Under an occurrence policy, an insurer cannot determine its profit or loss for decades because of possible incurred but not reported claims.

Disadvantages of claims made insurance

The primary disadvantage of claims-made insurance is its complexity. This presents challenges for the insurance professionals writing these policies, and makes the purchase of proper coverage difficult for the consumer. A second disadvantage is the necessity of following precisely the notification procedures for claims and potential claims situations. Because coverage is triggered by your awareness and notification of a claim or potential claim situation, failure to properly provide notification to the insurer will eliminate coverage. The following examples show how this can be a problem.

Example 1

Assume a professional changes professional liability insurance carriers and fails to notify the expiring carrier of his knowledge of a potential claim situation. Should the matter later develop into a lawsuit, both the old and new insurer will deny coverage based upon a breach of the notification requirements. Changing from one claims-made policy to another can be accomplished without gaps, but it requires careful compliance with each policy's reporting provisions.

Example 2

Assume a professional retires from practice and simply does not renew her claims-made policy. All coverage for prior services ceases once a claims made policy is allowed to expire. A special endorsement known as an “Extended Reporting Period,” “tail” or “run-off” can be used to solve this problem, but it is not without cost.

Basic claims-made principles

Four conditions trigger a claims-made policy:

1. The insured design professional must receive his/ her first notification of a claim or potential claim situation during the policy period.
2. The claim or potential claim situation must be reported to the insurer during the policy period.
3. The negligent act, error or omission giving rise to the claim must occur after a “prior acts” or “retroactive” date that is set forth in the policy declarations.
4. The insured must make a “good faith” statement (in some cases, a certification or warranty) that the professional and the firm had no knowledge of the mistake, error or controversy on the date coverage was purchased.

“Prior acts” date determines retroactive coverage

The “prior acts” or “retroactive” date is an important element in a claims-made policy. The policy declaration page will clearly identify a “prior acts” date that determines the extent of retroactive coverage. Claims resulting from services rendered before the “prior acts” date are not covered. The prior acts date is a critical item for negotiation and discussion at the time you purchase insurance. Your objective is to negotiate a prior acts date that coincides with the first date you and your predecessors provided services. Your insurer may be reluctant to provide you with extensive prior acts coverage, especially if you are presently uninsured or have gaps in your past insurance.

Claims-made reporting requirements

The reporting requirements set forth in a claims made policy are also an important factor in determining coverage. Pay special attention to the reporting requirements applicable to both claims and potential claims situations. Most policies state the notice requirements in the Conditions section of the insurance contract. Read and comply strictly with these conditions to preserve your coverage. Most claims-made policies include a provision that allow you to notify your insurer of a potential claim situation (sometimes called an “awareness provision”) and requires the insurer to accept this notification as the coverage

trigger for any future claims. This is important because many claims begin as complaints or controversies that take months, and sometimes years, to develop into actual claims.

Claims-made policies are complex

Your professional liability contract of insurance is the centerpiece of your risk-management program. As such, it is imperative that you understand just how the claims-made coverage works."

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