

Designed Protection® for Professional Service Providers Risk Management Resources

Liability Risk Management For Professional Service Providers

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We often read and hear about how the U.S. economy has transitioned from an agricultural to a manufacturing and, more recently, to a service economy. A very large portion of American workers are now professional service providers. The services in the marketplace span a remarkably wide range of needs. Most of these are in addition to the classic professions such as clergy, medicine, law, architecture, engineering, accounting and such. Now we can find services ranging from software developers to agricultural consultants to travel agents and beyond.

Each of these specialized services have evolved so that they are offered and provided without the formalized agreements, like written contracts, that are still used in connection with providing the more complex kinds of services. Even though formalized agreements are not used for many of these services, the public has developed and the law recognizes and enforces certain expectations and holds such service providers to certain standards of performance. When a service provider fails to meet those expectations and the service results in economic loss to the client, any service provider can find itself dealing with allegations of negligence or deficient performance arising out of their services. Often times these allegations result in a legal action being filed.

Since the providers of such services have a major investment in and reliance on the economic health of their service businesses, there is a need for planning for and protection from the risks associated from allegations of deficient performance. Malpractice in any profession, often referred to as errors and omissions (E&O), can result in claims, lawsuits, economic loss and, ultimately, dissolution of the business. To meet the need for protecting from such loss, there has evolved a class of insurance known to some as Miscellaneous Professional Liability E&O insurance.

Much of the insurance industry relies on the laws of large numbers to spread risk of loss among many insureds. Automobile and homeowners insurance involves spreading risks among millions of policyholders. Even the classic professions are generally found in sufficient numbers to allow spreading the risk of loss among large numbers of policyholders. As the class of insureds gets smaller, however, it becomes more difficult for an insurer to not only spread the risk among large numbers of similar professionals, but, also, it becomes more difficult to rely on actuarial analysis to predict and provide for losses. Accordingly, the providers of Miscellaneous E&O insurance are a special breed of risk takers.

They need to find ways other than statistical analysis of large numbers to evaluate and price risks.

As the professional liability risk management needs of such a wide variety of service professionals are met by insurers, more attention is being directed to viewing the risk management needs from a broader perspective. There is more to liability risk management than purchasing insurance. Without loss avoidance awareness and training, the providers of a wide range of services are likely to face increasing insurance costs. Such increased costs can become as much of a threat to a smaller professional service provider as the risk of E&O claims and lawsuits. A balance between learning to avoid liability loss and insurance to cover those liability losses that get past the loss avoidance efforts becomes the prudent approach to risk management.

Accordingly, the writers of Miscellaneous E&O insurance are increasingly getting involved in providing risk management and loss avoidance tips, suggestions and training. But, as with underwriting a broad range of service providers, it is difficult to develop risk management tools of use to a varied audience. It is interesting, however, to note that there are risk management principles that can be applied to a varied range of professional service providers. Before proceeding with a brief examination of what such principles might be, we examine a relatively random sampling of one insurer's Miscellaneous E&O claims to get a more concrete idea of what this is about.

Agricultural Consultants

- Correspondence reflecting allegations of mismanagement of a livestock production facility where organic market hogs are produced.
- Dairy consulting - claimant suit alleging illness and death of dairy cows and reduced milk production in others after ingestion of a mineral supplement recommended by policyholder.

Home Inspectors

- Lawsuit alleging failure of policyholder home inspector to disclose major defects including structural components of the foundation and framing.
- Correspondence reporting a claim arising out of a roof inspection that failed to disclose a leaking roof that had been repaired. The inspection disclosed the repairs but not the continued leakage.

Other Inspection Services

- Boiler inspection service – subrogation claim by boiler insurer. The boiler overheated and caught on fire during a low water shut down test required for state safety certification. Policyholder was observing and documenting the test which was performed by the boiler operator.

- Amusement ride inspection service - lawsuit sought damages in connection with an amusement park injury at an attraction inspected by the policyholder.
- Compressed gas container inspection service – report of failure to properly inspect and document cylinders manufactured by a client.

Property Managers

- Correspondence seeking information in connection with loss arising out of the alleged mismanagement and/or mishandling of funds.
- Legal proceeding arising out of management and handling of a property that incurred costs to convert it from septic to sewer.

Title Search Services

- Title Insurance Company claim arising out of errors in a real estate closing. The claimant alleged that the policyholder failed to identify a mortgage lien on a property that was sold.

Travel Agents

- Airline claim arising out of error in pricing tickets.
- Claim arising out of tour services. Events planned for a number of tour groups were cancelled when the organizer became financially insolvent.

Other Examples

- Construction industry administrative service – Claim sought to recover a loss resulting from policyholder failure to timely file a lien on behalf of the claimant/ client.
- Computer training service - Lawsuit arose out of competition for government contracts.
- Marketing consulting and management recruiting - lawsuit alleging misappropriation of trade secrets in violation of statute, breach of fiduciary duty, common law unfair competition, and tortious interference with prospective economic advantage.
- Litigation support service. Claim alleging failure to timely serve suit papers leading to a defense motion to dismiss.

Examining the sample can lead to some observations.

First, we note that there does not need to be an actual error or omission for a claim or lawsuit to be pursued against the provider of any service. No matter

how careful and risk of liability averse the service provider is, there continues to be a risk that someone will make a claim and allege a deficiency in the service. Even if the service provider ultimately prevails, the costs of litigation alone are a burden that most businesses are unable to sustain without major disruption.

Beyond the risk of having to incur significant legal costs to defend against allegations – whether meritorious nor not – there is the risk that, after all the evidence is in, the questions of whether there was an error or not and whether there were damages caused by the alleged error or not, the outcome is impossible to predict. After conflicting evidence and testimony from experts, there often is no clear conclusion as to fault. A judge or jury can see it either way. And, the future financial viability of a service provider can easily hang in the balance.

Insurance can, of course, help in making the outcome and cost of such claims more predictable. That is, predictable in the sense that high uncertainty and variability with regard to costs and outcome are considerably narrowed and provided for through a series of more predictable payments.

Of course, uncertainties are not completely eliminated. Miscellaneous E&O liability insurance policies provide coverage for claims under defined conditions. There are boundaries to the coverage. Certain kinds of allegations and losses may fall outside of those boundaries. Some of those gaps can be filled by other kinds of insurance. Other gaps just may not be insurable.

Insurers need to place time constraints (when the claim is made and when the alleged error took place, for example) on the coverage. Without placing time boundaries on the risk being covered, the insurer would find it difficult or impossible to evaluate the risk and properly price it. And, without this pricing capability, insurers would not be able to stay in business long. Or, they would have to charge exorbitant premiums to insure poorly defined risks.

Policies typically include constraints other than temporal on the circumstances under which coverage would apply. Some are non negotiable. Others might be adjustable for additional premium. The purchaser of professional liability insurance needs to carefully define and review the risks that are to be protected against and then work with an insurance broker to find the specific kinds of insurance needed to cover those risks.

There are certain kinds of risks that are not insurable. They may not be insurable because they involve moral risk, business risk, or are illegal to insure. Moral and illegal risks, for example can include consequences of intentional acts or fraud. Certain kinds of business risk – like the risk of losing a client or a contract - might be insurable but not under a professional liability insurance policy. It is important for a purchaser of professional liability insurance to carefully review the policy and understand the limitations of the coverage.

Insurance is a risk management tool. It is not the only tool available to a provider of services. In fact, insurance is intended to be the tool for addressing risk and loss after the other risk management tools have failed. These risk management considerations need to include:

1. Carefully select clients to stay away from those likely to become a problem.
2. Carefully define the services to be provided and avoid over promising or raising expectations beyond what can be delivered.
3. Exercise quality control techniques to assure, as much as possible, that high quality service is provided.
4. Avoid service agreements that unfairly shift risk to your business. For example, if there has to be “hold harmless and indemnify” language in the service agreement, it should run in your favor and not the other way around.
5. Keep open channels of communication with the client and work at staying on good terms. These both go a long way toward avoiding E&O claims.
6. Promptly address problems and issues. Often the E&O claims arise out of frustration due to inability to address a problem at an early stage. This can also reduce the consequences of errors.
7. Stay within your area of expertise. All too often E&O claims arise when a service provider strays outside of his/ her area of knowledge and experience.
8. Train and monitor employees to ascertain quality of performance and communication.
9. Devise organized systems of work flow and documentation of communications. Lack of good documentation often leads to increased costs of defending E&O claims.
10. Know when to get help. Struggling with a dissatisfied client without getting help can lead to a worse claim or lawsuit.

The many and varied providers of professional services form a challenging market for providers of risk management tools. Understanding the risks your service provider business faces and managing those risks can mean the difference between survival and growth.