

Anderson Kill & Olick, P.C.

POLICYHOLDER ADVISOR

The Policyholder Law Firm



Does Your E&O Insurance Need a Tune-Up?

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Any business that provides professional services to its customers — whether as a core function or an ancillary activity — faces many litigation threats and potential multimillion-dollar liabilities. That also may mean personal liability for legions of their employees as there are many supporting actors entangled in every lawsuit involving a marquee name. Recently, for example, allegations of malfeasance against banking institutions have dominated the business news, including impending litigation arising from the London Interbank Offered Rate, or Libor, manipulation scandal and class action litigation brought against a number of commercial banks focusing on their overdraft fee policies.

Policyholders concerned about such exposures will look to their professional liability insurance policies, also known as errors and omissions policies. Standard E&O policies — and the E&O claims process — are fraught with exclusions, catch-22's, and creative defenses against coverage.

Policyholder vigilance is required at all stages of the E&O insurance process — negotiating policy terms, filing claims, maneuver-

ing through the claims process, and, all too often, fighting for coverage in court.

The Insuring Agreement

The insuring agreement of an E&O policy typically contains a promise by the insurance company to pay for all loss that the policyholder becomes legally obligated to pay as a result of claims first made against the policyholder during the policy period and arising out of any actual or alleged negligent act, error, or omission in the policyholder's performance of professional services, sometimes only on behalf of a client or pursuant to a contract. The policy terms discussed below are frequent points of contention.

Claims made. E&O policies are typically written on a "claims made" basis, which means that a "claim" must be first made against the policyholder during the policy period. In addition, some require that the claim be reported to the insurance company during that period. A claim is typically defined to include commencement of a civil proceeding or criminal proceeding and/or demand for money or services.

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Sometimes a dispute arises in one policy period but the claim appears in another period with a different company. Faced with this scenario, the policyholder should notify the first insurance company when the dispute arises and should notify the second insurer when filling out the application and when the claim arises. This will ensure a recovery from one of the insurance companies; which one will depend on the court's resolution of when a claim arose.

Professional services. Insurance companies often challenge whether the negligent act, error or omission allegedly occurred in the policyholder's rendition of "professional services." The phrase "professional services" is usually defined in the policy. If it is not defined in great detail, a policyholder may be able to rely on the extensive body of case law, in which the consensus construction is "services related to the performance of duties within the person's area of expertise."

A delineation in the policy of the services the professional performs can help, but a broad definition is usually better, because once there is a list of activities it becomes easier to argue that other activities are not covered, even if the list is designated as non-exclusive.

Loss. Policies generally define "loss" to include all damages and judgments rendered against, or settlements entered into by the policyholder. Most policies also include all costs of the policyholder's defense.

Some E&O policies are like other types of liability insurance policies in containing a duty to defend, which is equivalent to a promise to hire and pay counsel to defend the policyholder. In most E&O policies, however, defense costs are normally charged against limits and the policyholder is responsible for hiring counsel and handling the defense. Policyholders should pay close attention to this distinction.

Insurance companies also argue in response to many E&O claims that the claimed loss arises from "matters which are uninsurable under the law." Certain cases, notably the Level 3 Communications decision, advance a public policy position that restitutionary payments

or disgorgement of any funds are not covered loss. Insurance companies argue that this negates coverage for certain settlements with the government or with customers or clients seeking a return of fees (e.g., overdraft fee litigation). This argument is highly fact-specific and varies by jurisdiction. Sometimes courts will allocate loss between covered and non-covered claims or reject excluding coverage where the policy's exclusions are not specific.

Exclusions Can Bar Coverage

Even if coverage is initially triggered, there are exclusions that can operate to bar coverage under E&O policies, including:

Known prior acts. Claims arising from circumstances known by the policyholder before the policy period as likely to lead to a claim are often excluded. At renewal time, policyholders should carefully coordinate the purchase of a new policy with notice to the existing policy and carrier of all potential claims and circumstances.

Dishonest, fraudulent, intentional or criminal acts. These are generally excluded, but a claimant typically sues the policyholder based upon a variety of alleged acts and theories, ranging from negligence to recklessness to intentional misconduct.

The application of this exclusion usually depends on a final adjudication or other determination of wrongdoing. The specific language of this clause is critical. Some policies require a final in-court determination for the exclusion to apply; others could be triggered by interim regulatory decisions or other less final events. Often, settlement of an underlying case can preclude application of this exclusion, but the language of the settlement can be critical.

Improper profit or remuneration. Many policies exclude coverage for any claim arising from a "profit or remuneration" to which a policyholder was not legally entitled. Application of this exclusion is also conditioned on a final adjudication or determination, and so can be less oppressive than the "uninsurable as a matter of law" doctrine discussed above.

What To Do To Protect Your Coverage

Policyholders should, at a minimum, do the following in connection with their E&O insurance policies:

- Use a reputable broker.
- Purchase insurance from companies with good claims-paying track records.
- Review the terms with a highly qualified professional.
- Notify the insurance company of all circumstances that could lead to a claim.
- Purchase optional extended reporting period when necessary.
- Select an appropriate retroactive date for prior-acts coverage.

- When applying for the policy, carefully describe all services performed.
- Ensure that the limits are adequate, and any retention or deductible is appropriate.
- Make sure that the policy contains a severability provision for innocent insureds.
- Properly document all settlement offers and responses by claimants.

While E&O insurance provides essential protection, that protection is not to be had simply by buying a policy. Vigilance is required at every phase, from assessing policy language to giving notice to following through on the often contentious claims process.▲

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