Understanding Extended Reporting Periods or "Tail" Coverage

Every firm has a life-cycle; professionals leave firms to practice individually or to join another firm. A firm might dissolve as a business entity. The firm might be acquired by or merged with another firm. Or firm owners may retire or be unable to continue providing professional services. All of these changes require special protection, and they should be discussed with a firm's professional liability insurance broker or agent.

All professional liability insurance available to design firms is written on a claims-made basis. For a claim to be covered, the claim has to be first made against the policyholder *and* reported to the insurance company during the policy period (also known as claims-made and reported coverage). If a policy expires and a claim is thereafter made, the individual professional and the firm will not have coverage under that policy. Coverage is provided for claims made and reported after the expiration of a claims-made policy only if such claims arose from acts or omissions occurring during an insured period of time and reported before the extended reporting period ends. Some policies, however, will provide coverage for claims related to negligent performance during the policy period provided that the claim is reported within a set and limited time after the policy expiration date. For instance, the CNA policy offered through Schinnerer includes an automatic 60-day reporting period after the policy is terminated.

Professional liability coverage is sometimes referred to as a "long-tail" line of insurance. A negligent act or omission may take place today, but harm arising from that act or omission may not be discovered or a claim made against the design firm or the individual professional (who by signing and sealing the design documents took responsibility for the project under state licensure laws) for a considerable period of time. In most states, this period is cut off by the applicable statute of repose. In other states and in those where the statute of repose only encompasses improvements to real property, the risk could be in perpetuity because of the obligation placed on the professional and the professional's firm by the state.

To extend the coverage of a professional liability policy beyond its policy term, it's possible to purchase reporting coverage through an "Extended Reporting Period" or "ERP." The extended reporting period is the time during which a claim arising from an act or omission occurring prior to the inception date of the ERP can (in most cases) be reported and covered, subject to the policy's terms and conditions. Most professional liability policies provide an insured with options to purchase ERPs of varying length. The insured typically may purchase the ERP for a period of one year, three years, five years, and, under some policies, ten years. The cost is generally a multiple of the last annual policy premium and depends upon the length of time selected for the extended reporting period.

Acknowledge that Changes Require Attention

The following scenarios are examples of why a design professional would purchase "tail" coverage. A continuation of coverage or the purchase of an extended reporting period is important to design professionals and their design firms if any of the following occur:

A Professional Changes Firms or Decides to Open a Separate Practice

If an individual leaves one firm for other employment or to start a new firm, the professional should be concerned that, as an individual, he or she remains covered for services performed while working for the prior practice.

If the original firm remains an ongoing entity, the professional is usually covered as a former employee of the firm for claims arising from services rendered while the professional was with the firm. However, this assumes that the firm retains its claims-made coverage, including prior acts coverage. If the firm divides or dissolves at some point thereafter and does not maintain professional liability coverage upon its termination, then all coverage will cease and there will be no coverage for the professional who left the firm or for the professionals who were still with the firm for any claim made after the termination date of the professional liability insurance policy.

If a professional leaves one firm and joins another, it is usually not possible for the individual to purchase coverage for acts or omissions that occurred prior to joining the new firm. In most cases, the new firm's insurance policy will cover only the professional's performance on behalf of the new firm. Most firms, and their insurance carriers, will not agree to provide coverage for claims arising from acts or omissions of the professional prior to joining the firm. And it is highly unlikely that the individual will be able to cover prior acts or omissions by purchasing an ERP when leaving a firm since the option for an individual ERP is not normally available.

A Professional Decides to Leave a Firm, but Perform Limited Services in a Solo Practice

There may be several options for a partner or other principal to secure coverage for prior acts in this particular circumstance. As the professional's prior firm remains covered under a typical claims-made policy, the professional will have coverage for claims arising from services performed while at that firm. A design professional leaving a firm and going solo may be able to purchase a new policy to cover the professional's solo activities with some form of prior acts coverage in connection with the earlier services. Not all insurers will provide prior acts coverage in these cases if the prior firm is still in business. And it is highly unusual that an insurer will offer a policy to part-time professionals who are performing a limited amount of services while retired from active practice. In some cases, a retired professional who is performing design services or providing other construction-related professional services can purchase a separate policy covering the services going forward, especially if the services are not related to design for construction. For instance, forensic services, sustainability advice, or other consulting services might be covered under a separate policy.

A Design Firm Merges with Another Firm through a Purchase of Firm Assets

Firms merging with other firms often face unrecognized exposures. Insurance coverage for all parties involved in this type of transaction is most effective when contemplated as part of a pre-merger, due diligence strategy. Such a strategy includes a well-drafted buy/sell agreement that attempts to protect the acquiring firm from claims arising out of successor liability and the purchased or merging firm from future litigation.

The buy/sell agreement should clearly evaluate the assets and exposures of both firms and assign the appropriate risks to either party. The structure of each company's insurance policy may determine who is going to be responsible should a professional liability claim arise. The successor company—prior to completion of the acquisition—should use prudent risk management measures to either avoid claims from acts of the predecessor firm or be prepared to address claims through insurance coverage. The firm closing out its practice needs to understand its ongoing risks and provide coverage even after the acquisition has taken place. It is important that the allocation of responsibilities between the parties be compatible and contemporary with the insurance coverage in place.

If the selling firm still has projects in process, that exposure should be addressed. If all projects have not been completed, a policy just to cover the discovery period for projects finished by the selling firm will not be effective. The acquiring firm can, however, assume the risk and responsibility for the incomplete projects. This would allow the selling firm to close up its operations and buy "tail" coverage for claims on its completed projects during the discovery period. A policy for this continuing exposure can be paid for as part of the terms of the merger or acquisition, or the selling firm could set up a separate, continuing entity to finish off the remaining projects. The selling firm's policy would have to remain in place until all the projects are completed, after which time a "tail" policy could be instituted. Many firms pay for this continuation and tail coverage through an escrow account set up at the time of the sale of the firm's assets.

The acquiring firm may choose to insure the risks of projects that are not completed by the selling firm. To cover the risks associated with these projects, they would have to be specifically endorsed onto the policy of the acquiring firm. As an alternative, these projects could be specifically excluded from the coverage of the acquiring firm. If these projects are added later, additional premium will be charged for this increased exposure. This can leave a gap in coverage: the selling firm will be closed and the only available insurance coverage will be for claims resulting from completed projects. The acquiring firm will have no coverage for projects not yet completed. And if the projects are specifically excluded, there will be no coverage for future claims involving the projects. In essence, they will remain uninsured projects.

Mergers or acquisitions often happen as a result of principals wishing to retire and using their ownership in a firm as a means to fund that retirement. Recognizing the personal exposure professionals have for their professional acts, the merger or acquisition agreement may require the ongoing entity to maintain coverage for the retiring principals.

The Owners of the Professional Service Firm Decide to Dissolve the Firm

Professional liability may be attributed to the owners of design firms and those who took responsibility for the licensed services throughout the period of the statute of repose even if firm owners decide to dissolve the firm. Dissolution does not extinguish the potential for claims. Firms need to maintain insurance coverage for potential exposure to personal liability that attaches to professional practice.

Among professional services firms, dissolutions most frequently occur in partnerships. The liability of partners is, almost without exception, joint and several. Thus, either one or both partners can be held liable for the wrongful acts, errors, or omissions arising out of the partnership practice. The questions that need to be addressed and answered are much the same as in mergers and acquisitions. Often in partnership dissolutions, the individual partners intend to continue practicing separately. The question of coverage for prior acts can be easily managed by one of the following:

- One of the individuals continuing in practice can simply name the dissolved partnership on its new policy. Any deductible obligation for claims arising out of services performed by the dissolved partnership will become the obligation of the former partner's firm continuing coverage in its own name.

- The individual principals of the dissolved partnership can each purchase policies for their respective new practices. These new policies can cover their individual exposures from the previous firm through prior acts coverage. In some situations, a professional liability insurer might allow the individuals to maintain coverage for claims arising out of the services performed by the partnership if the principals can agree on a specific list of projects for which each is willing to respond. To operate efficiently, any such list must be clear, all-inclusive, and evaluated in the insuring process. Anything not disclosed would not be covered by either policy.

The Owner of the Firm Retires from Practice or Permanently Leaves Practice

If all owners intend to retire and cease practice, some insurance carriers offer two distinct possibilities: the purchase of "retired partners" coverage or, for qualified firms, the continuation of the policy in existence at the time of the dissolution on a minimum premium basis.

Purchasing retired partners policies secures protection from claims arising out of the partners' past performance of professional services. This is true regardless of how the practice is organized (e.g., sole proprietorship, partnership, corporation, or other entity). This type of policy can protect financial interests by covering the residual risks associated with the firm's prior practice. This protection is extended to both the retired owners and any employees for the covered acts committed in the performance of services on behalf of the dissolved firm. For the purchase of a retired partners policy, most carriers mandate that all projects must be completed through construction and any claims from past projects must be closed. Often, a carrier will require that the firm have a record with the carrier of at least three years of continuous coverage. The cost of a retired partners policy is usually based on a multiple of the cost of the firm's three-year average premium. So a retired partners policy is an expensive way for a firm to wind down a practice.

Carrying a policy at a minimum premium—basically reporting zero billings for services but continuing the policy—might be available from some carriers, but is usually discouraged. Often, an independent insurance broker serving the firm will recommend that the practice wind down by reporting zero billings, renew the policy at the minimum premium for a few years, and then buy an extended reporting period which is based on the prior billings for a period of years. By doing this, the extended reporting period is then less expensive since it is partially based on the zero billings years. While this is a clever way to reduce the overall cost of long-term coverage, many carriers, however, will not allow this practice because it prevents them from accurately capturing an adequate premium for the exposure of past projects that would be carried over into the extended reporting period.

The CNA Policy Provides Extended Reporting Period Options

Any design professional anticipating a change in practice or the termination of practice needs to carefully examine the options available with the professional's insurance advisor and, through the insurance advisor, the underwriter who provides coverage for the firm. Design professionals who work through their independent insurance broker can explore the CNA policy options available through the Schinnerer design professionals program. They include multiple options that can address most of the concerns of retiring professionals and those transferring their practices to others.

The CNA policy has optional extended reporting periods following the non-renewal or cancellation of a policy, which can be purchased by the policyholder. A purchased ERP is not tacked onto the automatic 60-day period, but is a concurrent period that can extend the protection of the policy from claims related to services provided before the termination of the policy. The extension is available for one, three, five, or, in some states, ten years after the policy is terminated.

Since most professional liability claims happen before or within one year after the substantial completion of a project, many firms that are dissolving their operations are comfortable with purchasing one of the options. In situations where a firm is being bought out or merged into the operations of another firm, the cost of the extended reporting period is usually built into the selling price since no firm buying up the assets of another firm intentionally buys up the selling firm's liabilities—even if they are contingent liabilities from future claims related to past professional services.

An Automatic Extended Reporting Period for Death or Disability Is Available

The policy for design professionals offered through the Schinnerer program also offers an extended reporting period with no specific time limit and at no cost to a policyholder when the firm can no longer provide services because the principal dies or becomes disabled during the policy term. If the policyholder's estate, heir, executor, or administrator provides notice of a policyholder's death within 60 days of the policy's expiration date, an extended reporting period is provided so that the estate can be closed while coverage is provided for services performed before the policyholder's demise. If the policyholder becomes unable to continue services because of a medical disability, an open-ended ERP can be provided that ends when the policyholder resumes practice or dies. This exclusive coverage option might become available from other carriers in the future.

A Special Longevity Extended Reporting Period Can Be Bought

Perhaps unique to the Schinnerer program is a special extended ERP. If the insured firm voluntarily ceases practice, such as through retirement or dissolution, and has been insured through Schinnerer for at least ten consecutive years, the firm may purchase a ten-year extended reporting period for 250% of the prior policy premium. As firm owners sell their firms or are absorbed into other firms, this option gives owners the protection they need from claims that might take years to develop, such as claims on condominiums or projects where the construction phase extends far beyond the completion of professional services provided by the policyholder. Since few states have statutes of repose that extend beyond ten years, the longevity benefit—which costs the same as a normal five-year ERP—provides significant protection from claims from earlier services. And, unlike the ERP coverage provided by most policies, the longevity ERP is not disturbed if the practitioner provides *pro bono* services after terminating the insured practice.

Recognize the Importance of an Extended Reporting Period

As the individual who signs and seals documents, a design professional's exposure for claims arising from services performed during a particular policy period extends well past the expiration of the policy period since such a claim may not be made for several years after the work is performed. This exposure, often referred to as "tail exposure," requires coverage for this exposure provided throughout an extended reporting period.

Usually, when a firm's policy is terminated by the insured firm or cancelled or non-renewed by the carrier, an automatic, non-cancellable extended reporting period starts at the termination of the policy. It usually extends for 60 days to assist the insured firm in ending its practice or finding an alternative coverage. The extended reporting period only covers claims arising out of professional services rendered prior to the expiration or termination of the policy that are made and reported subsequent to the policy expiration or termination date and prior to the end of the extended reporting period's termination date. The ERP never covers any services performed after the termination of the policy term.

Tail coverage is not commercially available as a “stand-alone” insurance product. As a rule, an extended reporting period is only available in conjunction with the coverage of a previously issued claims-made policy, and the decision to purchase the ERP must be made during the period allowed by the policy. So, practitioners retiring, selling their practice, or otherwise transitioning out of active practice with the firm need to consider their extended reporting period options in a timely manner. Working with the firm’s independent professional liability insurance advisor and the underwriter for the carrier can provide specific information needed for this decision.

For more information on the professional liability policy offered through Schinnerer, go to www.schinnerer.com/industries/design-firms/news/Pages/NewAEPolicyForm.aspx.

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