COMMERCIAL GENERAL LIABILITY COVERAGE: AN E&O CHALLENGE

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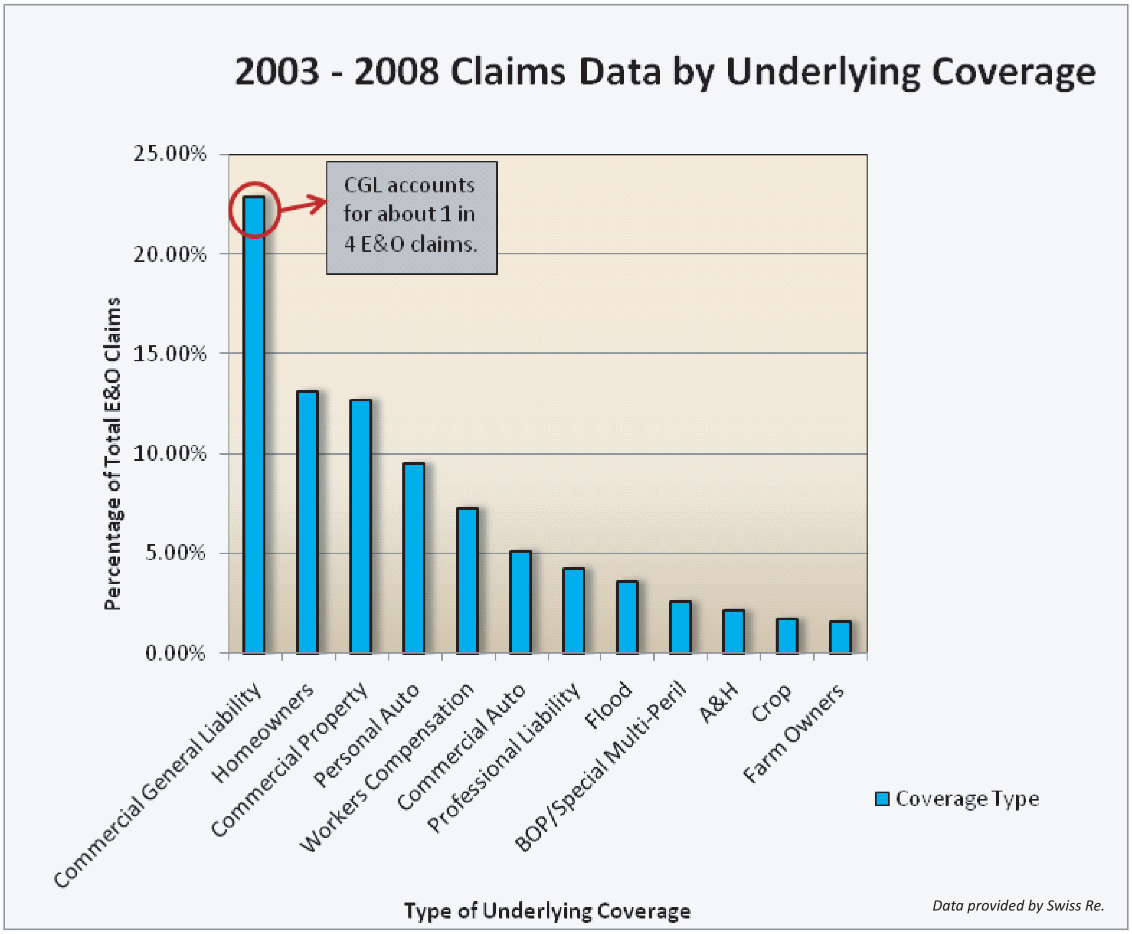

Commercial General Liability (CGL) is the underlying coverage involved in nearly 1 in 4 E&O claims made against agents in the past 5 years according to claims data from Swiss Re, the endorsed carrier for the Big "I" Professional Liability Program. This is more than any other underlying coverage. This disproportionate amount of E&O claims involving CGL is likely because the broad use of the form, the diverse types of underlying risks the form insures, the vast number of endorsements, volumes of certificates of insurance, and issues related to providing additional insureds. The following will explore some of the areas of greatest concern when dealing with these coverage parts of CGL.

Risk Assessment: The First Step for Any Coverage

The top four types of E&O errors are the following:

1. Failure to procure proper coverage
2. Failure to adequately explain policy provisions
3. Failure to identify exposures
4. Failure to recommend the correct type of coverage.

When you are working with a client does your agency first research specifics about the customer 's type of business and operational exposures associated with it? Do you review their website to get a better understanding of scope

Did you know? ***The Big "I" Virtual Risk Consultant identifies approximately 200 endorsements by form number and title available to modify or attach to the Insurance Services Office (ISO) Commercial General Liability (CGL) Coverage Forms. This list does not include any state specific endorsements or any of the various ISO Terrorism Endorsements. It also provides recommended CGL class codes.***

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of their services? Do you use risk specific questionnaires to determine not only their CGL exposures but others as well? It is very difficult to think of every possible risk exposure that the insured could have but questionnaires can provide you a road map to uncover them. Checklists can be used during the proposal presentation process to document coverages that are offered and accepted and those rejected by the customer. This serves as valuable client file documentation should a claim arise. Industry specific questionnaires and checklists are highly recommended for use no matter the type of customer being insured or the particular line of coverage being offered.

Utilizing more than one method to identify risks is preferrable. Your agency should consider coupling industry specific questionnaires and checklists with an inspection of the insured's premises or operations, interviewing the right people, asking lots of questions, doing a flowchart, looking at financials, etc. It can't be stressed enough how revealing looking at the insured's website can be. You will see firsthand what the insured is promising to the public. The idea is to uncover not only the risks that can be insured but those that cannot as well. Only then can the insured prepare for the retention he/she may have to face in the future.

Understand the CGL Policy Form

As with any insurance product you are selling you must be familiar with the language in the policy form being used. If you are using the ISO CGL coverage form, be familiar with the limitations, exclusions, definitions and extensions of coverage. Forms change over time and not all carriers will use the same form so don't assume that you will remember them all. I teach CGL coverages and I don't remember them all! Don't forget to check state exceptions, especially if it's a state that is not your primary state of operation. Coverage may be taken away or broadened utilizing these endorsements and they will be added to all CGL policies written in that state.

Who's Insured? Partnerships, Joint Ventures & LLC's

In reviewing the "Who is an Insured" provisions of the ISO CGL coverage form, included is coverage for newly acquired or formed organizations over which your insured maintains ownership or majority interest. The provision specifically excludes newly acquired or formed partnerships, joint ventures or limited liability companies (LLC). It further limits coverage for any current or past partnership, joint venture or LLC that is not shown as a Named Insured in the Declarations. Insureds are always forming new LLCs based on the advice of their accountant. Do you advise them when you write the coverage and at each renewal, that there is no CGL coverage for the newly formed, current or past LLC unless they are shown as a Named Insured in the Declarations? It should be included in all of your proposal forms.

Policy Forms and Manual (PF&M) on the Big "I" Virtual Risk Consultant provides P&C policy forms analysis and explanations along with examples. It also includes lists of endorsements that are available.

CGL Endorsements and Class Codes

Don't forget to run through all of the endorsements that are available to be added to the CGL coverage form. It takes time to run through the list to see if there are any endorsements that would be beneficial to your insured. I know, you're thinking that they probably won't buy it. You're missing the point. The problem is that if you don't offer it to them and a claim occurs that would have been covered by that endorsement, you have no defense against an E & O claim. The insured is going to tell the judge "If it had been offered to me, I certainly would have purchased it!" You want to offer the insured as much as possible in the way of handling their CGL exposures. Document your file when coverage is offered and rejected. Confirm everything in writing to the insured. Remember, you are building a defense in the event an E & O claim is filed.

Endorsements can be added when a specific class code is used. You should be checking the CGL section of the Commercial Lines Manual for any footnotes that might apply to the class code you are utilizing. The footnote could indicate that an exclusionary endorsement will be added automatically to the policy. Be careful in determining the correct class code for the insured's operations. The Big "I" Virtual Risk Consultant can provide recommended CGL class codes to help you classify the insured correctly.

Additional Insureds

Speaking of endorsements, how about all those additional insured endorsements? When you issue a certificate indicating an additional insured, the policy must be endorsed to reflect the additional insured status through the use of the proper AI form. Read those additional insured endorsements because they provide only on-going operations additional insured status. There is a separate endorsement for completed operations coverage for additional insureds. That endorsement must be added as well if the additional insured is to apply to both on-going and completed operations.

Of course, you have the blanket additional insured endorsement on the policy so you don't have to worry, right? Wrong! Most blanket additional insured endorsements require that there be a written contract between the insured and the additional insured. If there isn't a written contract, there is no additional insured status provided under the form. You would need to add another additional insured endorsement to accomplish this. When an insured calls looking for a certificate to be issued, don't forget to ask if there is a written contract.

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CGL & Leased Property Damage

Most insureds sign a lease to a premises at some point in their business career. We all know that a lease is one of the "insured contracts" under the ISO CGL form, right? The policy provides a limited amount of coverage for "damage to premises rented to you". Actually, most carriers include a minimum limit of $100,000. Is it enough? Remember that this coverage is designed to provide coverage for the portion of the premises occupied/rented by the insured. This portion of the premises is excluded under the care, custody or control exclusion. The rest of the building is covered under Property Damage coverage. What if your insured occupies 75% of a $5,000,000 building? They have an exposure to $3,750,000 in damages if they are legally liable for damage to that portion of the property. This coverage can be increased but you won't find an endorsement in the ISO arsenal of CGL endorsements. The coverage can be increased by adding the Commercial Property form Legal Liability coverage.

Employees Benefits Liability Endorsement

If your account offers employee benefits, they have an exposure to an error being made in the administration of those benefits. The ISO Employee Benefits Liability endorsement is designed to cover this exposure. If you have sold them a Fiduciary Liability Policy, the employee benefits coverage is included so you don't need the endorsement added to the CGL. If you do add the Employee Benefits endorsement, remember that this endorsement is a claims-made form and it has a retroactive date. It's very easy to forget that and not check the retro date at renewal.

E&O Exposure

Professional liability is not excluded under the ISO CGL form unless the classification has an exposure then an endorsement is added to exclude the exposure. Make sure you bring professional exposures to the insured's attention. Get them to complete a professional liability application and obtain a quotation for them. This will allow the insured to determine if they want to transfer the exposure by purchasing insurance or if they want to retain the exposure in part or entirely. Once again, document your file accordingly.

How Much Is Enough?

What about liability limits? CGL policies include aggregates that should be at least two times the occurrence limits. Do you explain to your insured how the aggregate works? Most insureds do not fully understand the insurance business so you'd be very surprised by what they believe the aggregate is! Ask them sometime.

How much is enough? Your clients ask you that all the time. I would tell my insureds that I had no idea. I can't predict how a court case will play out or who is going to present a claim. All I can do for him/her is give them the opportunity to see what limits are available and what each incremental increase will cost. They have to make a decision on their limits based on what they feel comfortable with. Cost will always be a concern for them but they also need to consider the level of risk they are willing to retain. As an example when I worked in an agency, I started at $1,000,000 per occurrence with a $2,000,000 aggregate, added the CG 2503 (Designated Construction Projects General Aggregate Limits) & CG 2504 (Designated Locations General Aggregate Limits) and recommended increased limits through an umbrella policy. Remember nothing stays the same and neither should your offer of coverage. You also need to continue to recommend higher limits at renewal.

When discussing limits of liability with your clients, it's not a bad idea to check what types of CGL suits have been brought in your area and what the outcome was. You could also check with industry associations to get a history of losses that might come about from your insured's operations. It doesn't mean that it will happen to them but it does tell them that you aren't just trying to scare him/her into a higher limit just for the additional commission income.

Audit Provisions Issues

It is very important that you explain to your insured that most CGL policies are auditable. Include the words "estimated premium" on your proposal so the insured can see that the premium listed isn't the final premium for the term. Explain to the insured how the final premium will be calculated. You might even want the auditor to visit the insured to provide the insured with details of what documents will be needed at the time of audit. You would be surprised at how many insureds do not fully understand this concept. Include detailed information about audits in your new business proposal as well as all renewal proposals. Be very clear what the premium bases will be and that the insured should be reviewing it regularly so it can be adjusted as needed. It will be much easier to deal with increasing exposures during the policy term when payment options may be more flexible than at audit.

Truckers and CGL

What about truckers and their need for CGL coverage. I have heard several individuals indicate that since they deliver by truck, they don't have a need for CGL coverage. Wrong! Under the CGL and ISO Commercial Auto forms, you will find the loading and unloading exclusions. The idea of having these on both policies is that the two forms will fit together like pieces of a puzzle. When one ends, the other begins. Let me give you a couple of areas you might want to keep in mind. The auto policy ends abruptly and the CGL takes over if the loading or unloading is being done by a mechanical device not attached to the auto. How does your insured deliver their product?

After reviewing this with the insured, you find that they deliver by hand truck or by hand. So you think you are all set, right? The loading and unloading is all auto exposures. Not so fast! Once the product is placed in its final resting place, the auto policy will no longer cover the operations of the insured. So while your insured is walking back to his truck, his operations of loading and unloading have been

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completed and any injury or damage he does at that point would be covered under the CGL, if he is legally liable. Of course, if you didn't sell him a CGL. Back to the E & O problems again!

"Your Work" & "Your Product"

Agents have the best intentions when writing a CGL for a client. One of the areas that has to be explained completely to an insured is the "your work" or "your product" exclusions. The CGL is not designed to provide a warranty for your insured's work or product. If the roof leaks after the insured installed a new roof, the CGL will pay for the resulting damage, if the insured is legally liable, but it will never pay for the repairs to the roof. The same thing happens with the insured's product. If the product causes injury to someone or damage to someone's property, the CGL will pay for the injury caused or the property damage done, if the insured is legally liable. It will never pay for the product itself or repairs to it. Nor will it guarantee that the product will perform as promised.

When dealing with a client who produces a product, you need to bring to their attention that there is no coverage for product recall expenses under the standard CGL. They must purchase that coverage for an additional premium. Another recommendation you want to keep in mind when talking to the insured about their exposures to loss.

Completed and Discontinued Operations

What about when the insured retires from his business? Do you just cancel the CGL and say "Have a great retirement"? Do you offer them discontinued operations coverage? You might say that they don't need the CGL anymore because they aren't operating a business any longer. What about completed operations? Let's say that you are a contractor and you build decks. You have built hundreds of decks in the last 10-15 years. This year, you decide to retire on January 1st. You cancel your CGL policy and go to Florida. Three years later, one of your decks collapses and injures 4 people. The CGL that was in effect when the deck was built will not respond because the definition of an occurrence is when the injury or damage is incurred. Three years later, you don't have a CGL policy in effect. So there goes your retirement money to pay damages and lawyer fees, of course until your lawyer advises you to sue your agent for not recommending discontinued operations coverage. Most clients will not purchase the coverage but that's not the problem. The problem is that you, the agent must identify this exposure and offer solutions to the insured. Documentation in the agent's file that the coverage was offered and the insured didn't buy it could save the agent in an E & O situation.

Other Potential Trouble Areas of CGL

Claims-made CGL Form Consideration

The carrier is not willing to write the CGL coverage unless it is on a claims-made basis. You don't get involved in claims-made policies very often. You need to brush up on the pitfalls of claims-made like the retroactive date. Never change the retroactive date once it has been set. It should reflect the effective date of the very first claims made policy. By changing that date, you could leave your insured with a large gap in coverage.

Claims-made to Occurrence Form

You finally have an opportunity to place the insured's CGL coverage with a carrier who will write it on an occurrence basis rather than the claims-made basis you have had it written on for the last few years. Going from occurrence to claims-made is usually uneventful but going back to occurrence from claims-made can cause lots of problems. First of all, the claims-made form provides an extended reporting provision but it is very limited. Basically it provides the insured with a 60 day period after the expiration of the claims-made policy to report any incidents that may give rise to a claim in the future. If the insured is aware of the situation and advises the carrier within the 60 day time period, the form allows for a period of 5 years for the claim to actually be made. It's not always possible for the insured to know something has happened that quickly. The new occurrence form will not pick up anything that happened before its effective date. So what do you do? You'll need to quote the insured an extended reporting endorsement. The insured may not buy it but offer it anyway and document your file accordingly.

Non-admitted CGL Form

CGL coverage placed with a non-admitted carrier could also pose a problem. Never assume that the forms utilized will be ISO. Even if they are ISO forms, what edition date of the form is being used? Anyone remember M&C (Manufacturers and Contractors) and OL&T (Owners, Landlords and Tenants)? Check some of the non-admitted CGL policies and you might be surprised to find these old friends.

Above are some of the key areas to consider in avoiding E&O claims related to CGL. While it's difficult to avoid all possible E & O situations, using risk specific questionnaires and checklists to understand the exposures of your customers and thoroughly understanding the CGL form can go a long way toward satisfying the customer while protecting the agency. Customer file documentation should include every conversation and signed checklists outlining coverages offered and accepted and those rejected. Remember that each time you work on your insured's account, you are setting up your defense in the event of an E & O claim.

Judith G. Durst, CPIW, CPCU, AU, ARE, has been in the insurance industry for over 30 years, having experience in both the agency and company side of the business. Judy is past President of the NH Chapter of CPCU as well as the former Education Chairperson & Coordinator for the Chapter. Judy has been an insurance instructor for more than 20 years and has been recognized as an Outstanding Course Leader by the American Institute. Judy joined the Independent Insurance Agents & Brokers of NH as the Director of Education in January of 2005.