

# Professional indemnity - 'run-off' insurance cover

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Each year councils throughout New Zealand enter into hundreds of contracts with consultants and contractors. Inevitably the work required to be undertaken carries with it variable levels of risk for both councils and for the consultants or contractors.

As a risk mitigation measure councils, as principals in contract, require consultants and contractors to carry certain insurance cover. Insurance is essentially a mechanism by which 'risk' is transferred to another party (the insurance company) and insurance policies primarily provide a means of protection against financial losses from unexpected events. It is this aspect which is important to councils since, if something does go wrong, there is comfort in knowing that the consultant or contractor has an insurance policy behind them.

Where professional services are engaged, professional indemnity is one of the insurances councils require. Professional indemnity insurance covers a consultant or contractor for damages, amounts for which they are legally liable by reason of any negligent act, error or omission. Invariably, contracts call for the consultant or contractor to carry professional indemnity insurance for six years following the completion of a contract.

Professional indemnity policies are generally annual policies and it is necessary for policies to be renewed each year – in fact a new policy is issued each year. Professional indemnity policies are written on a "claims made" basis, which means they will only cover claims made during the currency of the policy, notwithstanding that the error may have occurred in a prior insurance period.

To ensure compliance with contractual obligations it is essential that consultants and contractors renew their professional indemnity insurance; it is also prudent business practice that they do so. The logic behind the requirement to carry cover for six years from the completion of contracted work is that:

the effects of negligent acts, errors or omissions can take years to manifest into noticeable damage and consequently insurance claims can arise many years after completion of the work; and

six years generally fits with the statute of limitations.

The obligation to carry professional indemnity insurance for six years continues even if the consultant or contractor ceases to practise.

So what is the insurance situation if a consultant or contractor ceases to trade, is unable to trade or, dies within six years of the contract?

Ceasing to trade does not alter the consultant or contractors legal liability for any negligent act, error or omission;

claims may be made against a deceased person's estate.

A solution is for the consultant or contractor to buy what is known as 'run-off' professional indemnity insurance cover. Professional indemnity run-off insurance provides the same

cover as a trading consultant or contractor, but as the name suggests it provides cover for a run-off period following cessation of trading. Cover is arranged to provide for any work undertaken by a consultant or contractor prior to the run-off date. The cover can be purchased by the policyholder or their estate.

Generally it is preferable to buy professional indemnity run-off insurance for a non-cancellable six-year period for the payment of one lump sum premium. However, attitudes of insurance companies do vary from time to time and cover for the fixed term may not be available. If such is the case then annually renewable cover can be purchased. And so the message to contract managers is monitor the legacy requirements under contracts and be alert to consultants or contractors who cease to trade; their contractual obligations to hold professional indemnity insurance for the required period will continue. Having run-off professional indemnity insurance in place will meet that obligation.

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