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Malpractice Insurance – Contractual Indemnity and Tail Coverage

By David J. Hochman

Contractual Indemnity

While a malpractice insurance policy maintained by a healthcare provider typically provides broad coverage, it does not cover all liabilities arising out of the provider's professional practice. Malpractice policies typically include a sizeable list of claims which are excluded from coverage (e.g., illegal or criminal acts, sexual misconduct, misrepresentation in the application for the insurance policy, etc.). While coverage exclusions are set forth in the policy and the provider may be required in the policy application to acknowledge that he is aware of the exclusions, a provider may not realize how these exclusions may limit his coverage – until it happens.

Many malpractice policies exclude coverage for a claim based upon a contractual indemnity (e.g., an agreement by which the insured assumes a liability of someone else). For example, a physician's employment agreement with a medical group obligates the physician to defend, indemnify and hold harmless his employer from any damages, losses, claims (including attorneys' fees), etc. related to the physician's performance of medical services. Because of this provision, the physician has agreed by contract to cover the liability of his employer arising out of his professional services. This indemnity obligation is most often triggered by a malpractice suit against the physician in which his employer is also named as a defendant. The physician's malpractice carrier should undertake his defense and pay any damages or settlement on behalf of the physician, up to the applicable policy limits. But because the physician's malpractice insurance policy excludes claims based on a contractual indemnity, the physician's malpractice insurer has no duty to defend the physician's employer nor to make any payments on its behalf. The employer would presumably look to the physician to make it whole under the indemnity provision in the physician's employment agreement.

Healthcare providers may also encounter contractual indemnity provisions in agreements with hospitals (e.g., medical directorship contracts, agreements to retain a hospital-based group as the exclusive provider of certain professional services, etc.). In these contracts, the hospital often seeks a provision obligating the provider to indemnify the hospital against all liability arising out of the provider's negligence. The exclusion for contractual indemnity claims in the provider's malpractice policy would leave the physician or the group responsible for paying any amounts under the indemnity from their own resources.

Two final comments on this topic. While a contractual indemnity can be created without using words such as "indemnify", "indemnity" or "hold harmless," those terms are frequently used. If you see such wording in an agreement, we recommend that you contact legal counsel to determine how this should be addressed. It may be tempting to forego having a contract reviewed by your lawyer before it is signed, because the agreement is for a limited amount of services or the compensation for the services to be performed is small. If the contract imposes an indemnity obligation, the financial risk created would far exceed the legal fees to review the document.

Changes in Tail Coverage

There are two types of professional liability insurance widely available to healthcare providers – occurrence policies and claims-made policies. An occurrence policy provides coverage for any claim that occurs during the policy term, even if the claim is filed after the policy terminates. A claims-made policy provides coverage only if the act or omission takes place during the term of the policy **and** the claim is made during the policy term. The starting date for coverage under a claims-made policy is known as the "retroactive date." When a claims-made policy is renewed each year, the retroactive date remains the same. For example, a physician obtained a claims-made policy in late 2017, which has a retroactive date of January 1, 2018 and an initial policy year ending December 31, 2018. The physician renewed his policy for 2019. This policy will insure the physician for an incident which occurs on or after January 1, 2018 and before December 31, 2019 if the claim is made no later than December 31, 2019. If the policy is not renewed for the policy year beginning January 1, 2020 and the physician takes no other action, there would be no coverage for a claim made after December 31, 2019, even if the incident giving rise to the claim occurred in 2018 or 2019.

Because a substantial period of time can elapse between the time an incident occurs and when a malpractice claim or lawsuit is filed, healthcare providers who are insured for professional liability under a claims-made policy must address how to continue coverage when their claims-made policy terminates. One option is to purchase prior acts or "nose" coverage from a new insurer. A prior acts policy will cover claims based on incidents occurring on and after the retroactive date in the claims-made policy being replaced. A second option is to obtain continuing coverage by purchasing an extended reporting endorsement or "tail." Tail coverage will insure claims for acts or omissions which occur while the claims-made policy is in effect but which are not made until **after** the claims-made policy ends. While tail coverage is most frequently purchased from the insurer issuing the claims-made policy, there are several insurers that sell tail coverage even though they did not issue the claims-made policy.

For over 30 years, the majority of physicians in private practice in Illinois have been insured under a claims-made policy. Until recently, the tail coverage offered by these policies was unlimited – that is, the tail provided coverage without regard to when the claim was made and the policy limits (i.e., $1,000,000 per claim/$3,000,000 aggregate) were applied annually. While such an unlimited tail was attractive because it mirrored the protection provided by the claims-made policy when it was in effect, there was a problem – the premium for an unlimited tail was often over two times the physician's annual premium.

In contrast, insurance companies that wrote malpractice policies for professions other than medicine have offered tail policies which limited the period of coverage to a specified number of years and which have a single set of policy limits applicable to the entire period of the tail (rather than an annual limit which renews each year). The premiums for such coverage were substantially lower reflecting that the coverage was not as broad. In the past few years, physician malpractice insurers have begun to offer limited tails with similar options.

The purchase of a limited tail by a physician departing a medical practice can adversely affect the remaining physicians and the practice. Physician employment agreements, almost without exception, require that a departing physician must continue malpractice insurance coverage, without a gap in coverage, after termination of employment. In many cases, the departing physician bears the cost of this continuing coverage. The acquisition of tail coverage by a departing physician benefits his former employer because this will provide a larger amount of malpractice insurance coverage if a malpractice claim is made after the physician's departure. But if the departing doctor's employment agreement only states that he must purchase a tail (without mentioning any requirements that the tail must satisfy), the

physician may not be required to purchase an unlimited tail and could satisfy his obligation by purchasing a tail with a duration of only a few years or a single set of policy limits and from a different insurer. For example, upon leaving a medical group, a departing physician purchased tail coverage from another carrier with policy limits of $1,000,000 per claim. The physician's former employer has its own malpractice policy with a similar policy limit. After his termination, the doctor and his former employer are sued for malpractice alleged to have occurred during the physician's employment. At the time the malpractice suit is filed, $2,000,000 in coverage is available -- $1,000,000 under the departing physician's tail policy and a similar amount under his former employer's policy. Shortly before the case is set for trial, the physician's carrier becomes insolvent and is no longer able to pay any claims. As a result, the only insurance coverage is the $1,000,000 policy of the former employer.

We recommend that a physician or a physician group that employs other healthcare providers review the employment agreement of these providers to determine whether a revision to the malpractice insurance provisions is desirable.

If you have any questions regarding these topics or other healthcare-related matters, please contact any of the listed attorneys.

Ericka Adler, Manager
312.582.1602 | eadler@ralaw.com

Anna Moore Carulas
Practice Group Manager
Medical Defense/Health Care Litigation
216.615.7401 | acarulas@ralaw.com

Lesley Arca
312.582.1621 | larca@ralaw.com

Avery Delott
312.582.1636 | adelott@ralaw.com

Michael Hudak
330.849.6704 | mhudak@ralaw.com

R. Mark Jones
216.615.4820 | mjones@ralaw.com

Christina Kuta
312.582.1680 | ckuta@ralaw.com

Lee Levin
312.580.1248 | llevin@ralaw.com

John B. Waters
312.582.1685 | jwaters@ralaw.com