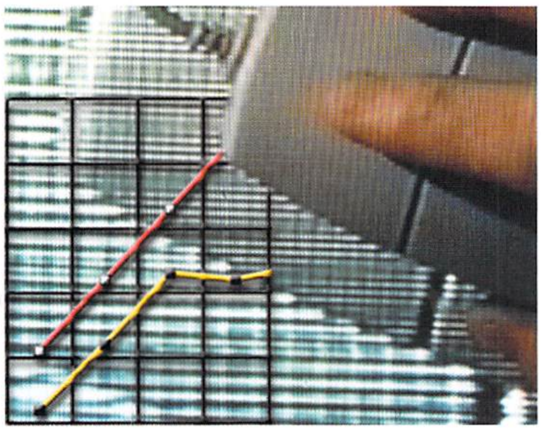
Insuring Your Law Practice

By Paul Sullivan

Deciding how much and what kind of insurance coverage to carry is an important strategic decision for any law practice. While consulting an insurance professional whom you trust is an essential first step, it's almost impossible for any agent to be a one-stop shop for your insurance needs. By educating yourself, you increase your odds of making the right decisions. Here's an overview of your options (excluding professional liability and health insurance, each of which deserves its own column).



What kinds of insurance does your practice need, and how much? Here's an overview.

The package policy and the pitfalls of coinsurance

"Package" defined. "Package insurance" refers to combined coverage for property (your building and its contents), liability, and workers' compensation, along with an "umbrella" to insure losses above the amounts covered by other liability insurance policies. A good package policy will also insure loss of business income for a disaster that forces you out of business for a time.

Vehicles. Company vehicles are covered under the package policy. If you use personal vehicles, you'll want to carry hired and nonowned automobile liability insurance, which covers your firm's liability for accidents caused by employees driving their own (or rental) cars on company business.

Electronics. You should also "schedule" your electronic equipment under the package – i.e., you should list computers and other electronic items separately and insure them individually over and above your regular furniture and fixtures. Consider coverage for items you use in your practice but take outside the office, like a laptop computer.

Coinsurance. Perhaps the most important, yet least understood, issue of building and/or contents coverages is coinsurance. Failure to fully comprehend how it works can cost you dearly.

Coinsurance allows you to cover a percentage of a total loss, thereby earning a discount on the premium. Only 5 to 10 percent of claims are total losses, so this makes good business sense. Beware, though: if you adequately insure your property, the insurance covers 100 percent of the loss up to the limits of your coverage; if you underinsure, you can be in for a nasty surprise.

Many people think 80 percent coinsurance means 80/20 up to the coverage limits. In fact, the "80 percent" refers to the portion of the total value of the property you're buying coverage for (you're assuming the risk, or "coinsuring," the other 20 percent). For example, assume you have your property insured for $100,000, which you believe covers 80 percent of its value, and a fire causes $50,000 damage. When the insurance company investigates the claim, it will pay the full $50,000 if the replacement value of the property is $125,000 or less, because $100,000 is at least 80 percent of the replacement value.

Assume, however, that the insurance company discovers that the true replacement value of the property was $200,000. Under the terms of 80 percent coinsurance, the insured would be required to carry $160,000. Because it was only insured for $100,000, the company will invoke the coinsurance clause and pay a settlement of $31,250, not $50,000. It arrives at this figure using the following formula:

Amount of coverage divided by *80 percent of value of property* times *loss* equals *recovery* $100,000 ÷ $160,000 x $50,000 = $31,250.

This example underscores the need to stay on top of your property values. In a growing office, it's easy to overlook the value added each time you buy furniture and fixtures or make improvements. Don't overinsure, though. That wastes premium dollars. A good insurance agent will review coverages with you before each renewal, making sure everything is up to date.

Disability income insurance – expensive but attractive

Disability income insurance provides an income stream when you are unable to work. It is available in both short- and long-term versions, but long-term – which could provide income until you reach age 65 – is the most common and, usually, the most attractive alternative. The typical coverage insures 60 percent of your average past income. There is always a waiting or "elimination" period, usually 90 days, though you can negotiate longer periods to lower your premiums.

While disability insurance is expensive and the underwriting requirements are strict, the peace of mind it brings is well worth the investment for many.

There are, however, a couple of things to keep in mind.

First, "disability" can mean different things to different people. A policy that includes "own occupation" coverage is the most comprehensive. Under this approach, insureds are covered if unable to perform the major duties of their occupation at the time they become disabled, and the company will pay the claim even if the insured is engaged in another occupation.

Without "own occupation" (also known as "gainful occupation") coverage, payments end when and if the insured can perform the requirements of another suitable occupation – and the insurance company's definition of "suitable" may be quite different than the insured's. Some carriers now offer a hybrid called "income replacement" insurance, under which benefits are reduced, not eliminated, if and when the insured does other work. Be sure you understand what you're getting before choosing this option.

Most disability policies integrate their coverage with Social Security. Thus, if an insured becomes disabled and is eligible for Social Security payments before age 65, the disability benefit will be reduced.

"Key man" life insurance

Life insurance can provide security to business owners, particularly those who have key employees or partners. Under so-called "key man" policies, the business itself owns the policy and pays the premiums. If the insured dies, the business is the beneficiary and receives the policy payout, using the proceeds to keep creditors at bay while the organization recovers, to buy out the deceased owner's interest, or otherwise to weather the financial impact caused by the death.

When evaluating who should be covered, keep in mind that the person's rank is less important than his or her importance to the business. In other words, coverage shouldn't be limited to owners. Any employee whose loss would significantly disrupt the operation of the business is a candidate.

Review your coverage

Be sure to regularly review the types and amounts of insurance you carry to account for changes in your business, the insurers' products, and the economy at large. Insurance is one of your biggest expenses, and although you can't do without it, you should do your best to get your money's worth. ■

Paul Sullivan is the office administrator of Quinn Johnston Henderson & Pretorius with offices in Peoria and Springfield. He is a charter member of the Central Illinois Association of Legal Administrators and the ALA Cyber chapter and serves on the ISBA Law Office Economics Section Council. You can send comments, questions, or other correspondence about the column or any office management issues to him at <psullivan@qjhp.com> or 227 NE Jefferson, Peoria, IL 61602.