

# THE ASPPA Journal

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## Consequential Damages: A Wide-ranging Impact

by Tracey L. Matthews

When a professional undertakes an obligation to perform certain services for a client, the professional must perform his or her duties in a manner that meets the requisite standard of care and delivers the promised service to the client.

**W**hen an error occurs as the result of the professional's negligence or failure to adhere to the standard of care, the professional must often call on his or her Errors and Omissions (E&O) insurer to respond to the claim or monetary demands of the client. The client at that point morphs into a "Claimant," and the relationship can become strained and could dissolve. Thus, the professional and the company have sustained their first consequential damages from the error, which include a broken relationship and loss of income from a client. Just as the client sustains consequential damages as the result of an error, so does the professional.

There is little doubt that while an insurer can defend and indemnify a professional for errors and omissions and can take care of the consequential damages to an injured claimant, no insurer can fully indemnify an insured professional for the consequential damages he or she will suffer when an error is made.

### Let's Review an Example

During the summer of 2008, the professional was retained by the client, a plan sponsor, to calculate various benefits under an early retirement package for plan participants. The initial idea presented to the professional was for a credit of five years and an offer of early retirement benefits to eligible participants. The early retirement plan eventually became a more complex offering that included a calculation of age plus service time, medical benefits, a lump sum payment outside of the plan and an enhanced payment to monthly benefits and a bridge payment for early retirees up to age 65 Social Security eligibility.

For a subset of plan participants, generally those older than age 65, the professional's calculations contained an error that artificially inflated the monthly and lump sum benefit payments. Once the plan components were finalized, there were 42 employees who fell into the eligibility criteria whose calculations were incorrect. Incorrect figures were presented only to 12 employees and before any payments were made. In addition,

once the corrections were made to the calculations, an additional 90-day opt-in period for the incentive offer had to be extended to the plan participants. As a remedy, Claimant offered an enhanced monthly benefit and an additional lump sum payment of up to \$20,000 to each of the impacted plan participants, thus driving up the anticipated costs.

Claimant is seeking in excess of \$1,000,000 for the following categories of claimed damages:

- Professional fees paid to correct the error;
- Staff resources and time expended to service the pension plan;
- Additional pay and benefits paid to employees during delay period;
- Breach of contract damages paid to employees;
- Employees' lump sum additional benefits;
- Employees' monthly additional benefits;
- Additional compensation for executive who opted-in during additional extension period; and
- Difference in actual payments versus erroneous calculations presented to participants.

The initial reaction to the exhaustive list of damages is, "How is this possible? Why is the benefit administrator responsible for these types of damages?" Such a list of damages is commonly referred to as consequential damages for the Claimant. As long as an injured party can establish proximate causation (legal cause) between the error and the claimed damages, liability for such consequential damages is established and the issue turns to the damages calculations and verification of the numbers.

It is important for benefit administrators and actuaries to understand that even where an error appears to be contained as to the actual out of pocket payments, if an employer or plan sponsor has to take certain action to protect itself or to correct the error, the costs of those actions will become a part of the E&O claim.

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In this instance, the employer had communicated certain figures to plan participants that the participants relied upon to make a decision as to early retirement. The employer took action by hiring another vendor to perform the calculations. The employer had to pay for those services. Employees who opted into the early retirement plan continued to work while the correction was being worked on. The employer lost the benefit of the savings had the initial calculations been correct. Further, once the corrected figures were known, the payouts were less and the employer was faced with the real possibility that a very low number of employees would accept the corrected figures. The employer acted to preserve its long-term savings potential that could be maximized by the number of participants who accepted the early retirement offer. Further, the employer had to re-open the opt-in period based on the new calculations. During the second opt-in period, a highly compensated employee exercised the option for early retirement.

For the professional, the consequential damages are numerous. As mentioned, a client is now an adversarial Claimant. The relationship has been jeopardized and it may be next to impossible to continue the business relationship as communication becomes guarded and strained and trust becomes an issue. Of course, there is the added impact of the loss of revenue from the business generated by the relationship and the cost of the claim.

The E&O investigation shows that the professional did err in the calculations. Further, as the client retained counsel and morphed into a Claimant, the professional's E&O insurer had to likewise retain counsel for the professional as well. Experts have also been retained for both sides. For the professional, this means that regardless of the payment of damages, their sizeable deductible, usually at least \$10,000, will be paid as most policy deductibles apply to loss and claim expenses.

All professionals need to maintain adequate E&O insurance to protect their interests as disputes over services rendered can and do arise during the course of operating a business. It is a fact that claim costs along with loss payments impact the availability and price of E&O insurance. Thus, a cold hard reality is that one significant claim can have a substantial impact on the carrier's decision to renew coverage and at what rate. Thus, we arrive at the crossroads where the professional will likely lose revenue and experience an increase in operating expenses as a direct impact of an E&O claim.

Another critical loss to the professional Insured includes the amount of time that this matter has required and the countless uncompensated hours of time staff members have had to dedicate to responding to the lawyers and the experts. This time commitment drains the professional's time and staff time to deal with a matter that is not generating revenue and steals time from revenue generating activities on a daily and ongoing basis. The average life of an E&O claim is six months!

Further, the relationship with the Claimant has ended. The loss of a long-term client takes a toll on any business. The loss multiplies when it was caused by an error and the good will of the professional is impacted through word of mouth. Most clients belong to professional organizations, community organizations or know someone who does. For the Insured, the value of the consequential damages are not so easily determined, especially if word of the error leaks to current or potential clients. This Insured may never know the losses it will sustain as the result of this error.

All who perform professional services are at risk for these types of claims. All who perform these types of professional services are well served by taking great care in the delivery of services to clients who rely upon professionals for advice and services to operate and plan their business and financial future. ▀



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