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Small Talk

By Kelly Spors

[Kelly Spors answers questions from readers about entrepreneurship]

Q: I started my own business four years ago and am still a one-person consulting shop. I've resisted buying professional liability insurance, despite losing several contracts over the issue. Could you tell me the pluses and minuses of liability insurance for one-person firms?

-- Roger Patrick, Santa Fe, N.M.

A: It's not difficult to see why many self-employed individuals, from the independent consultant to the professional dog walker, find it unnecessary to buy liability coverage. Besides the high price, some business owners don't think they're vulnerable to lawsuit or fear that having a deep pocket of insurance might entice customers to sue.

But weigh those reservations against a much scarier alternative: What if you get sued without it? You risk losing your business, and possibly even personal assets depending on the firm's structure and how well it's maintained.

Liability insurance typically pays judgment money and legal fees if you're sued for anything related to your business activity -- ranging from someone injuring themselves on your property to a client feeling that you doled out damaging advice. Several types of insurance exist. Professional liability covers negligence, errors and omissions that arise out of service provided by your practice.

Of course, the policies come with exclusions you must read carefully, and coverage isn't cheap. Firms with annual revenues of $200 million or less paid an average $3.29 for every $1,000 in revenue for general liability insurance in 2005, according to a survey by broker Marsh Inc., a unit of Marsh & McLennan. However, premiums vary widely depending on your business type and the lawsuit risks in your industry. A one-person business with low claims risk and no prior loss experience could pay about $5,000 annually for a $1 million primary liability policy that includes professional coverage, says George Pallis, Marsh's managing director.

Assuming you're immune from legal risk can be a dangerous game. Firms, large and small, are frequently sued for what sometimes may appear a frivolous or unjust claim. The average jury award to plaintiffs in injury and liability cases in 2004 was $1.39 million, up from $602,000 in 1998, according to the Insurance Information Institute, a trade group.

Sole proprietors, comprising about 70% of all U.S. businesses, especially need liability coverage because no separation exists between their personal assets and business assets. Their home, their car and their personal investment accounts are threatened by any lawsuit stemming from their business if they're not insured.

An incorporated business generally shields personal assets from the business's assets, meaning insurance may be less necessary. But there's still a small chance that a lawyer can pierce that protection by convincing a judge your business wasn't following corporate procedures, says the insurance institute's chief economist, Robert Hartwig. And, even when incorporated, all your business assets are still up for grabs if someone sues you.

Incorporated or not, there are other compelling arguments to get insurance. You alluded to one yourself. Many clients prefer, or demand, the consultants they hire carry insurance, says Elizabeth Gaudio, senior executive counsel for the National Federation of Independent Business, a small-business lobbying group. So you may sacrifice some income by forgoing coverage. A 2002 survey by the federation found that 67% of small firms purchased professional liability coverage.

All that said, a financially strapped business owner with few personal or business assets probably doesn't need insurance until there are assets to protect, says James Lange, a Pittsburgh tax attorney. "If he's 23 years old, has thousands of dollars in student loans and has this fledgling business," there's little to lose, Mr. Lange says. It comes down to weighing the insurance costs versus the assets you could potentially lose, along with the reassurance of simply being insured.

If you do decide to buy liability coverage, shop carefully. Some policies only cover current policyholders, while others will cover events that occurred while you were insured, even after you've ended coverage, Mr. Hartwig says.

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