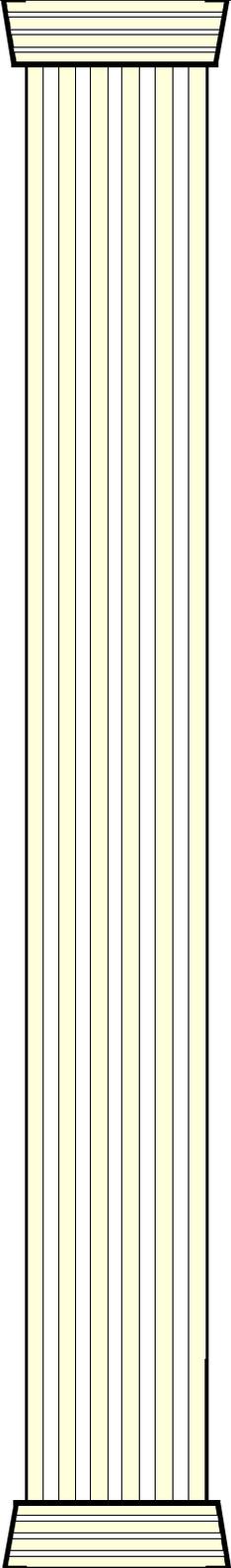

PROFESSIONAL LIABILITY UPDATE

A Loss Prevention Newsletter for the Design Profession

MSP PL 07/2005: "The Importance of Your Professional Liability Application"

July, 2005



The Importance of Your Professional Liability Application

By Jeffrey W. Cavnac, CPCU, RPLU

It's that time of year again. You just received your professional liability insurance renewal application, and now you must begin the arduous task of completing "The App."

As daunting a task as completing this form might be, it really represents an opportunity for design professionals to reduce their total cost of risk. Most design professionals pay somewhere in the area of 1% to 5% of their gross income for professional liability insurance. In many cases, after payroll and rent, this can be a design firm's largest expense.

Most applications will ask questions about many different areas. This article will provide insight into why such questions are asked and the implications of the answers.

The Underwriter

Insurance underwriters determine your insurance premiums. No, an "underwriter" is not related to "undertaker." The name comes from the London insurance market in the 1700's. Terms, conditions and rates were presented to an insurance company, and if the insurance company was agreeable, an individual representing the company would write their name at the bottom of the form, literally "under" the terms and conditions, hence the name "underwriter."

Underwriters evaluate your application on both objective and subjective bases. Objectively, they look at things like discipline, areas of practice, firm size and loss history. Subjectively, they look at the quality of the firm, the resumes of the key players, and (if they respect the opinion of the broker) the guidance the broker provides. Based almost exclusively on this one form, they will determine what your premium will be for the next year.

"The App" is also an opportunity to evaluate your firm once a year to see

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what it's doing right and what it's doing wrong. Many of the questions on the form serve as a risk management audit for your firm's operations.

In most cases an application is warranted to the policy. This means that if there are material misrepresentations in the application, the insurance company can subsequently void coverage. It is imperative that the application be an accurate representation of the firm's work profile.

Some questions on the application may not fit your firm. When in doubt, create a new category and explain your answer.

The quality of your submission is critical. It should be professionally prepared, complete, and should provide any additional information that will help the underwriter understand specific questions. All requested attachments should be included, and we generally recommend that a principal of the firm write an Executive Summary of the company to explain why, from an underwriter's perspective, the firm deserves a favorable rate. A specialist insurance broker can help you draft this letter. The broker should also provide his/her own letter profiling your firm's positive attributes.

Firm Profile

All insurance companies will want to know who you are and where you work. They will also want to know whether your firm is a sole proprietorship, a partnership, or a corporation.

➤ **Named Insured** – It's important that you list not only current entities, but also pre-existing entities. Your policy will provide coverage only for those entities specifically listed as a "named insured."

If you have purchased the stock of another firm, you will probably want to list not only the company you bought, but also any other entities that the acquired firm was responsible for.

➤ **Number of Personnel** – The number of personnel is usually broken down between principals, professional and technical personnel, and other job classifications. This gives underwriters an idea of the overall quality of the staff, and also (when compared to revenue) whether the firm appears to be over- or under-staffed. (Most design firm generate between \$85,000 and \$200,000 of revenue per employee).

➤ **Professional Associations** – Underwriters want to know what professional associations you belong to. This shows a commitment to the industry.

➤ **Ownership** – Underwriters want to know if anyone else has an ownership interest in your firm. Sometimes outside ownership can compromise the autonomy of a firm. If there is a parent company, the exposures of the parent company need to be evaluated as well. In some cases the parent company will be specifically excluded.

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Risk Profile

The application process provides underwriters with what they need to determine your Risk Profile. The table below compares two similar firms using "worst case" and "best case" rating factors from a typical professional liability insurer.

Rating Factors

Rating Factor	Debit	Worst Case	Premium	Best Case	Credit	Premium
Initial Premium			\$50,000			\$50,000
Territory	+ 20%	Southern California	60,000	Indianapolis, IN	-20%	40,000
Type of Work	+ 25%	Residential	75,000	Office Buildings	-25%	30,000
Subcontractors	0 to -10%	Uninsured	75,000	Insured	-10%	27,000
Claim Experience	+ 20%	Higher than Expected	90,000	Lower than Expected	-20%	21,600
Business Practices	+ 25%	Needs Improvement	99,188	Well-Managed Firm	-25%	16,200
Premium Quote			\$112,500			\$16,200

Application (Continued from page 2)

Underwriters also want to know if any of a firm's key personnel have an ownership interest in another entity. Common ownership can create conflicts of interest.

- **Equity Interest** – Nearly all professional liability policies contain an equity interest exclusion. If a firm has an equity interest in a project over a certain percentage (10-25% is common), the project is excluded from coverage under the policy.

The preferred exclusion makes an exception for third party claims. In other words, if you have a major equity in other projects, the only type of claim that would be excluded would be if the entity makes a case against you. Note in some cases you can eliminate this exclusion for an additional premium. Underwriters will require additional information.

- **Revenues** – In order to arrive at your premium, underwriters calculate a rate based on the application and multiply it by a revenue number. Some insurance companies use the last fiscal year as that number, while others use an average of prior years and the projected year.

It is important to note the insurance company's definition of "gross receipts." Here is a typical definition: "the exact dollar amount of your firm's gross revenues but not including interest income, rental income on real estate or sales and service taxes." By exception this includes what you pay to sub consultants.

- **Branch offices** – Underwriters want to know if you have any branch offices, where they are located, and what percentage of gross revenues they generate. The breakdown of gross receipts by office location is needed because premium is developed in part by using territorial rating factors. Premium taxes may also vary by state.

Sub-Consultants

The insurance company wants to know the percentage of your firm's gross receipts that were paid to sub-consultants and sub-contractors. This tells underwriters to what extent a firm has vicarious liability for the work it sublets to other consultants and contractors.

Most insurance companies will provide a rating credit for fees paid to insured sub consultants.

Risk Management Workshop

Contract Review



Please join us as we discuss some of the latest contract provisions that impact design professionals. We'll look at each item in detail from a risk management perspective.

If you are responsible for reviewing contracts on behalf of your firm, you should attend this seminar **on Thursday, July 28th.**

For more information and to sign up, go to <http://www.cavignac.com/pdfs/CRinvite728.pdf>.

Seating is limited for this workshop, so we'll need your *RSVP on or before Monday, July 25, 2005.*

The fee for this seminar will be donated to the design professional society that you designate.

We look forward to seeing you there! ✨

However, if a sub-consultant doesn't have the appropriate insurance or is otherwise financially irresponsible, the prime consultant will be on the hook (your professional liability policy also provides coverage for this), and no credit will be given.

Underwriters look for firms who have well developed sub-consultant and sub-contractor policies and procedures. For example, a firm should have a procedure for reviewing certificates of insurance. This procedure should include awareness of the adequacy of limits, appropriateness of coverage and deductibles, the solvency of the insurance company writing the coverage, and a diary system for follow-up by policy expiration date.

Types of Services

This is one of the most important sections of the application. It deals with the type of services you provide, which are usually broken down between design and non-design services. It also asks questions about environmental services. The questions are not always straightforward, but how you categorize your services will have a material impact on your rate. This is an area you will want to discuss with a "specialist" insurance broker.

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Application (continued from page 3)

One insurance company's claims experience reveals that performing design services without providing construction review or onsite observation tends toward greater frequency and severity in claims. Construction observation enables the designer to review construction for general compliance with the plans and specifications. An underwriter for this insurer would provide a credit if a firm does construction observation and a debit if it does not.

Non-design services generally carry a lower rate than design services. Note that although this work is credited, it is not without liability. There have been some very interesting claims arising out of programming and studies.

Forensic engineering is also a "credit" area. The contract is the most critical factor for such firms. Note that many underwriters are not thrilled about insuring "plaintiff experts."

A firm that performs construction observation for projects designed by others may have a higher exposure. There is a risk that the firm could be held responsible for design errors or omissions which it fails to recognize during the construction observation process. A well-written contractual provision that exonerates the firm from any work done by others is appropriate.

Inspection as stand-alone service can also create potential problems. It is imperative that the scope of services provision adequately describes what the firm is and is not going to do. Disclaimer language that makes it clear that the inspection services involve professional opinions and *not* certifications, guarantees or warranties are also appropriate.

Discipline

Certain disciplines have higher exposures than others. Structural and geotechnical engineering tend to be at the high end of the range, while landscape architecture and surveying tend to be at the low end of the range. Architecture and civil engineering are near the middle.

Application questions about your discipline have a material impact on your rate. You want to make certain your operations are appropriately classified.

Project Type

The types of projects a firm handles are an important underwriting issue. Architectural firms

identical in all other respects will have significantly different rates if one specializes in residential condominiums and the other specializes in office buildings.

Residential projects tend to be the most hazardous, condominiums in particular. Underwriters consider office and retail building design to be the least hazardous.

Preferred

- Office, Warehouse, Industrial
- Retail, Shopping Centers
- Restaurants
- Utilities

High Risk

- Condominiums, Residential
- High Rise (over 15 stories)
- Correctional Institutions
- Mines, Quarries, Tunnels
- Sports Facilities, Convention Centers, Theaters, Amusement Parks
- Bridges, Trestles

Period Under Review

Most applications ask for the percentage of your firm's gross receipts attributable to projects during the last complete year. This is the information that should be used.

Type of Client

Some clients are more litigious than others. Developers, for example, tend to bring more suits against their design professionals than do public owners. Foreign projects also pose underwriting issues that need to be considered.

Project Delivery Methods

Underwriters typically want to know if you're providing your services in the traditional design-bid-build fashion, through designer led design-build, or other methods. They ask about fast-track projects, turnkey projects, and some want to know about construction management work.

From an underwriter's perspective, design-bid and design-build projects have similar underwriting exposures. However, fast-track projects tend to create high liability. The insurance industry's definition of "fast-track" is a project in which construc-

Application (continued from page 4)

tion begins before all of the design professional's drawings and specifications are complete. Turnkey projects also have greater exposures than a typical design-bid or design-build project.

Construction Management is a term that many in the insurance industry do not understand. For the purpose of professional liability, most AE underwriters will insure Construction Management – Advisory but will not insure Construction Management – At Risk.

In other words, if a firm is representing the owner in an advisory capacity, underwriters will consider insuring the exposure. However, if the firm assumes direct responsibility for means, methods or sequences (“at risk”), they will not. Means, methods and sequences have traditionally been the general contractor's responsibility.

(Note: Contractors Professional Liability underwriters will insure CM — At Risk.)

Business Practices

Underwriters want to know how well you run your business, and the series of questions in this section are designed to determine that. They will want to know if you have:

- A written quality control manual
- Procedures for reviewing all client and subcontract agreements
- Whether or not you use specification checklists
- Procedural or technical manuals for in-house and field personnel
- Continuing education and training programs

They also want to know how you contract for your services. Firms are better risks if they use a standard contract (assuming it's correctly written). Client-generated contract agreements are much riskier. If your firm must sign them, explain the steps your firm takes to review such forms to make certain they are acceptable.

Underwriters prefer that firms use professional association contract forms. Note that in every case these forms should be tailored to the specific project.

Underwriters do not like client purchase order forms. These are usually written for contractors and contain uninsurable warranty, insurance and indemnity provisions. Underwriters also frown upon verbal agreements. Although they may be legal in

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some states, such agreements tend to be convenient but detrimental to the design firm if there is litigation.

Loss History

All insurance companies want information about your loss history. Most companies ask for the last five years, while some ask for the last ten. Every claim will require a supplemental claim form. Include as much detail as you can in these areas, and pay particular attention to the question that asks, “*What has the firm done to avoid a similar claim in the future?*”

In the loss history section you'll be asked, “*Is any member the firm aware of a circumstance which may arise to a claim?*” This question is critical. Your professional liability coverage renews every year. It is conceivable that a potential claim from one year could result in an actual claim the following year.

Even if you renew with the same insurance company, that company could deny coverage if you did not report the potential claim. Remember that an application is warranted to the policy, and if you indicated that you were not aware of any potential claims, this would be considered a material misrepresentation.

Prior to renewal each year, contact your key personnel to make certain they're not aware of any claims or circumstances that have not yet been reported. If you have any questions as to whether or not a certain circumstance requires notice, you should discuss it with your insurance broker. Take note of the following red flags:

- Has the firm been asked to correct a problem on a project?

Application (continued on page 6)

Application (continued from page 5)

- Has the firm specified a product or procedure that is now known to be defective or unfit for its designated purpose?
- Has any member of the firm given a statement, deposition, or testified in a proceeding other than as an expert witness relative to any problems on one of the firm's own projects?
- Is the firm aware of any unresolved construction problems, delays, or change orders?
- Has the firm made any goodwill payment or waived any fees to avoid a problem?
- Has a client stopped paying you?
- Has a client stopped talking to you?

Prior Insurance Information

Assuming yours is a new application, underwriters want to know who you have been insured with before. They are interested in prior limits of liability, deductible, and premiums as well as the previous retroactive date. Although most underwriters will honor a previous retroactive date, you should make sure of this before changing insurance companies.

Quotation Options

This allows you to select the limits and deductibles you are interested in as well as any possible defense-sharing endorsements, such as dollar one defense or shared expense.

We recommend that you always obtain quotes for higher limits of coverage. It is not uncommon during the year to be asked for higher limits by your clients, and having these limits previously quoted simplifies the process of determining that cost.

Additional Information

Underwriters will often want to review additional information about your firm such as:

- **Resumes for Principals, Partners and Officers** - Underwriters compare areas of experience to those services and projects that generate a firm's fees, and identify any significant deviations. Resumes can also determine whether the principals have the appropriate licenses or registrations required by the state.
- **A List of Your Firm's Ten Largest Projects** - This gives underwriters an idea of what type of

work you do, and might raise additional questions you'll need to answer. For example, if you indicate that your firm has done no residential work, but one of its largest projects was a high-rise condominium, a red flag would go up.

- **A Copy of Your Firm's Standard Contract Form and Sub-Consultant Form** - Your contracts are critical. Underwriters want to know that your in-house contracts are appropriately written to provide your firm with necessary contractual protections.
- **Brochures Describing Your Firm's Services** - Underwriters look carefully at a firm's brochures and Web sites. We had one firm who had never done a condominium project, but indicated on its Web site that this was an area of practice in which it was proficient.

Although the firm had never before performed that type of work, it had the experience on staff to do it, and did not want to exclude potential projects of that type. Unfortunately condominium projects are very high risk, and it raised a huge red flag with the underwriters who audited the Web site.

It is sound risk management to periodically review your Web site and brochures to make certain they don't misrepresent the capabilities of and activities performed by your firm.

Conclusion

There is no substitute for a thoroughly completed professional liability application. It not only materially affects what you pay for your insurance program, but also serves as a self-audit of your business risk management procedures.

There is also no substitute for the expertise of a specialized insurance broker who can help you understand the application and assist you in completing it correctly by most favorably reflecting the positive attributes of your firm. ✨

Jeff Cavnac, President and Principal of Cavnac & Associates, heads the Agency's Professional Liability Department

Disclaimer: This article is written from an insurance perspective and is meant to be used for informational purposes only. It is not the intent of this article to provide legal advice, or advice for any specific fact, situation or circumstance. Contact legal counsel for specific advice.

Fleet Safety

Employer Pull Notice (EPN) Program

By Stuart Nakutin, PHR, AIC, WCCP, CPDM

There are many tools available to help you manage your Total Cost of Risk. One of these is an Employer Pull Notice (EPN) Program.

The Employer Pull Notice (EPN) Program allows your organization to monitor the driver's license records of employees who drive on your organization's behalf. This monitoring accomplishes the following:

- Improves public safety
- Determines if each driver has a valid drivers license
- Reveals problem drivers or driving behavior
- Helps to minimize your liability

Prospective Hires

The employer of a prospective driver is required to obtain a copy of the driver record showing the driver's current public record. If hired, the driver record is to be reviewed, signed, and dated by the employer and maintained at the employer's place of business until the employer enrolls the driver in the EPN Program.

EPN Action Reports

The EPN Program automatically generate a driver record to you when any of the following actions/activities occurs:

1. Upon enrollment of driver in the EPN Program.
2. Annually from the date of enrollment or 12 months from the last action/activity printout.
3. When a driver has any of the following actions/activities added to his/her driver record:
 - Convictions
 - Failures to Appear
 - Accidents
 - Driver License Suspensions or Revocations
 - Any other actions taken against the driving privilege

Driver Record

A driver record, also referred to as a DL print-out, MVR, or ISD 414R, contains information obtained from an individual's driver license application, abstracts of convictions and accidents. (CVC) Section 1808 describes this information as open to public inspection.

A driver record will be generated and mailed automatically to the employer for newly enrolled drivers, upon action/activity or annually for currently enrolled drivers. An employer may also re-

EPN Program (continued on page 8)

2005 Training Sessions

To be held in the Cavnac Training Room

Bank of America Plaza, 450 B Street, 18th Floor
San Diego, CA California 92101-8005

- **Sexual Harassment Training (AB 1825 Compliant)**
Friday, August 5th, 9:00—11:00 AM
- **Workers Compensation Claims Management**
Friday, September 16th, 9:00—11:00 AM
- **Personal Protective Equipment, and Post-Accident Response Training**
Friday, September 30th, 9:00—11:00 AM
- **How to Bullet-Proof Your Workers Compensation Audit**
Friday, October 7th, 9:00—11:00 AM
- **Sexual Harassment Training (AB1825 Compliant)**
Friday, October 21st, 9:00—11:00 AM
- **Injury & Illness Prevention Program (IIPP): How to Set Up an Effective Training Program**
Friday, November 4th, 9:00—11:00 AM
- **Fleet Safety**
Friday, December 2nd, 9:00—11:00 AM

All training sessions available to our clients

Seating is limited!

Contact **EILEEN JOLLY** by e-mail at ejolly@cavnac.com or by phone at **619-744-0551** for information about upcoming training sessions. ✨

EPN Program *(continued from page 7)*

quest a copy of a driver record for a prospective hire or casual driver.

Required to Enroll

Employers must enroll any driver employed for the operation of any vehicle if the driver is required to have any of the following:

1. Class A (formerly known as Class 1) license.
2. Class B (formerly known as Class 2) license.
3. Class C (formerly known as Class 3) license with Hazardous Materials Endorsement.
4. Class C (formerly known as Class 3) license with Special Certificates, issued pursuant to CVC Sections 2512, 12517, 12519, 12520, 12523, or 12523.5.
5. Any driver of a passenger vehicle having a seating capacity of not more than 10 persons, including the driver, operated for compensation by a charter-party carrier of passengers.
6. Passenger stage corporation with a certificate of public convenience and necessity or permit issued by PUC.
7. In addition, if any of the following individuals drive any vehicle requiring a license or certificate described above, they must be enrolled in the EPN Program as a driver:
 - Owners who own, lease or otherwise operate more than one motor unit or more than three towed vehicles
 - Owner/operators who have partners
 - Family members and volunteer drivers

Employer Responsibility

In order for the EPN Program to maintain accurate record information, it is imperative that the employer notify the department in a timely manner whenever changes occur to their EPN account. Such changes include:

- Termination of enrolled drivers pursuant to CVC Section 1808.1(d)
- Address changes (mailing and physical)
- Change of ownership (corporate officers, partners)

- Employment changes (new driver, termination of drivers)
- Change of Federal Employer Identification Number (FEIN)
- Change of telephone number
- Close of business
- Mergers
- Sale of business
- Company name change
- Account contact person change

Security Requirements

The following guidelines will assist EPN account holders in complying with security requirements for the Department's record information:

1. DMV information may only be used for the purpose for which it was approved by the department. It may not be combined with any other information.
2. DMV information must be destroyed when it is no longer needed for the reason for which it was originally requested. The method of destruction must be in a manner that it cannot be reproduced or identified in any physical or electronic form.
3. Security measures must be in place to prevent unauthorized access to any DMV data.
4. Requester codes (<http://www.dmv.ca.gov/vehindustry/ept/epngeninfo.htm>) are confidential and must be protected from unauthorized use or disclosure.
5. An EPN contact person should be appointed and placed in charge of maintaining the security of Department record information.
6. Any changes in information contained in your application/contract (INF 1105) (<http://www.dmv.ca.gov/vehindustry/ept/epnformlist.htm>) must be made to the department within 10 days of the occurrence (<http://www.dmv.ca.gov/forms/ept/inf4.pdf>).

The fees at this time are \$5 per driver for enrollment and \$1 for every printout generated after the initial one. Printouts are generated once every 12 months or when there is a negative activity on the driving record. ✂

Stuart Nakutin is the Director of Claims, Loss Control and Human Resources for Cavignac & Associates.