

# PROTECTION FOR TECH PROS:

Insurance to Help Your IT Business Thrive



## » Protection for Tech Pros: Insurance to Help Your IT Business Thrive

Working as an IT consultant or independent contractor, it may seem like you're on your own, but the truth is you're in good company. Micro businesses (i.e., those with fewer than 10 employees) have grown more rapidly than any other type of business in recent years, and the number of self-employed professionals in the U.S. has grown tenfold since 1980.

But it's true that micro businesses, independent contractors, and consultants are on their own in another sense. Because of your small size, you don't have the financial resources to absorb heavy losses from property damage, lawsuits, or other liabilities. What's more, small businesses pay out a disproportionate amount of the nation's lawsuit costs. According to a 2010 publication from the [Chamber of Commerce's Institute for Legal Reform](#), "small businesses bore 81% of business tort liability costs but took in only 22% of revenue." In other words, you're more likely than bigger businesses to be involved in a lawsuit, and less likely to win one.



You also don't have a team of experts helping you make decisions about your financial planning. Much of your business you've had to figure out on the fly. That's both the thrill and headache of being a small-business owner.

If you're reading this, you're considering buying insurance, but finding the right coverage on your own can be difficult. There's a whole new world of terminology to learn and dozens of policy options. You might be unsure what makes sense for your business.

We've written this guide to explain how business insurance and risk management strategies can help your IT or technology business maintain revenue, avoid disaster, and survive long into the future.

### This guide covers...

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<sup>1</sup> U.S. Chamber Institute for Legal Reform, "Tort Liability Costs for Small Businesses." Last modified 07 2010. Accessed September 5, 2013. <sup>2</sup> Ibid.

## » What is IT Business Insurance?

As a small business, you probably don't have the financial resources to cover huge, sudden expenses from things like office fires, lawsuits, professional mistakes, and other liabilities. That's where business insurance comes in. Business insurance works on a simple principle: for a guaranteed, small cost in the present, you can avoid a bigger, unpredictable cost in the future. It works based on four key components:

- ▶ **Premium.** This is the present cost you pay the insurance company. Premiums can be paid yearly, monthly, or at other intervals.
- ▶ **Claim.** After a fire, theft, lawsuit, or other covered event, businesses file a "claim" with their insurance provider in order to receive money for the cost of these expenses.
- ▶ **Deductible.** Deductibles for business insurance work the same way they do for your medical or dental insurance. A deductible is the amount that you must pay before your insurance company will start to pay benefits. In other words, a Property Insurance policy may have a \$500 deductible, which means you'll pay out of pocket for property damage expenses that cost less than \$500. Once your claims exceed \$500, your insurance policy will pay.
- ▶ **Policy limit.** All policies have limits, usually a per-claim limit and a total limit. In other words, the maximum amount your insurance will pay for a single claim and for all claims during a policy's lifetime. A General Liability Insurance policy may have a \$1,000,000 per-incident liability limit and a \$2,000,000 aggregate limit, which means it will cover your expenses until the total cost of legal fees and other expenses reaches \$1,000,000 for a single claim or \$2,000,000 for all claims in a single policy period (typically one year).

There are many different types of business insurance, but at their core, they're all about one thing: cost certainty.

Between legal fees and other expenses, a lawsuit can run up a six- or seven-figure bill. Few sole proprietors have a bank account capable of absorbing that kind of loss – you simply can't budget for lawsuits.

But you can budget for insurance. Compared to a lawsuit, premiums are a much smaller expense, one you can fit into your budget. Each year, you know how much your insurance will cost, which allows you to plan. Plus, you know that when a lawsuit does happen, your insurance will cover it. And that could make the difference between continuing to grow your business and filing for bankruptcy.

Keep reading for a breakdown of your coverage options.



81%

**Small businesses**  
bear 81% of tort  
liability costs.

## » Which Policies Should a Small IT Business Consider?

As a small-business owner, you have a limited budget, so it's important to know which policies are most essential for the risks you face.

This section outlines the various policies you'll want to consider. While you may not be able to purchase them all right now, this section explains what each policy covers (and what it doesn't) so you can decide which policies to buy first.

- ▶ **General Liability Insurance**
- ▶ **Property Insurance**
- ▶ **Property Insurance for home-based businesses**
- ▶ **Business Owner's Policy**
- ▶ **Cyber Liability Insurance**
- ▶ **Errors and Omissions Insurance**
- ▶ **Fidelity Bonds**
- ▶ **Workers' Compensation Insurance**



### General Liability Insurance Helps Small IT Businesses Win New Clients

If you're hired as a consultant, your client contract will likely require you to carry **General Liability Insurance (GL)**. In fact, **many clients won't sign a contract until you can prove you have an active GL policy.**

Insurance terminology can get confusing, but one trick to help you make sense of everything is to know that when you hear the word "liability," you're really talking about lawsuits. "Liability" is legal lingo for "responsibility:" a business's responsibility to fix a problem it created or to pay financial restitution after causing injury or financial loss.

Liabilities come in different categories. In insurance, your general liabilities are those regarding...

- ▶ Property damage to third parties.
- ▶ Bodily injury to third parties.
- ▶ Reputational damage to third parties.

Who counts as a third party? Anyone besides your insurance provider and people employed by your company.

Here's an example of what General Liability Insurance can cover: you're working at a client's office, wiring new hardware. As you run cable above the ceiling, you accidentally damage the ceiling and your client demands that you pay for what turn out to be very expensive repairs.

When the client sues you for replacement costs, your GL kicks in to cover the costs, including...

- ▶ Lawyer's expenses.
- ▶ Costs for witnesses.
- ▶ Damages paid to the injured party (through a settlement or judgment).

GL also covers injuries you may cause to clients, vendors, or other people you interact with who aren't part of your business. For instance, if a client is injured after tripping over the network cable you're installing, they could sue your business.

As an IT professional, you're often working on other people's property and the contracts you sign may specify that you need General Liability Insurance in order to cover accidents at those location. It's important to note, though, that GLI will typically not pay for damage you may cause to clients' computer hardware or other devices while they're in your possession or while you're working on them. For that you need Property Insurance.

Property Insurance: Protect Your Equipment, Gear, and Office Space and Clients' Property in Your Care.

Commercial Property Insurance helps your business recover from a sudden loss of property caused by...

- ▶ Fire.
- ▶ Theft.
- ▶ Certain weather events.
- ▶ Vandalism.

You're probably familiar with personal Property Insurance (i.e., Homeowner's or Renter's Insurance). Commercial Property Insurance works in much the same way. If your property is stolen or damaged by a covered event, your insurance carrier can reimburse you for the lost property and help you pay for repairs, debris removal, or other costs associated with getting your business up and running.

If you own your building, Property Insurance can cover your premises and other property. If you rent, Property Insurance can cover your gear and equipment, including...

- ▶ Tools.
- ▶ IT equipment, electronics, computers, tablets, etc.
- ▶ Supplies.
- ▶ Office equipment and furnishings

**(Work at home? See below.)**

If a fire starts in your office and sets off the sprinkler system, in the span of a few minutes your business could lose thousands of dollars' worth of electronics and thousands more in damage to your building. Here's how the claims process would work:

- ▶ You contact your insurance company to file a claim.
- ▶ You provide documentation of the disaster, including pictures of the damage.
- ▶ You get a quote from a repairman or shop around for new gear.
- ▶ The insurance company sends a claims adjuster to your property to verify the payout amount.
- ▶ You submit a final claim to your insurance company.
- ▶ Your insurance company sends you a check, which you use to fund repairs or replacements.



**Fact** Homeowner's Insurance does NOT protect your business property.

### Your Clients' Property

If you're like many independent IT contractors or consultants, you may not have much business property. But even if your "business assets" consist of a couple of laptops and a printer, Property Insurance is probably a good investment.

Why? Because while you're working on or handling your clients' property, you're responsible for any physical damage you cause, accidental or otherwise. For example, if you drop a server or monitor, you'll likely be expected to pay for the costs of repair or replacement.

When you are working on or handling your clients' computer equipment, you are responsible for any accidental physical damage you might cause. If you drop a server or damage a monitor you'll likely be expected to pay for the repair or replacement cost.



\$500

starting annual premium for a BOP

In fact, **any client property in your "care, custody, or control" can be covered under your Property Insurance.**

So even if your business property is minimal, coverage for your clients' property can easily justify the cost of a Property policy.

### Does a Home-Based IT Business Need Property Insurance?

This is a common insurance question, so we'll give you the common insurance answer: maybe. For a straightforward answer, check the language of your Homeowner's policy.

Many Homeowner's policies have explicit exclusions for commercial property (computers, equipment, tools, etc.). So if someone breaks into your house, smashes the back window, and steals your work laptop and electronics, your Homeowner's policy may not reimburse you. You would have to pay out of pocket to replace your computers.

How do you know if your policy covers your commercial property? Each policy is different, so you'll have to look at the language in your policy and / or talk to your insurance agent.

### Business Owner's Policy: Property + General Liability for Less

If your head's spinning from all the various policies, we've got good news. Here's one policy that can make your coverage simpler: the **Business Owner's Policy** (or BOP).

A lower-cost option, BOPs bundle three types of coverage...

- ▶ General Liability Insurance.
- ▶ Property Insurance.
- ▶ Business Interruption Insurance

Business Interruption Insurance is a coverage tacked onto Property policies. It can help you survive if you're forced to shut down by an event covered by your Property Insurance. For example: a storm or fire could damage your building to such an extent that you can't open for a few weeks. While ongoing repairs may force you to relocate or suspend operations, Business Interruption Insurance can pay for relocation costs and reimburse your IT business for the income it loses during a closure.

BOPs are tailored for small businesses and actually "reward" you for not having the higher liabilities your larger competitors do, giving you a lower premium on your insurance. Sometimes, it's nice to be the little guy.

In order to qualify, a small IT business must meet certain criteria, which often include....

- ▶ Having fewer than 100 employees.
- ▶ Operating in small business premises.
- ▶ Working in a lower-risk environment or workplace.
- ▶ Needing no more than a year's worth of Business Interruption Insurance.

Many independent contractors, IT consultants, and other small IT operations have no problem meeting these requirements and take advantage of the cost savings these policies offer.

### Cyber Liability Insurance: Financial Protection from Cyber Criminals

As an IT professional, you know the importance of protecting networks from cyber criminals – **Cyber Liability Insurance** (also called Cyber Risk Insurance or Data Breach Insurance) can cover your business's liabilities when its clients' computers are hacked.

That's right: if you work on a client's software, hardware, or network and then that client suffers a data breach, you could be held liable for the losses

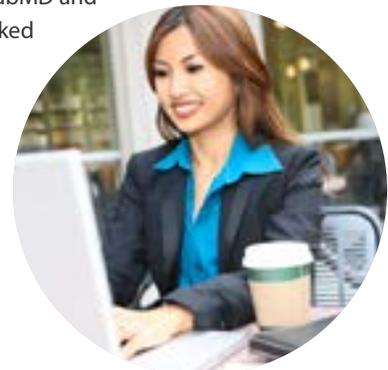
associated with the breach. Even if you primarily provide advice (say, you suggest a certain cloud storage platform for a client's backup data), you could be held financially and legally responsible if a program or tool you recommended enables a hack. Luckily, Cyber Liability Insurance prevents you from having to pay the associated costs out of pocket.

Most non-tech businesses purchase Cyber Liability Insurance with first-party coverage. This provides financial compensation when a hacker accesses their information through a data breach. As an IT business, though, you'll probably need the additional layer of protection of third-party defense and liability. Third-party Cyber Liability Insurance protects you when your clients' networks are hacked.

But first, let's go over first-party coverage. When a hacker breaches your security, client data, employee records, and other financial information could be compromised. When that happens, you're legally obligated to inform any affected parties and explain that they could be the victim of identity theft in the future.

#### HERE'S AN EXAMPLE.

In 2012, California police traced a series of identity thefts to a security breach at LabMD, a medical testing company with thousands of medical records, SSNs, and other private patient data. Amazingly, the stolen data was found in downloadable spreadsheets on P2P file sharing networks. (Read the full story, "[Medical Lab Allegedly Exposed Customer Info on P2P, Claims It Was the Victim](#)," from *ArsTechnica*). As a result of this security breach, the Federal Trade Commission has filed a petition against LabMD and the two are currently locked in legal proceedings, which could cost LabMD millions in fines, not to mention reputational damage.



Cyber Liability Insurance could have helped LabMD by paying the costs of...

- ▶ Crisis management (alerting clients, implementing new security measures, etc.).
- ▶ Additional personnel to help respond to the attack.
- ▶ Fraud and credit monitoring for its clients.
- ▶ Investigations into the causes of the attack.
- ▶ Public relations / advertising campaigns to repair its reputation.

So to summarize: First-party Cyber Liability Insurance covers the costs associated with data breaches to your company data.

Now let's take a look at how third-party Cyber Liability can protect you as an IT business owner.

Recently, the New York Times and Washington Post were hacked by a group of international hackers called the Syrian Electronic Army. What's significant is that these news sites were vulnerable not from their own website, but because of the third-party web service Outbrain, an advertising company that posts recommended links at the bottom of articles. The SEA was able to exploit security weaknesses at Outbrain to gain access to some of its clients' websites. (Read the full story, "[Washington Post, CNN Websites Disrupted by Hacker Groups](#)," from the [LA Times](#).)

While Outbrain itself wasn't affected by the breach, it could be held legally responsible because its services enabled the hack. So the two news sites could file claims on a first-party Cyber Liability Insurance policy, but if they didn't have such coverage, or if their limits were lower than the costs of the data breach, they could sue Outbrain for damages. In that case, Outbrain's third-party Cyber Liability coverage would kick in to pay the cost of the lawsuit.



So to summarize: Third-party Cyber Liability Insurance pays for lawsuits over a technology company's role in enabling or failing to prevent a cyber attack for one of its clients.

As an IT professional, much of the work you do exposes you to cyber liability. Whether you're writing custom software, installing networks for clients, or offering consulting services, you can be held responsible for security breaches that happen on your clients' computers, networks, and websites.

One of the difficult things about cyber liability lawsuits is that a judge or jury (not a team of IT professionals) gets to determine whether you're responsible for an incident. A judge or jury may not have expert-level knowledge of cyber security. This lack of expertise could lead them to hold you liable for something that your client could have prevented on their own.

### Errors and Omissions Insurance: Protection from Your Mistakes

Doctors have "malpractice" insurance – shouldn't there be a similar policy for IT businesses and other professions? There is. **Errors and Omissions Insurance** pays for lawsuits over professional liabilities (i.e., mistakes or oversights you make as part of your work).

For independent IT contractors, consultants, and sole proprietors, professional mistakes might include....

- ▶ Delivery of malfunctioning software or hardware.
- ▶ Omissions.
- ▶ Failure to perform a job.
- ▶ Failure to deliver the goods and services agreed to.
- ▶ Professional negligence.
- ▶ Incorrect advice.

In other words: E & O Insurance covers costs associated with mistakes, omissions, recommendations, and advice that cost your clients money.

Your professional liabilities are different from your general liabilities in one major way: general liabilities are things that go wrong that could happen in any industry. Professional liabilities are things that are unique to the work you do.

HERE ARE TWO EXAMPLES.

Let's say your IT consulting firm recommends that your client, a marketing firm, purchase the full suite of Adobe design products, which costs thousands of dollars. After a month of using them, the marketing firm realizes it only needs one of the more stripped-down applications and is frustrated that it purchased the whole package. The firm could sue your business for the recommendation, saying you incorrectly assessed its needs and wasted its money.

Or imagine you set up Microsoft Office for a publishing company. This is as standard as it gets – nearly everyone uses MS Office. However, this publishing company runs an academic press that relies on anonymous peer review. MS Word automatically lists a document's owner and anyone who edits it under the document properties. For months, the printing press thinks it is sending anonymous feedback back to its authors, only to find that your recommendation actually compromises its review process and damages its reputation in the academic community. Your business could be sued even for recommending something as simple as MS Office. A judge may rule that you should have done more to understand the intricacies of the software and the client's needs.



One more key consideration about E&O Insurance: Your clients may allege you've made professional mistakes even when you haven't – which is one reason it's vital to have Errors and Omissions coverage. An IT contractor can do everything correctly, dotting all the i's and crossing the t's – but still be sued by a dissatisfied customer. And even if a lawsuit against you is frivolous, your E&O coverage will kick in to cover the costs.

Policy check: many E&O policies include some Cyber Liability protection. To determine whether your E&O policy has this crucial coverage, ask your insurance agent.

### Important Notes about Errors and Omissions Insurance: Understanding Claims-Made Coverage

Here's something every IT contractor should know about E&O coverage: **the timing of a lawsuit can affect whether or not your Errors and Omissions Insurance covers it.**

Let's imagine you receive a court summons. You answer your office door and are a little startled when the person standing in front of you asks your name. After you respond, they serve you with a court summons and walk away. At your desk, you spread out the documents. You vaguely recall the work you did for the company that's suing you. You scan through old emails and the details start coming back. It becomes clear that the company is suing you for a malfunction in the software you installed five years ago, which it's apparently still running. The big question is, *does your E&O Insurance cover something that happened that long ago?*

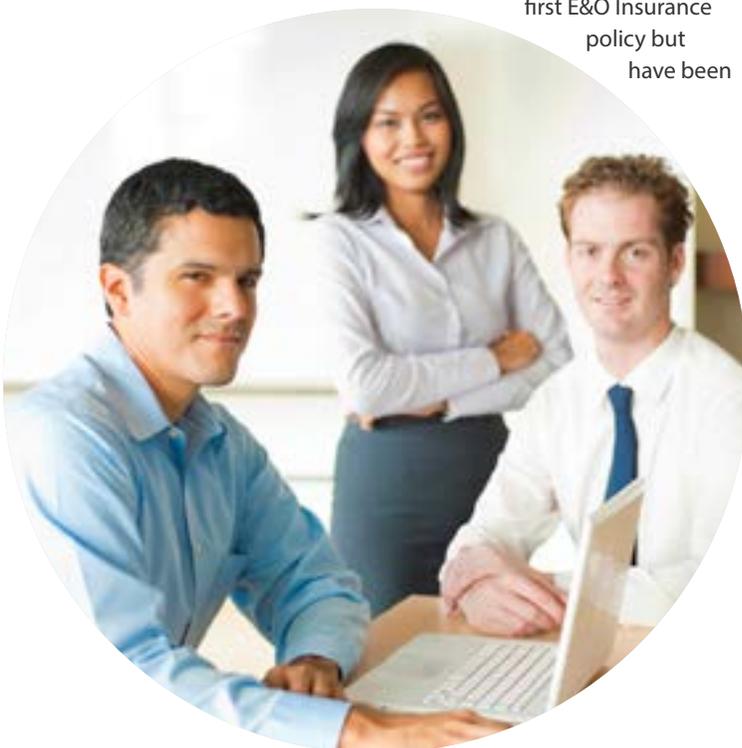
**E&O  
Fact**

**The timing of a lawsuit can affect whether or not your Errors & Omissions Insurance covers it.**

Lawsuits can materialize years after the event that triggered them. Typically, **E&O only covers events that happened after you started your policy and for claims that are filed while the policy in force** (this is called “claims-made” coverage). If you are sued today for something that happened years ago, your current coverage would only pay for the lawsuit if you started your policy before you delivered the work in question and you still have an active policy. In other words, your policy needs to have been active when you made the alleged mistake and still active, years later, when the lawsuit occurs.

What happens if you switch insurance carriers? Your new policy may not cover something that happened under your old one. But you can take steps to make sure you’re covered by mistakes you made in the past:

- ▶ **Stay with one provider during your business’s lifespan.** Because you can adjust your policy to meet your business’s changing needs, you can buy E&O coverage from one insurer and update it as you grow. If you keep a policy throughout the duration of your business’s life, you won’t have any gaps in coverage.
- ▶ **Buy Prior Acts Coverage.** If you switch policies, make sure your new policy has Prior Acts Coverage, which pays for lawsuits from events before you purchased that policy. If you’re purchasing your first E&O Insurance policy but have been



conducting business for a while, you can also purchase Prior Acts coverage to cover work you already completed.

- ▶ **Make sure to disclose required information.** If you buy a new policy (or switch policies), make sure you disclose all the required information. If you fail to tell your new insurer about an old client who might sue you, the insurance company may refuse to cover the lawsuit when it occurs.

### Fidelity Bond Insurance: Why Your Clients May Require This Coverage

For some jobs, your client may require you to have **Fidelity Bond** coverage (also called Employee Dishonesty Bond). Basically, this bond pays the client when an independent contractor is dishonest and steals money from them, including electronic funds transfer. From the client’s perspective, it’s an extra guarantee that the contractor they hire will be honest.

If you work with clients in the financial sector or do work that requires you to handle a client’s financial records, your contract may stipulate that you have Fidelity Bond Insurance.

Unlike many types of insurance, Fidelity Bonds provide coverage for intentionally wrongful acts like theft and fraud.

### Workers’ Compensation Insurance for IT Consultants

Depending on the size of your business and where in the country you operate, you may be required to purchase **Workers’ Compensation Insurance** (commonly shortened to Workers’ Comp or Workman’s Comp).

If you’re a sole proprietor, you don’t have to worry about Workers’ Comp until you hire an employee.

If you do have employees, most states require you to carry this coverage, which protects both you and the people who work for you. Here’s an example of how: you own a small app-designing business

and your one employee develops carpal tunnel syndrome. In this case, Workers' Comp can pay for the employee's medical expenses, carpal tunnel surgery, rehabilitation costs, and lost wages.

It can also cover your legal expenses. Even though the employee receives medical treatment, they could still sue, claiming you didn't do enough to prevent their injury. If that happens, a part of Workers' Comp called Employer's Liability Insurance pays for your legal defense and other lawsuit expenses.

Workers' Compensation Insurance covers a variety of workplace injuries and illnesses, even ones that are only peripherally related to work, like when an employee trips and falls at the office. You read that right – **you can be liable when an employee is injured at your office, even if they're not injured because of work.**

Workers' Comp Coverage includes payments for...

- ▶ Employee medical bills and rehabilitation costs.
- ▶ Wages an employee loses as a result of being unable to work.
- ▶ Disability expenses.
- ▶ Legal costs for employers sued by their employees after an accident or illness.

### How Do You Meet the Insurance Requirements in Your Contracts?

Many contracts explicitly require a certain amount of business insurance. When that happens you may be required to purchase a policy or expand your current coverage. Here are three scenarios you could face...

- ▶ **You're required to purchase coverage in order to get a contract.** This is a common scenario. A business wants to hire you for a six-month project, but before it will do so, you need to supply a **Certificate of Liability Insurance**. In situations like this, you may be asked to purchase General Liability Insurance, Errors and Omissions Insurance, or other policies. When this happens, **our agents** can send you insurance quotes and supply you with a Certificate of Insurance quickly to help you land the job.

- ▶ **You are required to purchase more E&O coverage.** Let's say you already have E&O Insurance with a \$100,000 limit, which you purchased in order to sign a contract with your last employer. Now you're on the cusp of signing a new contract, but your prospective employer requires you to have E&O coverage for up to \$2,000,000. Each business sets its own requirements, so you may have to purchase more coverage from time to time. If that happens, simply talk with your insurance agent about adding coverage to your existing policy.

- ▶ **The contract doesn't require insurance.** Your prospective employer may not mention insurance at all in your contract. But that doesn't mean you aren't liable. You can still be sued. The only protection from lawsuits you'll have are the policies that you chose to carry.

Find out which policies will satisfy your contract requirements: Use our Contract Decoder to translate contract lingo into insurance requirements.

### Who is Responsible for Subcontractor Insurance?

As a sole proprietor or the owner of a small business, you may find you need additional help from time to time. IT staffing agencies are a great place to turn for temporary or contract workers, but those workers bring with them additional risks you should consider.



Insurance for IT subcontractors can get complicated because so many parties are involved...

- ▶ The subcontractor.
- ▶ You, the business that hires them.
- ▶ The IT staffing firm that connects the contractor to their employer.
- ▶ The client(s) whose projects the subcontractor will be working on.

In some cases, your business insurance may cover independent contractors you hire. For instance, your E&O Coverage may insure any professional mistakes independent contractors make, or your Workers' Comp may cover any workplace injuries involving them. But in most cases independent contractors don't have direct coverage under your policies. They can still be sued and be held responsible for their own defense.

Other times, the staffing firm you use to hire contractors may offer partial coverage. But most often, they won't provide coverage, either.

This brings up an important question: **are you responsible for an independent contractor's insurance?**

To make this clearer, let's go over the basic underlying question: How is an independent contractor different from an employee? You probably know the basic answers to this question. Businesses don't have to offer independent contractors the same benefits they offer full-time employees. Generally speaking, independent contractors don't get health insurance and other benefits, and are only hired for a particular task or body of work, after

which the company has no responsibility to keep the contractor. The other benefit you get by using independent contractors is that you don't have to pay payroll taxes on their wages.

In order for businesses to qualify for the benefits of using independent contractors (i.e., not having to offer health insurance or pay certain taxes), they can't treat them as employees. We said before that your insurance may cover contractors, but if you give them too much coverage, you actually run the risk of treating them too much like employees. This can have huge tax ramifications. If you extend too many benefits to an independent contractor, the IRS or other government agency may reclassify the independent contractor as an employee and force you to pay additional benefits and taxes.

In other words, if you hire an independent contractor and cover them under your insurance, you could accidentally end up having to pay thousands more in taxes. This puts you in a sticky situation. On the one hand, you want your contractors to be covered. If they make a mistake, you could be liable for it. On the other hand, you can't cover them without exposing your business to financial / tax risk.

So what does this mean for you, insurance-wise? Here are your options...

- ▶ Require contractors to purchase their own insurance.
- ▶ Talk with your insurance agent about adding a contractor as an "additional insured" to your policy. Your agent should be able to advise you about whether you could face a "reclassification" risk if you offer this coverage to a contractor.
- ▶ Only hire independent contractors from staffing firms that provide insurance coverage.

As we said earlier, the situation is complicated because there are so many parties involved. When you sign a contract with another business, they often require a certain amount of insurance coverage (as we saw in the previous section). That makes things tricky. If the other business requires \$1,000,000 in E&O coverage, you'll have to have that much



coverage for yourself, but you'll also need to make sure that your independent contractors meet those requirements. They'll have to show you their proof of insurance demonstrating \$1,000,000 in E&O Insurance.

One way to simplify this is to only hire from IT staffing firms that carry insurance coverage for their contractors. You may not have that luxury, but if it's available, you should use it.

The takeaway: **You can be held liable for the work done by independent contractors you hire.**

## » When Should I Purchase Insurance?

We started this guide noting that you may have to prioritize your coverage needs based on your budget. One thing to keep in mind is that your insurance needs will change as your business does. Here are some common scenarios that could affect your insurance needs.

- ▶ **You business grows.** As your sales expand and you start to work with more clients, your liabilities also expand. Some policies, like Business Interruption Insurance, are tied to your business's income. If your income increases, you may need to adjust your coverage. Other policies, including Errors and Omissions Insurance, are tied to the amount and type of work you do. New clients and higher-stakes jobs mean that a lawsuit could be more expensive now than when you first purchased E&O Insurance. You may need to bolster your coverage.
- ▶ **You hire new employees.** Workers' Compensation Insurance and other policies may be tied to the number of employees you have. Hiring your first employee typically means you'll need to invest in a WC policy.
- ▶ **You sign a new contract.** Many contracts include language requiring you to have a certain amount Errors and Omissions Insurance, General Liability, or Property Insurance.

### ▶ **You expand or change your services.**

Naturally, changing what you do will change your coverage needs. If your business expands to include more driving, you may need to purchase Commercial Auto Insurance / Hired and Non-Owned Auto coverage (which can be purchased as an endorsement to a General Liability Insurance policy). If you start to work with clients who have a lot of sensitive data, a Cyber Liability Insurance policy could be vital to protecting your business.

### ▶ **You purchase new equipment or other property.**

If your business moves to a new office or purchases new computers, it may need to change its property insurance to reflect its new property. Many big-ticket pieces of equipment and tools must be listed out in a schedule with your Property Insurance (usually this is for property worth more than \$1,000, like computers).

You may be wondering, *How do I change or expand my insurance?* For many policies, you can simply talk with your insurance agent and they'll be able to increase your coverage. Naturally, for increased coverage, you'll have to pay increased premiums. Luckily, our insurance agents can send you a Certificate of Insurance quickly to reflect your new coverage so you can sign new contracts.



## » How Do Contracts Protect Your Business?

In a perfect world, you'd have the budget to hire a lawyer any time you signed a new contract. Your lawyer would vet the agreement, looking for potential pitfalls and adding language to protect you from lawsuits. While that would be nice, we know it's not practical for most sole proprietors.

So what can you do? Here are six tips on how to use contracts more effectively.

► **1. Be explicit about the work you offer. Include a detailed exhibit at the end of the contract.**

You should be using contracts for all projects you work on. In these contracts, make sure you list the services you will provide. A simple way to do this is to add an "exhibit" at the end of the document, which is an appendix tacked on an agreement to explain in detail what your work will entail. Remember, being specific in your language will help prevent miscommunications that could lead to lawsuits or payment disagreements.

► **2. Have a lawyer write a boilerplate contract you can use for many different agreements.**

Another way to prevent lawsuits is to meet with a lawyer and ask them to draft a "boilerplate" agreement that you can use as a template for your contracts. Paying a lawyer once may be smarter than paying a lawyer every time to review your contract. It will cost a little bit of money, of course, but it's better to spend that now than to pay for a lawsuit later. (You can save even more time and money by starting with one of TechInsurance's [free sample contracts](#), sponsored by [ContractEdge](#)).

► **3. Know what to add to a contract to protect yourself.**

When you contract with a much larger business, it's often standard for them to provide the contract. While this saves you time and money, they may expect you to sign without making any changes.

As an independent contractor, you're in a difficult position here. While you may want to suggest changes to their contract, you don't want to push back against a new client. At the same time, you need to make sure the contract doesn't include language that could potentially harm your business down the road.

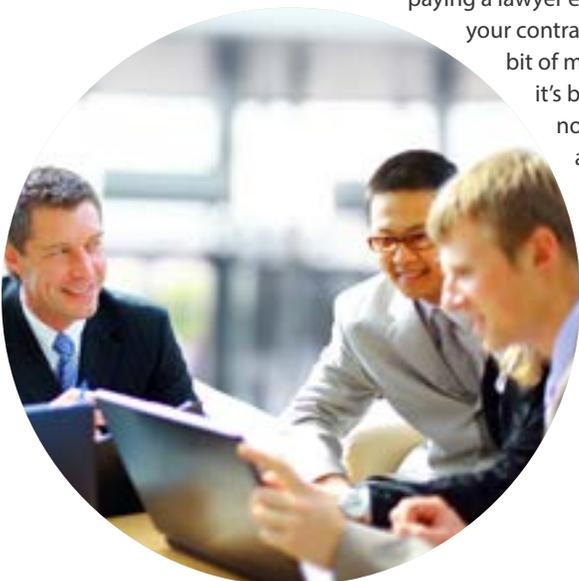
Again, though taking these contracts to a lawyer would be ideal, it's often not feasible. You may ask a lawyer to walk you through one, and ask them what kinds of things you should be looking for in the indemnification sections of the contract ("indemnification," like "liability," means your responsibility to pay someone for damage or injury you've caused). These sections can determine how much you'd have to pay if you lost a lawsuit. Any large, long-term contracts should be vetted by a lawyer, because the stakes are high and you accept a lot of risk when you dedicate that much time to a project.

► **4. Add language capping your damages.**

One standard way to protect your business is to put a cap on the amount of damages you could be liable for. In the indemnification sections, many independent contractors include language to specify that they cannot be held liable for damages greater than the fee for their services. For example, if you're getting paid \$10,000 for a project, your contract may stipulate that you can only be sued for \$10,000 worth of damages.

► **5. Add language to protect you from having to pay for lost profits.**

Developers and IT consultants may also want to include contract language that limits their liabilities for lost profits a client may suffer. If a client feels that your software or website caused a decrease in their sales, they could hold you responsible. In the book "Legal Guide to Web & Software Development,"



Stephen Fishman argues you should include language to the effect of...

*"In no event shall Developer be liable to Client for lost profits of Client, or special consequential damages, even if Developer has been advised of the possibility of such damages."*

Translation: *you can't file a lawsuit against me claiming my work caused you to lose money.*

► **6. Know which contracts to use when.**

You may also need to use contracts for other situations. Meeting with prospective business partners or investors, you'll want them to sign a Non-Disclosure Agreement (here's a free [sample NDA](#), sponsored by [ContractEdge.com](#), that you can adapt for your business).

If you're a web developer, you may need to post User Agreements on your website. Here are a [free sample Privacy Policy](#) and [Terms of Use Agreement](#).

### Protect Your Business from Financial Loss by Breaking Your Work into Segments

Sometimes it may seem that your business is living from contract to contract, but that's the nature of the work you do as an independent contractor or IT consultant. In addition to causing stress, the ups and downs of your workflow can cause cash flow turbulence. One way to avoid running short on cash is to segment your work. (We'll talk about cash flow problems in more detail in a later section.)

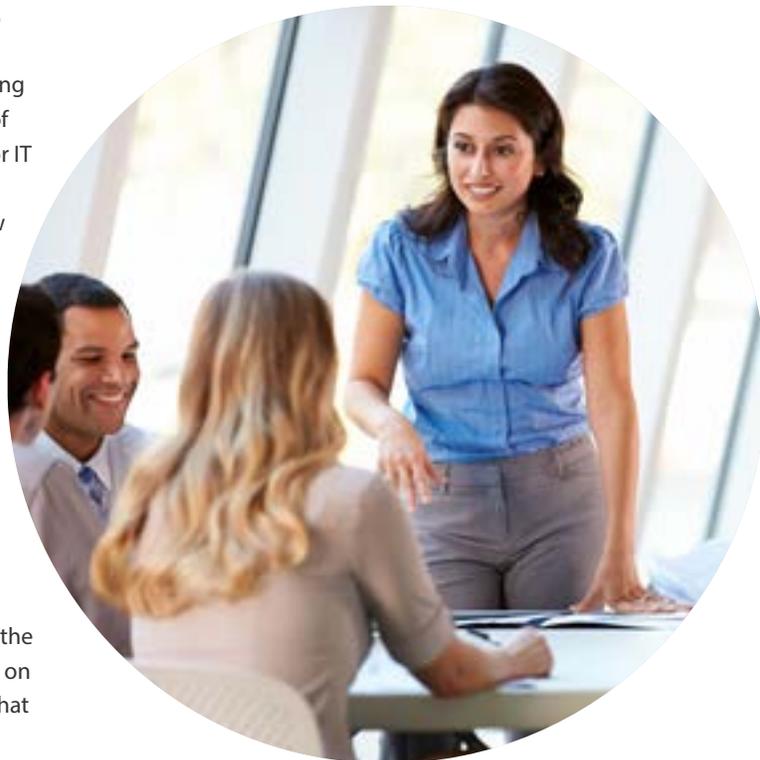
If you're about to take on a big contract, consider creating a payment / deliverables schedule. Let's say you have a two-month project, for which you'll be overhauling a client's email system, installing new security software, and setting up new computers for their office. Rather than accepting a lump sum at the end of the job, split your fee into biweekly payments based on certain milestones. For instance, you might say that

after two weeks, you'll have the new email system operational, after which you'll receive one-fourth of the payment.

Segmenting your work will help keep your bank accounts more stable. Clients may be amenable because they can see a schedule of your work and know what they're getting and when. In addition, they may be more likely to make timely payments in smaller chunks.

The second benefit segmenting offers is that you'll protect yourself from clients who are unable to pay for your services.

Naturally, not all contracts can be segmented this way. If you're writing code for a client, it might not make sense to break your work into chunks. The program won't work until it's finished and having to show prototypes to your client may be more of a headache than it's worth.



### Who Owns the Code: Client or Developer?

If you're a programmer, as you negotiate contracts, you should ask yourself whether there are parts of your code that you use frequently or would like to use again in the future. Some contracts will specify that a client owns the code a developer writes for their business. In other contracts, the developer will retain ownership. But many contracts don't include this language at all.

Why should this matter? Here's what could happen: a web developer gives a pet store's website a complete makeover. The site works great and draws new business. Everything's great until a second pet store contacts the developer asking them to renovate its website and online marketplace.

The web developer faces a bit of a conundrum. If they didn't specify that they retained ownership of their code, it's unclear whether they can reuse it. If their original client sees the competitor's website has some of the same characteristics as its own, it could sue the developer.

For this reason, it's best to specify in your contracts that you'll retain the right to use your code for future projects.

### Limit Your Liabilities by Closing Contracts

As an independent contractor or IT service business, you may have administrative privileges and logins to a number of client networks. It's important to remember that by having this access, you expose your business to more liabilities. If a hacker breaks into your network, the last thing you want is for them to gain access to an old client's account.

In his article "[What to Disclaim at the End of a Consulting Contract](#)," Ken Hardin of [Tech-Republic.com](#) argues that you should always send a "close-out" email to your client after completing a job, telling them...

- ▶ What accounts you have access to.
- ▶ What data you have copies of.
- ▶ What administrative access you have.
- ▶ What shared cloud services you can access.

Once you share this info, tell them that it's "standard operating procedure" or "best practices" for them to remove your access, delete your accounts, etc. Inform them that you may delete any data you have downloaded.

The trick is to do this in a professional way, emphasizing the "standard" nature of your actions, so as not to appear unfriendly. When you finish contracts in this way – removing your access to the client's network – you'll reduce your liabilities. In addition, this may help you avoid situations where your clients are trying to get free services from you by asking you to "look at" ongoing problems they have that are unrelated to your original work.



**\$475K** = Average court costs for disputes over technology transactions

## » How Can Insurance Improve Cash Flow Problems for Small Businesses?

One of the biggest challenges for micro-business owners is managing their cash flow. Your work can be feast or famine. Jobs may pile up one week and fall off a cliff the next.

Because your work and income can fluctuate so much, unforeseen expenses pose a major threat to your business. In a piece called “[How to Prevent a Cash Flow Crisis](#),” the business data website [Dun and Bradstreet](#) estimates that 90 percent of small businesses fail because of a mismanagement of their income and expenses. Theoretically, small businesses should build up a “cash cushion” to help them pay for unexpected costs and make it through a month or two of low sales.

That’s a great strategy, and while it offers some protection for the normal ups and downs of a business, most small businesses don’t have adequate savings to cover lawsuits or property damage.

If a client refuses to make a payment and claims that your work was unsatisfactory, you might have enough savings to survive a few months without income, but you won’t have enough to settle an expensive Errors and Omissions lawsuit.

Paying for lawyers and other legal expenses can drain your bank account in a hurry and fill the time you would normally spend focusing on your business.

Having proper business insurance is one way of managing your cash flow. By covering all costs associated with a liability lawsuit (including court fees, lawyer’s fees, and settlements or judgments), business insurance can make those peaks and valleys less severe.

90%

of small business failures result from financial mismanagement



## » What Do the New ACA (Affordable Care Act) Laws Mean for Sole Proprietors and Small Businesses?

As of October 1, 2013, independent contractors and self-employed professionals are able to purchase healthcare coverage through online marketplaces set up by state governments. To find your online marketplace, visit <https://www.healthcare.gov/>.

Depending on your coverage needs, you may be able to find cheaper personal coverage through the state-run marketplaces. If you have employees and want to offer them insurance, you can visit the [small-business insurance section](#) of the website.

Here are a couple of the most important aspects of the new law:

- ▶ As a business owner, you won’t have to offer health care coverage if you have fewer than 50 employees.
- ▶ You will personally need to have health insurance in 2014, or you’ll have to pay a penalty (you’re allowed to have lapses in coverage, potentially up to three months, but will ultimately need to be covered).
- ▶ You’ll need to purchase coverage that meets minimum requirements. The lowest acceptable coverage plans are called “Bronze” plans. They cover at least 60% of the average person’s medical expenses.
- ▶ Depending on the size of your family and your income, you may qualify for a subsidy on your insurance (visit the [Kaiser Family Foundation’s subsidy calculator](#) for details).

## » How Can You Get Lower Rates on Small Business Liability Insurance?

By incorporating some of these practices, your business may be able to reduce its Errors and Omissions cost, General Liability Insurance premiums, or the cost of other policies.

► **Supply training manuals and other best-practices documentation to your insurance agent.**

You may qualify to reduce your Workers' Comp or Errors and Omissions costs by demonstrating to your insurance company that you follow safety protocol, use contracts with your clients, train your employees, or use other recommended practices.

► **Use strong contracts.** Insurance companies may offer E&O for less to businesses that use strong contracts with their clients. Limiting your liability exposure and taking some of the other steps outlined above will reduce the cost and likelihood of a potential lawsuit, which may help you qualify for a lower premium.

► **Have a clean insurance record.** If you have a history of General Liability or other claims, your business may have to pay more for its insurance. Maintaining strong relationships with clients, customers, and business partners can help prevent lawsuits now and prevent higher premiums in the future.

► **Join state safety programs.** You might be able to lower your Workers' Comp costs by participating in certain safety-training programs that your state runs.

► **Help employees get back to work as soon as possible.** The longer an injured employee is unable to work, the higher your Workers' Comp premiums will be in the long run. If an employee is injured, talk with them about returning to work in a modified or part-time role. An IT technician with a broken leg may not be able to work on in clients' offices, but they may be able to stay in your office in a support role.

► **Classify your employees according to their responsibilities.** When you apply for Workers' Comp, you'll list out your employees. When you do so, don't make the mistake of listing them all

as "IT employees" if some of them are support staff or have other roles. A secretary or clerical worker may have lower risks than someone who installs IT equipment. Listing them properly may help your business get lower rates.

## » What Factors Affect the Cost of Business Insurance?

Now that we've outlined how you can get lower rates, you may want to know the other factors that go into determining the cost of business insurance.

► **The number of employees / independent contractors you have.** The more people who work for you, the higher your liabilities for E&O, General Liability, and Workers' Comp Insurance.

► **The amount of sales your business does.** The more money your business takes in, the higher the stakes for a potential professional liability lawsuit.

► **The type of IT services you offer.** Do you work onsite at clients' offices? Do you travel around town for work? Around the country? Do you work with businesses that have a lot of sensitive data? Variations like this in the type of work you do can increase or decrease your premiums.

► **The state you operate in.** In addition to meeting different state requirements, your coverage will change in order to reflect your state's laws. According to the U.S. Small Business Administration, some states tend to award more damages for personal injury lawsuits.<sup>1</sup> If your state is more "lawsuit-friendly," you may have to pay a higher premium.

► **Your claims history.**

As you would expect, businesses that have filed insurance claims in the past usually have to pay a higher premium for coverage.



- ▶ The contracts you've signed. Your contracts and your work history will naturally affect your Errors and Omissions Insurance. If you purchase a policy with Prior Acts Coverage, your insurer will want to see your previous contracts and the kind of work you did in the past.

To get a better idea of how an insurance policy might look for your IT business, check out our [sample insurance quotes](#) page, which includes a [sample insurance quote for independent IT contractors](#).

## » How Should You Get Coverage: On Your Own or Through a Broker?

You have a few options for how to purchase insurance. You can purchase your coverage from...

- ▶ An insurance company.
- ▶ An insurance broker.

What's the difference? A broker works semi-independently and sells insurance policies on behalf of an insurance company or a group of insurance companies. While you may think that cutting out the middleman and going directly to an insurance company will save you money, that's not necessarily true.

Businesses like kayak.com and orbitz.com help consumers save money by being the middleman. Insurance brokers can work the same way.

A broker lays out your options, soliciting various plans from different top-rated insurance companies. Brokers let you compare policies and find one that fits your budget and your coverage needs. They can make the purchasing process easier and faster, and help you know you're finding coverage at a reasonable price.



Brokers are sometimes able to get lower premiums from insurance companies because they work with the same group of insurance companies every day, know their price points, and know how to find Errors and Omissions Insurance for less and ways to save on other policies. Many brokers are also adept at cutting unnecessary coverage and tailoring business insurance to match a small business's needs.

They're also familiar with the standard inclusions and exclusions in various carriers' policies and can help you determine which policy offers coverage for the kind of work you do.

Purchasing insurance directly from an insurance company is more labor-intensive. If you go this route, be sure to...

- ▶ Check the insurer's rating. Insurance companies work like banks, with ratings that measure their credit and financial standing. Each year, companies are rated on the long-term outlook of their financials and how likely they are to have money to pay customer claims. These ratings are done by **A.M. Best**. The top-rated companies all have "A" ratings. Here's the scale that they use:

### A.M. Best Ratings

SECURE	VULNERABLE
<b>A++, A+</b> (Superior)	<b>B, B-</b> (Fair)
<b>A, A-</b> (Excellent)	<b>C++, C+</b> (Marginal)
<b>B++, B+</b> (Good)	<b>C, C-</b> (Weak)
	<b>D</b> (Poor)
	<b>E</b> (Under Regulatory Supervision)
	<b>F</b> (In Liquidation)
	<b>S</b> (Suspended)

<http://www.ambest.com/ratings/guide.asp>

You'll want to know that the insurance company that you're purchasing E&O Insurance from will still be able to pay for a lawsuit in five years. Remember that your E&O Insurance is a long commitment, so it's important to know that the insurer is financially stable.

► **Soliciting quotes from various companies.** You can easily spend an entire day on the phone getting quotes from various companies. Each time you call an insurance company, you'll have to give them the same information about the size of your business, your contracts, your property, etc. And each time, you'll have to haggle with their representative to see if they can reduce the initial quote that they throw at you. (Note: if you work with an agent, they'll do this for you.)

► **Comparing quotes.** This is more complicated than it would seem because some insurance policies may offer different types of coverage and may structure their policies differently. You may find yourself asking questions like, "How does an open perils Property Insurance policy compare to a named perils policy?" For many small-business owners, these are exactly the kinds of questions they hate: complicated, nit-picky questions that depend on how fluent you are in legalese. Nonetheless, your coverage depends on these issues. Two property insurance policies could both "insure" your commercial property for \$100,000 worth of damage but offer completely different coverage. On your own, you may be less certain to know what you're getting.

## » What Isn't Covered by Business Insurance?

No insurance policy covers everything. Here are a few things standard insurance policies don't cover.

- **Natural disasters / floods.** A standard Property Insurance policy doesn't cover disasters and other major weather events, but you may be able to customize a policy to have coverage you want. Businesses frequently add "riders" to their policies to buy coverage for a specific type of property damage (e.g., hail damage or floods).
- **Auto accidents.** Standard General Liability policies cover injuries and property damage your business may cause, but they don't cover auto-related injuries and accidents (if this coverage is important, you can add auto coverage to a General Liability Insurance policy). This is especially significant because many Personal Auto policies don't cover you when you drive your car for work. If you get into an accident while driving to a client's workplace to oversee an installation, your Personal Auto Insurance might not cover your legal, medical, and auto damage expenses.

► **Intentional acts.** If you or an employee intentionally tries to damage property or harm someone, your insurance won't cover it.

► **Fraudulent acts or intentional errors.** Professionally Liability Insurance (E&O Insurance) won't cover any fraudulent or intentional mistakes your business makes. (However, Fidelity Bond coverage does cover fraud and theft in certain situations.)

► **Damage to a client's property stored or serviced at your office.** Let's say that a hard drive fails in a client's laptop. You take it back to your office to try to retrieve the data on it. What would happen if a fire burned down your office? Or a burglar broke in and stole some of your property, including the client's laptop?

In these situations, your Property Insurance would cover not only your property but also your client's property.

### The Risks of Starting and Stopping Coverage

Some small-business owners ask, "can't I just start and stop coverage as I need it?" The idea is that they could stop coverage when they don't expect to need protection and save some money. In the future, they could start coverage when they felt they needed it.

The problem with this is fairly obvious. No one can anticipate when they'll need coverage for a lawsuit. That would require you to see the future. If you could do that, you probably wouldn't be worried about insurance. You'd have cashed in a winning lottery ticket and would be drinking Mai-Tais on a beach in Bermuda.



It's a natural impulse to try to save money on business insurance, and that's why savvy business owners prioritize their policies and take advantage of risk management techniques to limit their exposure to the kind of situations that could cause a lawsuit.

Another problem with shutting off your insurance coverage to save money is that some policies require you to have continuous coverage. As we saw with Errors and Omissions Insurance, when a policy lapses, you can lose coverage for any and all professional errors you made in the past.

What's worse, most insurance companies take a negative view of businesses that start and stop coverage. If you cancel and restart policies over and over, you may have difficulty finding coverage when you need it.

## » The Takeaway: Essential Facts to Know about Business Insurance

Here's a summary of the important points to take away from this guide.

- ▶ **Some contracts will require you to purchase insurance.** Your clients may want protection in case your business makes a mistake. Clients may require you to have a certain amount of Errors and Omissions Insurance before they hire you.



- ▶ **You can and should modify contracts to cover your business.** You may be able to limit your liabilities and restrict potential lawsuits through the language in your contracts.
- ▶ **Independent contractors are generally not protected by their clients.** If you're hired as an independent contractor, your client or staffing firm may offer you some coverage, but chances are they won't. You'll need to have your own coverage and may need it to get certain contracts.
- ▶ **IT professionals need third-party Cyber Insurance.** Cyber Liability Insurance comes in different varieties, but at a minimum, IT professionals need third-party Defense and Liability coverage. This policy protects them from lawsuits when their clients' networks are hacked.
- ▶ **Micro businesses and independent contractors may not need to purchase Workers' Compensation Insurance – yet.** Workers' Comp requirements differ in each state, but if you are the only employee of your business, you probably don't need to purchase Workers' Comp Insurance. However, as your business grows and you hire employees, you may need to purchase it.
- ▶ **Risk management strategies can help prevent lawsuits and limit financial instability.** Closing out contracts, segmenting work, and performing other risk management strategies can help your business avoid lawsuits and other situations that cause severe financial loss.
- ▶ **As of January 1, 2014, you need to have personal healthcare coverage.** Because your business has fewer than 50 employees, you won't be required to offer your team health insurance, but you will need to get coverage for yourself in order to meet the new requirements under the Affordable Care Act. If you don't, you'll have to pay a fine.

If you'd like to receive a free insurance quote on your Errors and Omissions Insurance or other business insurance policies, contact one of our agents.

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## RESOURCES

Kaiser Family Foundation's healthcare subsidy calculator. [<http://kff.org/interactive/subsidy-calculator/>]

KFF infographic for personal and commercial requirements for Affordable Care Act requirements. [<http://jama.jamanetwork.com/article.aspx?articleid=1487506>]

A.M. Best's explanation of their insurance rating system. [<http://www.ambest.com/ratings/guide.asp>]



## » Contact Us

When you're ready for a fast, reliable quote for your small business insurance needs, give us a call or send us an email. Whether you have a question about our company or your coverage needs, **we're ready to help!**

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## » Products

- ▶ Business Owner's Policy
- ▶ Cyber Liability Insurance
- ▶ Employment Practices Liability Insurance
- ▶ Errors & Omissions Insurance
- ▶ General Liability Insurance
- ▶ Professional Liability Insurance
- ▶ Property Insurance
- ▶ Umbrella / Excess Liability Insurance
- ▶ Workers' Compensation Insurance

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