



Economic Impact Analysis Virginia Department of Planning and Budget

16 VAC 25-55 – Financial Responsibility of Boiler and Pressure Vessel Contract Fee Inspectors

Department of Labor and Industry

August 22, 2005

The Department of Planning and Budget (DPB) has analyzed the economic impact of this proposed regulation in accordance with Section 2.2-4007.G of the Administrative Process Act and Executive Order Number 21 (02). Section 2.2-4007.G requires that such economic impact analyses include, but need not be limited to, the projected number of businesses or other entities to whom the regulation would apply, the identity of any localities and types of businesses or other entities particularly affected, the projected number of persons and employment positions to be affected, the projected costs to affected businesses or entities to implement or comply with the regulation, and the impact on the use and value of private property. The analysis presented below represents DPB's best estimate of these economic impacts.

Summary of the Proposed Regulation

The Safety and Health Codes Board (board) proposes that contract fee inspectors be required to indemnify boiler and pressure vessel owners against losses resulting from negligent inspection or recommendation for certification.

Estimated Economic Impact

The General Assembly has mandated that contract fee inspectors:

“...maintain evidence of their financial responsibility, including compensation to third parties, for bodily injury and property damage resulting from, or directly related to, an inspector's negligent inspection of or recommendation for certification of a boiler or pressure vessel.”

In order to implement the General Assembly's mandate, the board has been authorized to promulgate appropriate regulation. The regulation that the board proposes enumerates acceptable

methods of ensuring fee inspector financial responsibility, sets time frames during which inspectors must provide proof of guaranty and sets minimum aggregate financial responsibility limits that vary in steps with the market share held by an inspector or inspection company.

Per legislative mandate, the proposed regulation allows contract fee inspectors leeway to choose an acceptable instrument of financial responsibility that best suits their needs. Contract fee inspectors may choose to obtain specific liability or errors and omissions insurance, a surety bond, bank guaranty or may choose to self insure by holding assets in an amount equal to their mandated minimum financial responsibility limit. They may also choose to meet their total responsibility limits by holding several instruments that together meet that limit. For instance, a contract fee inspector may partially self insure and cover the rest of his responsibility limit by purchasing a surety bond. Given that the number of contract fee inspectors is so small and that there is not a well developed market for insurance instruments to cover them in the case of negligent inspection, the proposed regulation will allow contract fee inspectors to minimize the cost of ensuring financial responsibility by choosing among these competing instruments.

Current contract fee inspectors will be required to provide proof that they have indemnified boiler and pressure vessel owners against losses caused by negligent inspection and certification within 90 days of the promulgation of the proposed regulation. New contract fee inspectors will be required to provide proof of indemnification within 30 days of certification and before performing inspections. All contract fee inspectors will be required to provide proof of indemnification when their indemnification instrument is renewed or when they change their method of indemnification.

The proposed regulation defines market share as the percentage of total revenue for inspection of boiler and pressure vessels that is generated by an inspector or agency and mandates minimum guaranty limits that vary in steps with an inspector's or agency's market share. The proposed steps would require that contract fee inspectors or agencies that have a market share of less than 1% hold at least \$500,000 in some instrument of financial responsibility. Inspectors or agencies that have a market share of between 1% and 10% would be required to hold a minimum of \$1,000,000 and those who have a market share of greater than 10% would be required to hold a minimum of \$2,000,000 in some instrument of financial responsibility. There are seven companies that perform boiler and pressure vessel inspections in

the Commonwealth. The vast majority of these inspections are performed by one company, American Boiler Inspection Services, Inc. The Department of Labor and Industry (DOLI) estimates that the cost of meeting the requirements of the proposed regulation with errors and omissions insurance will range between \$2,500 and \$10,000.

Market share percentages for the current year are set using revenue figures from the previous calendar year and so will only be accurate if the boiler inspection market is fairly static from year to year. If the current total market for boiler and pressure vessel inspection grows (or shrinks) and that growth (decline) is unevenly distributed or if individual inspectors or agencies are currently doing considerably more (or considerably less) business in the same sized market then they did during the previous year, then the proposed minimum financial responsibility limits that inspectors and agencies will be required to maintain will not reflect current market conditions. In this case, individual inspectors may be required to hold instruments of financial responsibility that are smaller (or larger) than the proposed regulation intends. This would be particularly problematic for companies that are currently losing business, and revenue, but would still have to maintain larger and more costly guaranties. This market and its players are fairly static right now but this may not always be the case.

Boiler and pressure vessel owners benefit from the proposed regulation in that they will now be required to be indemnified against losses stemming from the negligent behavior of third party contract fee inspectors.

Businesses and Entities Affected

The proposed regulation will affect all fee inspectors and fee inspector companies currently operating in the Commonwealth. Individuals who wish to be fee inspectors but are not currently licensed would also be affected. There are currently 14 fee inspectors licensed by the Commonwealth.

Localities Particularly Affected

The proposed regulation will affect all localities in the Commonwealth.

Projected Impact on Employment

The proposed regulation may have the effect of suppressing supply-side entry into the fee inspection market since the cost associated with mandatory insurance limits may serve as a

barrier to entry. Since all existing fee inspection companies maintain insurance levels at least as high as those required by the proposed regulation, there is likely to be no impact on employment in the insurance industry.

Effects on the Use and Value of Private Property

The market for fee inspection errors and omissions insurance is not well developed or large. If the few insurance companies that currently write this type of policy decide to stop, fee inspection companies may have no choice but to shut down operations. None of the fee inspection companies contacted by DPB have assets valuable enough to allow them to self insure for the limits mandated by the proposed regulation. However, since all existing fee inspection companies maintain insurance levels at least as high as those required by the proposed regulation, there is likely to be no immediate impact on the use or value of the property of fee inspectors or fee inspection companies.

Small Businesses: Reporting, Recordkeeping, & Administrative Costs

The proposed regulation requires contract fee inspectors to provide proof of indemnification at least annually. Contract fee inspectors will have to spend a small amount of their time copying and mailing their certificate of insurance or proof of other indemnification and will have to pay the associated copy and postage fees.

Small Businesses: Alternative Method that Minimizes Adverse Impact

The proposed regulation effectively minimizes the adverse impact on the regulated community given the constraints mandated by the Legislature.