

DISCLAIMER

Electronic versions of the exhibits in these minutes may not be complete.

This information is supplied as an informational service only and should not be relied upon as an official record.

Original exhibits are on file at the Legislative Counsel Bureau Research Library in Carson City.

Contact the Library at (775) 684-6827 or library@lcb.state.nv.us.

Multiple Site Wrap-Ups in the Public Sector

James D. Pitcock

Williams Brothers Construction Co., Inc.

William S. McIntyre

Michael J. O'Neill

American Contractors Insurance Group

Introduction

Wrap-up insurance programs have been in use for over twenty-five years insuring large public sector projects. Examples include, nuclear power plants, fossil fuel power generating facilities, governmental office buildings, federal courthouses, light rail systems such as BART in San Francisco, MARTA in Atlanta and DART in Dallas. More recently state turnpike authorities, state highway departments and other public agencies are implementing wrap-up insurance programs.

Although owner controller wrap-up insurance programs might offer potential savings to an owner on a single project basis, owner controlled wrap-up insurance is bad public policy for ongoing public works programs for the following key reasons:

1. Owner controlled wrap-up programs encourage award of contracts to unsafe contractors.
2. Owner controlled wrap-up programs will increase accidents and loss of lives on ongoing public works programs.
3. Owner controlled wrap-up insurance will increase the cost of construction for ongoing public works programs.

Discussion

1. **Owner controlled wrap-up programs encourage award of contracts to unsafe contractors.**

Open competitive bidding with award to the lowest responsible and responsive bidder is required by law on most ongoing public works programs.

Cost of insurance to the contractor is a major cost included in each contractor's bid. The average insurance cost typically will amount to approximately 4% of the contractor's bid price.

Each contractor's insurance costs are experience rated so that the premium each contractor pays for insurance is different and can vary significantly between bidders. For example, if worker's compensation and general liability insurance costs are 4% on average of a contractor's bid, the contractor with a workers compensation experience modifier of 0.5 would have a bid 2% less of the total contract amount than the average bidder (EMR of 1.0) or 4% less total bid than a very unsafe contractor with an EMR of 1.50. In summary, bid prices for a contract can easily vary up to 4% due to a contractor's EMR and record of safe or unsafe experience.

Consequently, contractors with a good safety record have a significant advantage in being a low bidder for a project, whereas, contractors with a bad safety record are at a significant disadvantage at the bid table. This significantly increases the odds that the low bidder will be a safe contractor rather than an average or unsafe contractor, which is good public policy.

Under owner controlled wrap-up insurance, the owner grants the unsafe contractor the same chance to become low bidder as a safe contractor which is not good public policy.

2. Owner controlled wrap-up programs will increase accidents and loss of lives on ongoing public works programs.

Since the labor pool for all contractors is the same, the difference between safe contractors with a good experience modifier and unsafe contractors with a bad experience modifier is strictly management. Given the fact that no management wants to see workers hurt or killed, the key motivation for management to have an effective safety program and safety culture in a company is not concern for the welfare of the employees, but is a desire to reduce accidents in order to decrease costs and be more competitive at the bid table.

This motivation is totally eliminated under owner controlled wrap-up insurance.

If the motivation to reduce accidents is eliminated, there will be more accidents than if the motivation of management had not been removed.

This is not good public policy to have a program that does not provide for the maximum incentive and motivation to reduce and eliminate accidents to workers and the general public on an ongoing basis.

3. Owner controlled wrap-up insurance will increase the cost of construction for ongoing public works programs.

If the motivation for an effective ongoing safety culture in a company has been eliminated and accidents therefore increase, then contractors' experience modifiers will increase and contractors' costs that must be incorporated in future bids will increase.

This is not good policy because it guarantees the increase in costs of ongoing public works programs.

Other Concerns

4. **Possible increase in project cost to the owner.**

Since wrap-up programs usually have a loss sensitive feature, the insurance cost on the project is not fixed. In a nonwrap-up arrangement, insurance costs of the job are fixed by the lump sum bids that include the estimated insurance cost. However, if the contractor underestimates the insurance costs, and suffers adverse losses, the contractor is not able to pass this additional cost onto the owner. Safety, quality and productivity cannot be separated. If you take one out of the contractor's control you will effect the others and change the culture.

5. **Financial incentive for contractors under a wrap-up to apply best practices is removed.**

If the main financial incentive for the contractor is removed, i.e., retro return premiums and dividends, it only stands to reason that the contractor will not apply the same level of best practices to the wrap-up project as compared to the nonwrap-up projects. The greatest financial rewards can be achieved on a nonwrap-up project, thus shifting assets and effort away from the wrap-up to the nonwrap-up projects.

6. **Wrap-up programs remove the contractor's control over the safety function.**

As the employer, the contractor is in the best position to design and implement the safety program for the project. If the public entity under the wrap-up takes on the safety responsibility, it will remove the contractors from this important role. A safe contractor will be reluctant to give up control of its safety program.

7. **Under a wrap-up program, the safety culture developed and the systems implemented will not be used.**

Some contractors have worked diligently to develop a safety culture for their company. This includes a strong and unwavering commitment from top management to support the safety function, the development of safety manuals, policies and procedures, a hiring model that emphasis matching the employee to the job, a hands on training and orientation program, and a supervisory staff that is held both accountable and responsible for safety on the project. If the contractors are not going to benefit on a direct basis from the safety results on the job, there would be a tendency not to apply all of the best practice that have been developed to the wrap-up projects.

8. **The owner does not limit the contractors liability to the limits provided by the wrap-up insurance program.**

Most wrap-up programs do not contain a limitation of liability provision that would limit the contractors liability to the stipulated amount of the limits provided by the wrap-up program. Since the policy limits are shared limits, it is possible to have a claim that exhausts the total policy limits, however, the contractors liability is not capped. This exposes the contractor to a potentially uninsured loss due to the exhaustion of the wrap-up project policy limits.

9. **Wrap-up programs eliminate contractor input on the claims process.**

If the contractor is eliminated from the claims process, the results will deteriorate. In the case of a lost time injury, the contractor typically follows up with the injured employee at their home or hospital, they explain the workers compensation benefits and they also control the return to work program that will allow the injured worker to come back to work. When the contractor is removed from the claim process, the most important element in controlling claims costs is removed. Lack of contractor participation in the claims process results in higher claim costs eroding the potential savings to the owner.

10. **Some contractors may not be passing their true insurance credits onto the owner.**

Wrap-up programs require the contractors to deduct from their bids the insurance premiums for those coverages provided by the wrap-up. It is very difficult and time consuming to verify the individual contractor premium credits to make sure that the correct amount is being deducted by the contractor. This may result in the doubling up of insurance costs, therefore, the owner's overall contract cost is higher.

11. **Less emphasis on the selection of safe subcontractors.**

Since a wrap-up insurance program transfers the responsibility for the losses to the owner and the insurance company, the contractor has little or no incentive in awarding subcontracts to safe subcontractors. This allows an unsafe contractor on the jobsite that may have an affect on the overall safety and well being of all the contractors and their employees on the job.

12. **Possible conflicts between the wrap-up commercial general liability carrier and the nonwrap-up auto liability carrier.**

To avoid potential conflicts and coverage gaps, it is recommended that the same insurance company provide both the commercial general liability and auto liability coverage for a contracting company. In a wrap-up program, this is not possible since the wrap-up excludes auto liability. This sets the stage for possible conflicts between the commercial general liability insurer and the auto liability insurer. It will be in the owner's best interest to push these claims to the contractors automobile liability policy.

13. **Wrap-up programs often do not include important coverages, e.g., professional liability, pollution liability or extended completed operations coverage.**

This is a very important concern in that the contractor has exposures that extends beyond the insurance coverages provided by the traditional wrap-up insurance program. An example may clarify this situation. On a wrap-up construction project, several employees were overcome by toxic fumes released from an excavation at the project site. The wrap-up's commercial general liability policy had an absolute pollution exclusion and as such denied any claims arising out of the release. This created a potential uninsured loss for the contractor. This is just one example of potential gaps in coverages.

~~10~~

14. **Under a wrap-up, insurance administration would still be a contractor responsibility with no reimbursement.**

The contractor plays an important role in making sure that the wrap-up insurance program is administered in a proper manner. This includes completing all of the necessary documents such as enrollment forms, premium credit worksheets and certified monthly payrolls. In addition, if the contractor has subcontractors, the contractor will be charged with making sure that all of these administrative items are completed and filed on a timely basis for all of its subcontractors. This is an additional administrative burden on the contractor for which it is not reimbursed for its time or efforts. Over the long run, these costs of administration will be incorporated into the overall cost of the work.

15. **Does the wrap-up program have an impact on governmental immunity?**

While the governmental immunity laws vary from state to state, the key issue is that the public entity has full or limited governmental immunity from third party liability claims. If a state turnpike authority is sued for an accident that takes place in an active construction zone, does it have governmental immunity? The answer is probably yes. However, an argument could be made by the plaintiff attorney that the sponsorship of the wrap-up program is a for profit venture and that the governmental immunity is voided.

16. **Conflict of interest between the owner, broker and contractor.**

Most, if not all of the wrap-up programs will be underwritten on some form of loss sensitive program. The owners financial interest is enhanced if there is very low or no losses on the project. As such, if a claim can be denied or if the contractor must contribute to the claim, the owner is the direct beneficiary. The broker who sold the wrap-up program to the owner also has a fiduciary duty to protect the interests of all of the contractors and subcontractors in the wrap-up program. This relationship has the potential for conflicts of interest between the owner, broker and insured contractors.

17. **Long term service liability of the owner and broker.**

Services required on a wrap-up insurance program do not cease at the project's completion. Final audits, loss adjusting services and the filing of unit statistical information for experience modifiers and other services will be required. If the owner or broker does not make the provision for this ongoing service liability, services will not be performed. An area of repeated problems is producing the data on a timely and accurate basis for the unit statistical plan that feeds into the individual contractors experience modifier rating. Failure to perform these services exposes the owner and broker to litigation related to incorrect experience modifiers data being incorporated into the contractors experience modifiers.

II

18. **Public bidding of wrap-up services - brokers and insurers.**

If the public entity is required to use a competitive bidding method for selecting a wrap-up broker and/or insurer, it is plausible to have a broker and insurer selected based solely on the low bid and they would not have the level of experience, expertise and financial strength to underwrite and administer a sophisticated wrap-up insurance program.

19. **Violation of Fair Bidding Laws**

Some contractors are asking the question, "Do public sector wrap-up insurance programs violate the fair bidding laws?" The answer to this question will probably need to be answered via some form of litigation protesting the use of wrap-up insurance programs on public sector projects.

20. **Constitutional Question on Public Sector Wrap-Ups**

There is one instance where a contractor challenged the use of a public sector wrap-up on the grounds that the state agency did not have the constitutional right to in effect lend the credit of the state to support a wrap-up program. The public agency withdrew the wrap-up insurance program on this project.

Summary

Utilizing a wrap-up insurance program to insure public sector projects that is not founded on risk management best practices will over the long-term increase the number of accidents involving the contractors workers and members of the public. In addition, wrap-up programs puts additional cost and burden on the contractor, introduces more regulations and interference and penalizes the contractors with good safety and loss control programs. This will result in increased insurance costs, which in turn will increase the cost of the work for the owner. This will potentially subject the owner to damaging public relations and increased litigation.