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METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

October 25, 1993

(Engineering & Operations Committee--Action)
(Executive Committee--Action)
(Finance & Insurance Committee--Action)
(Legal & Claims Committee--Action)

To: Board of Directors

From: General Manager and General Counsel

Subject: Owner-Controlled Insurance Program (OCIP) for Domenigoni Valley Reservoir Project

Report

An owner-controlled insurance program (OCIP) is designed to protect all work performed at a job site under one insurance program. It is implemented by the owner (District) and provides coverage for all contractors, subcontractors and construction managers. An OCIP presents advantages over conventional construction insurance and loss control procedures for two reasons: the economies of scale produced by centralizing the purchase of insurance coverage, and the streamlining of project management by coordinating a number of on-site functions (loss control, safety, recordkeeping etc.) under a single authority. The key to the operation and success of an OCIP is control--control of essential project insurance lines (i.e., general liability, workers compensation, and builders risk), control of subcontractors in all tiers through their contracts, control of site security, and control of loss control programs by a single project manager (owner). The attached exhibit (A1) shows a comparison of costs between a District OCIP at a 55 percent loss ratio and a conventional insurance and loss prevention program. Under this conservative scenario, the financial benefit to the District is estimated to be approximately $11 million. The staff's objective is to establish a program of loss control and incentives that results in a substantially lower loss ratio than that which the aforementioned exhibit shows, and to demonstrate savings of $20/25 million (Exhibit A2) during the term of construction of the Domenigoni Reservoir.

In addition to the safety and economic benefits that accrue to the District under an OCIP, the District's current self-insured program ($25 million) is further protected against losses associated with this project.

Attached to this letter and following Exhibits A1 and A2, are a series of issues and the responses to the most frequently asked questions concerning OCIP or "wrap-ups." A detailed staff report entitled "Owner-Controlled Insurance Program, October 1993," was forwarded to the Board in October. Additional copies may be obtained from the Legal Department, by calling (213) 217-6328.

The Ad Hoc Committee for Owner-Controlled Insurance Program (Ad Hoc Committee) reviewed the proposed program on September 14, 1993. At the request of the Engineering and Operations Committee, the Ad Hoc Committee examined additional issues that had been raised subsequent to the aforementioned meeting. On October 22, 1993, the Ad Hoc Committee met again. After deliberations, the Ad Hoc Committee recommends the actions proposed under the Recommendations paragraph of this letter.

The proposed action is exempt from the provisions of the California Environmental Quality Act because there is no possibility that it would have a significant effect on the environment.

Board Committee Assignments

This letter is referred for action to:

The Executive Committee because of its authority to study, advise, and make recommendations with regard to major policy issues, pursuant to the provisions of the District's Administrative Code section 2417, subdivision (g);

The Engineering and Operations Committee because of its authority to study, advise, and make recommendations with regard to the initiation, scheduling, contracting, and performance of construction programs, pursuant to the provisions of the District's Administrative Code section 2431, subdivision (b);

The Finance and Insurance Committee because of its authority to study, advise, and make recommendations with regard to the financial aspects of the District's risk management program and questions pertaining to insurance coverage and self-insurance, pursuant to the District's Administrative Code section 2441, subdivisions (g) and (h); and

The Legal and Claims Committee because of its authority to study, advise, and make recommendations with regard to policy considerations concerning District contracts, pursuant to the provisions of the District's Administrative Code section 2461, subdivision (d).

Recommendations

ENGINEERING & OPERATIONS, EXECUTIVE, FINANCE & INSURANCE, AND LEGAL & CLAIMS COMMITTEES FOR ACTION.

It is recommended that the Board of Directors take the following actions:

1. Authorize the creation of an Owner-Controlled Insurance Program for the Domenigoni Reservoir; and

2. Authorize the staff to issue a Request for Proposal for broker/administrative services to support the program.

for R W Balcerzak

John R. Wodraska

N. Gregory Taylor

N. Gregory Taylor

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OCIPltr2.brd

Attachments

Exhibit A1

COST COMPARISON
OCIP vs. CONVENTIONAL

The Metropolitan Water District of Southern California
PERIOD 1994 to 2000

PROJECT COSTS
(55% Loss Ratio)

COST ELEMENT	OCIP	CONVENTIONAL
Workers' Compensation	$29.3 million	$39.2 million
Liability ($100 million)	$ 9.4 million	$11.7 million
Builders' Risk	$ 6.6 million	$ 8.7 million
SUBTOTAL:	$45.3 million	$59.6 million
OCIP Broker/Administrator	$ 3.0 million	-0-
*Pre-Construction	$ .05 million	-0-
	$48.35 million	$59.6 million

* existing staff and consultant resources

Exhibit A2

PROJECT COSTS
(Objective: 40%(-) Loss Ratio)

COST ELEMENT	OCIP	CONVENTIONAL
All Insurance	$38.9	$59.6
Broker/Administrator	3	0
TOTAL	$41.9	$59.6
Potential Cost Improvements thru Cash Flow, Retro/ Deductibles, Underwriter Negotiables, Potential Lessoning of Builders' Risk Costs	($8/10 million)	
Estimated Net Cost Element	$32/34 million	$59.6

TARGET NET COST $30 MILLION

ATTACHMENT

ISSUES/RESPONSES

OWNER-CONTROLLER INSURANCE PROGRAM

ISSUES/RESPONSES

1. Without penalties or claim deductibles, contractors have no incentive to act and operate safely.

   Contractors are required, by law, to operate and maintain a safe work environment in order to protect the workers employed therein. There are civil and criminal penalties associated with failing to do so.

   A strong safety program combined with financial incentives and sanctions will be a part of the OCIP program. 10% of the savings will be set aside to be shared with contractors who achieve safety objectives.

2. The door will be opened to contractors who cannot meet bonding and insurance standards.

   Not true! By California law, all contractors bidding on public works contracts in excess of $25,000 must post a payment bond. Metropolitan policy requires performance bonds. Contractors will be required to show proof of insurance in order to prevent off-site losses from encroaching on the "wrap up."

3. The door will be open to poor performing contractors if they do not have to provide their own insurance.

   There are several factors that inhibit this. The large prime contractors are always concerned with project performance and employ reliable sub-contractors whom they know, or are able to verify, have good construction performance records. The primes are well aware that the quality of work or the lack thereof on the part of the sub-contractors is ultimately their responsibility and will affect their reputation and credibility. Bonding requirements cited above (#2) tend to eliminate marginal firms. Liability and Builders' Risk insurance is not usually a major factor in the screening of contractors and these insurance costs represent a small fraction of a contractor's total bid. While there is some relationship between insurance and performance the presence or absence of insurance is not a determinant in establishing the work product quality of a contractor. Where insurance has been a screening factor, often it is the result of the owner setting insurance requirements at such a high level that many smaller firms, particularly MBE and WBE firms could not obtain the required level or the premiums required for the coverage put them at a competitive disadvantage.

4. Success of OCIP cannot be evaluated

Measures for evaluation include the monitoring of the actual experience in puchasing insurance vs. the projected cost; the achievement of the objective of a 40% or less loss ratio in workers' compesation; the achievement of an incident rate below the national heavy construction average (1991 - 8.30); the achievement of a cost per worker below the national average (1991 - $540 @). The latter two statistics are produced by the National Safety Council.

5. Insurance underwriters will not allow contractors credit against premium for non-OCIP insurance.

Construction insurance premiums are usually geared to payroll or contract cost and need to be identified to the insurer prior to commencement of a project. A clear definition of project site combined with early calculation of estimated payroll or contract cost provides an adequate basis to disassociate the two programs.

6. Contractors will not receive dividends or returns on premium based upon their own insurance plan.

In a conventional program, the owner pays the full price for the contractors' insurance which is dedicated to a specific project, but the owner does not share in the rebate if losses are low. Through a "wrap up" the owner shares this rebate.

7. Contractors provide their own construction insurance programs and "wrap ups" are disruptive of their program.

A loss under a "wrap up" is borne by the owner's program and not chargeable against the contractor. Recordkeeping under either system is the same and the contractor does not incur additional premiums or administrative costs.

8. Contractors may be self-insured.

Contractors will have a policy issued to them under "wrap up." A "wrap up" will not affect a contractor's financial arrangement that supports the self-insurance reserves.

9. Increases the requirements for meetings and the gathering of data.

True, but such meetings are directed toward more control and overall efficiency of the project. They increase safety, reduce the potential for claims, and contribute to a successful and cost-effective project.

10. Contractors' insurance brokers lose commission income when a job is in a "wrap up" project.

There is no solution to this. The first obligation of the owner is to ensure that the project is properly insured and that the costs are held to absolute minimums within the need to properly protect the public entity.