

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

BILL: SB 346  
 SPONSOR: Senators Wise and Bennett  
 SUBJECT: Insurance  
 DATE: January 10, 2004      REVISED: \_\_\_\_\_

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Johnson</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable</u>
2.	_____	_____	<u>RI</u>	_____
3.	_____	_____	<u>CM</u>	_____
4.	_____	_____	<u>GO</u>	_____
5.	_____	_____	<u>AGG</u>	_____
6.	_____	_____	<u>AP</u>	_____
7.	_____	_____	<u>RC</u>	_____

**I. Summary:**

The bill restricts the authority of certain public agencies (i.e., state agencies, political subdivisions, state universities, community colleges, and airport authorities) to purchase an owner-controlled-insurance program (OCIP) in connection with a public construction project, except under specified conditions. These conditions include a requirement that the estimated total cost of the public construction project must be at least \$75 million, at least \$30 million if the project is for construction or renovation of two or more public schools during a fiscal year, or at least \$10 million if the project is for construction or renovation of one public school. The bill exempts from these restrictions OCIPs in connection with road projects of the Department of Transportation, with existing projects that are the subject of ongoing OCIPs, or with projects advertising bids before October 1, 2004.

The bill requires each OCIP to maintain insurance coverage with respect to completed operations for a term that is reasonably commercially available, but for at least 5 years. In addition, the bill requires insurers to offer insurance coverage at an appropriate additional premium for liability arising out of current or completed operations under an OCIP for the period beyond the period covered by the OCIP.

The bill defines an “owner-controlled-insurance program” as a consolidated insurance program or series of insurance policies issued to a public agency which may provide one or more of the following types of insurance coverage for all of the contractors, subcontractors, architects, and engineers working at specified or multiple contracted work sites of a public construction project: general liability, property damage, workers’ compensation, employer’s liability, builder’s risk, or pollution liability coverage. An OCIP is commonly cited as a “wrap-up” insurance policy.

The bill does not restrict a contractor of a public agency from mandating that its subcontractors participate in a contractor-controlled-insurance program (CCIP) in connection with a public construction project. The bill also does not restrict a business in the private sector from mandating that its contractors or subcontractors participate in an OCIP or CCIP.

This bill creates sections 255.0517 and 627.441 of the Florida Statutes.

## **II. Present Situation:**

### **Insurance Coverage for Construction Projects**

For large construction projects, project owners (e.g., state and local government agencies), contractors, and subcontractors have traditionally purchased insurance independently to protect themselves against financial losses related to the project. The contractors' costs of insurance would be included in their bids and thus would be paid by the project owner as part of the contract. Under this traditional insurance arrangement, the contractors could receive rebates from their insurers based on the contractor's safety record. In addition, some project owners would provide contractors with good safety records with additional bonuses. Because the contractors' costs of insurance were paid by the project owner as part of the contract, subsequent rebates received by the contractors from their insurers generate additional profits for the contractors.

For almost 15 years, consolidated insurance programs (commonly cited as "wrap-up" insurance) have been offered in the insurance market for large construction projects. Wrap-up insurance is a program or series of insurance policies purchased by one party (e.g., project owner) to cover itself and all of its subordinate contractors and subcontractors. Unlike traditional insurance in which each party purchases its own coverage, under wrap-up insurance, one party is responsible for purchasing insurance coverage that applies to all parties performing work on the project under contract. The coverage provided in wrap-up insurance policies generally includes workers' compensation, general liability, architects' and engineers' professional liability, builders' risk, excess liability, and pollution liability.

Wrap-up insurance policies are commonly characterized by one of two types of consolidated insurance programs. In an owner-controlled-insurance program (OCIP), the project owner purchases insurance to cover itself and all of its contractors and subcontractors. In a contractor-controlled-insurance program (CCIP), the general contractor purchases coverage for itself and each of its subcontractors. In contrast to traditional insurance, the project owner pays the insurance premiums under an OCIP and receives the rebates from the insurer based on the project's safety record.

### **Study of Wrap-Up Insurance for Large Construction Projects**

In 1999, the U.S. General Accounting Office (GAO) published a report analyzing the advantages and disadvantages of wrap-up insurance for large construction projects.<sup>1</sup> According to the report, in 1998, wrap-up insurance provided coverage for approximately 300 construction projects

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<sup>1</sup> U.S. General Accounting Office, *Transportation Infrastructure: Advantages and Disadvantages of Wrap-Up Insurance for Large Construction Projects*, Report No. GAO/RCED-99-155 (June 1999).

nationwide. To determine the potential cost savings associated with wrap-up insurance, the GAO evaluated six large transportation projects.<sup>2</sup> The report identified the following advantages and disadvantages associated with the use of wrap-up insurance:

### *Advantages*

- Saves project owners up to 50 percent on the cost of traditional insurance, or from 1 to 3 percent of a project's construction cost. The GAO indicated that the initial savings from wrap-up insurance was attributable to an owner's bulk-purchasing power and economies of scale. However, the GAO noted that large, labor-intensive projects (\$50 to \$100 million in construction costs) would be in a more advantageous position to obtain such wrap-up policies.
- Eliminates duplication and overlap in coverage which may occur because the contractors and subcontractors are insuring themselves against the same accidents, even though they may not be liable for the resulting claims. Since only one policy is purchased, gaps in coverage and the resulting uninsured claims can be avoided.
- Provides for more efficient claims processing and for less litigation since a single insurer is used for reporting claims, conducting investigations, settling claims, and providing payments for claims.
- Facilitates comprehensive safety programs. The GAO noted that a significant portion of the potential savings from wrap-up insurance was driven from a well-managed centralized safety program that results in fewer injuries. Under traditional insurance, a coordinated approach to the project is difficult because the contractors and subcontractors only oversee safety for their segment of work. Also, some contractors may not emphasize safety and closely monitor safety at the construction site.

### *Disadvantages*

- Increases administrative costs. Additional resources related to emphasizing job safety, controlling losses, and managing claims were noted. Some project owners outsource these administrative functions to insurance brokers or agents, while others performed some or all of these functions with their staffs.
- Potentially requires owners to make large premium payments at the start of a construction project and to establish a special reserve in order to ensure that funds are available to pay deductible requirements on claims.

### *Factors Impacting the Use of Wrap-Up Insurance*

The GAO report also noted that state insurance laws, minimum project size, and contractors' concerns might limit the broader use of wrap-up insurance. The report cited a previous study on wrap-up insurance by the General Services Administration which noted that some states (North Dakota, Ohio, Washington, West Virginia, and Wyoming) require the use of a state fund for workers' compensation for construction projects.<sup>3</sup> Some states, such as Michigan and Oregon,

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<sup>2</sup> The total costs ranged from \$97.2 million to \$10.8 billion.

<sup>3</sup> U.S. General Services Administration, *Wrap-Up Insurance Study* (Dec. 1997).

have specific laws that limit wrap-up insurance. Both states require an owner to obtain prior approval for wrap-up insurance from the state insurance regulator. Michigan law establishes a minimum project cost of \$65 million to be eligible for wrap-up insurance. Oregon law sets a \$100 million minimum project cost. The General Services Administration's study also noted that insurers usually require at least \$1.25 million in annual premiums before they will assume the risk associated with a wrap-up insurance policy. The GAO also noted that some contractors dislike wrap-up policies because they view insurance rebates as a potential source of profits that would be eliminated by the use of a wrap-up policy, since such rebates would go to the project owner.

### **Use of OCIPs in Florida**

During the past decade, OCIPs have been used increasingly on large construction projects in Florida, in both the private and public sectors. Private sector companies that have used or are currently using OCIPs include Florida Power and Light, Disney World, and Universal Studios. State and local government agencies that are using or have used OCIPs include Department of Transportation (Suncoast Parkway project), Broward County Arena, Orlando Utilities Commission, Orange County Convention Center, Hillsborough County School District, Jacksonville Electric Authority, City of Jacksonville – Better Jacksonville Plan, Florida Board of Regents, and Miami International Airport. Proponents of wrap-up insurance have indicated that these corporations and government agencies have experienced significantly lower loss ratios under these policies.

Representatives of the Suncoast Parkway project have reported the following favorable outcomes with their OCIP, as it approaches final completion:

1. The project has reached 3.3 million man-hours without a fatality;
2. The overall loss ratio is 25 percent, which is far below the industry average; and
3. The anticipated savings from the program will fall between 1.9 percent and 2 percent of the project value.

According to the Department of Transportation (DOT), the critical factor for an OCIP to be successful is loss prevention. As part of the Suncoast Parkway project, a 10-hour OSHA<sup>4</sup> course was offered to all supervisory personnel and an on-site loss prevention engineer monitored the project for safety violations. The contractor was made aware of any violations and corrective actions were taken. The DOT noted a reduction in accidents and avoided OSHA violations.

The DOT noted that a major benefit of an OCIP was the financial savings. The number of workers' compensation and general liability losses under an OCIP were typically less than for those projects not included in an OCIP. Consequently, the savings generated were passed on to the state, with a portion being shared by the contractors as a "safety incentive bonus." By including the bonus, the department expects its contractors to become partners in the safety program.

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<sup>4</sup> The term "OSHA" refers to the Occupational Safety and Health Administration of the U.S. Department of Labor, which administers the federal Occupational Safety and Health Act.

According to information provided by the Hillsborough County School District, an OCIP was implemented in September 2000 to cover the district's 5-year construction plan including projects estimated in excess of \$750 million. Based on a comparison of estimated contractors' insurance costs to projected OCIP insurance costs, the district will save an estimated \$19.7 to \$29.9 million over the 5-year period. The actual savings is contingent on claims incurred under the OCIP and actual contractor insurance rates over the same period. Subsequent to September 11, 2001, contractors' insurance costs have increased significantly. Since the OCIP coverage was negotiated for a 5-year period, the district's insurance cost will remain stable, increasing the potential for savings when compared to the contractors' insurance cost.

### **Procurement Process for Governmental Entities**

Chapter 255, F.S., relating to public property and publicly owned buildings, specifies the requirements for construction bonds between a governmental entity and any contractors, or subcontractors that are involved in the project. Any person entering into a formal contract with the state or any county, city, political subdivision, or other public authority, for the construction of a public building, for the prosecution and completion of a public work, or for repairs upon a public building or public work must deliver to the public owner, and record in the public records, a payment and performance bond.<sup>5</sup> Any person providing materials, labor, or services under the improvement contract who does not receive proper payment has a claim against the bond for the amount due.

Chapter 287, F.S., relating to the public procurement of personal property and services, requires the ethical procurement of commodities and contractual services and the adherence to uniform procedures in carrying out such procurement. "The Legislature recognizes that fair and open competition is a basic tenet of public procurement; that such competition reduces the appearance and opportunity for favoritism and inspires public confidence that contracts are awarded equitably and economically."<sup>6</sup>

Section 287.057, F.S., delineates the conditions for the public procurement of commodities or contractual services. Unless otherwise authorized by law, all contracts for the purchase of commodities or contractual services for the purchase of commodities by an agency must be awarded by competitive sealed bidding. An agency for purposes of this section is defined to mean state officers and any unit of organization of the executive branch of government.<sup>7</sup> Local governmental entities are not subject to these procurement requirements. Examples of commodities and contractual services specifically exempt from the competitive procurement requirements include: legal services and auditing services. Also, the DOT contracts for construction and maintenance of state roads are subject to different procurement requirements, as provided in s. 337.11, F.S. When an agency determines in writing that the use of competitive sealed bidding (invitation to bid), is not practicable, commodities or contractual services must be procured by competitive sealed *proposals* (request for proposals). Particular situations are exempt from the competitive bid process, including when the agency head determines

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<sup>5</sup> Section 255.05, F.S.

<sup>6</sup> Section 287.001, F.S.

<sup>7</sup> Section 287.012(1), F.S.

emergency state action is required, the commodities or contractual services are available only from a single source, or it is in the best interest of the state.

The Department of Management Services (DMS) is responsible for purchasing insurance for state agencies, except that agencies may purchase title insurance or may make emergency purchases for periods no greater than 30 days. The purchase of insurance, whether made by the DMS or an agency, must comply with the competitive bid requirements for commodities, except that the DMS may authorize the purchase of insurance by negotiation when it is deemed to be in the best interest of the state.<sup>8</sup>

Although Florida law does not appear to specifically prohibit or restrict this type of consolidated policy, the Attorney General opined (AGO 93-34) that the School Board of Dade County was not authorized to purchase insurance for indemnify school board contractors or subcontractors who work on capital construction projects of the board. Presently, school districts, as well as other local governmental entities, are authorized to provide insurance for officers and employees of the district and their dependents. Section 10, Art. VII, State Constitution, prohibits the state, counties, or municipalities or any agency from using, giving, or lending its taxing power or credit to aid any private interest or individual. The opinion further stated that, “in the absence of statutory authority for such agreement, governmental authorities are prohibited from agreeing to indemnify private entities. Therefore, the school district “...would appear to be precluded from extending insurance benefits to contractors or subcontractors who work on capital construction projects for the district.”

### **III. Effect of Proposed Changes:**

#### **Restriction of Owner-Controlled-Insurance Programs**

The bill restricts the authority of certain public agencies in this state, or any instrumentalities of those agencies, to purchase owner-controlled-insurance programs in connection with a public construction project, except under specified conditions. The bill provides that these public agencies include state agencies, political subdivisions,<sup>9</sup> state universities, community colleges, airport authorities, and other public agencies in this state.

The bill defines an “owner-controlled-insurance program” (OCIP) as a consolidated insurance program or series of insurance policies issued to a public agency which may provide one or more of the following types of insurance coverage for *all* of the contractors, subcontractors, architects, and engineers working at specified or multiple contracted work sites of a public construction project: general liability, property damage, workers’ compensation, employer’s liability, builder’s risk, or pollution liability coverage. The bill defines a “specified contracted work site” as construction being performed during one or more fiscal years at one site or a series of contiguous sites separated only by a street, roadway, waterway, or railroad right-of-way, or along a continuous system for the provision for water and power. The bill defines a “multiple contracted work site” as construction being performed at multiple sites during one or more fiscal

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<sup>8</sup> Sections 287.022 and 287.057(4)(d), F.S.

<sup>9</sup> Section 1.01(8), F.S., specifies that, in construing the Florida Statutes, the term “political subdivision” includes counties, cities, towns, villages, special tax school districts, special road and bridge districts, bridge districts, and all other districts in this state.

years which is part of an ongoing capital infrastructure improvement program, or involves the construction of one or more public schools.

Because the bill specifies that a consolidated insurance program or series of insurance policies is defined as an OCIP only if *all* of the contractors, subcontractors, architects, and engineers are covered by the insurance program, the bill is unclear whether a consolidated insurance program that covers a majority, but not all, of the contractors, subcontractors, architects, and engineers would be considered an OCIP that is subject to the restrictions provided by the bill.

### **Conditions for Purchase of an OCIP by a Public Agency**

The bill provides several conditions required in order for a public agency to purchase an OCIP, which include the following:

- Purchase of the OCIP must be determined to be necessary and in the best interest of the public agency;
- The estimated total cost of the public construction project must be at least \$75 million, at least \$30 million if the project is for construction or renovation of two or more public schools during a fiscal year, or at least \$10 million if the project is for construction or renovation of one public school;
- The OCIP must maintain insurance coverage with respect to completed operations for a term that is reasonably commercially available, but for at least 5 years;
- The bid specifications for the public construction project must specify the insurance coverage provided under the OCIP and the minimum safety requirements;
- The OCIP must not prohibit a contractor or subcontractor from purchasing additional insurance coverage, and the cost of the additional coverage must be disclosed to the public agency;
- The OCIP may not include surety insurance;
- A deductible or self-insured retention on an OCIP may not exceed \$1 million; and
- The public agency must be responsible for payment of the deductibles of all claims.

### **Exemptions**

The bill exempts OCIPs for the following public construction projects from the restrictions otherwise placed on OCIPs by the bill:

- Any project for the construction and maintenance of all roads designated as part of the State Highway System or the State Park Road System or of any roads placed under supervision of the Department of Transportation by law;
- Any existing project or projects of a public agency which are the subject of an ongoing OCIP issued before October 1, 2004; or
- Any project of a public agency which is advertised by the public agency before October 1, 2004, for the purpose of receiving bids for the project.

### **Completed Operations Liability Coverage**

The bill requires each OCIP to maintain insurance coverage with respect to completed operations for a term that is reasonably commercially available, but for at least 5 years. In addition, the bill requires liability insurers to offer insurance coverage at an appropriate additional premium for liability arising out of current or completed operations under an OCIP for the period beyond the period covered by the OCIP. The bill specifies that the period of additional coverage to be offered by liability insurers must be sufficient to protect against liability arising out of an action founded on the design, planning, or construction of an improvement to real property which is brought within the legal time limits for commencing the action.

Under current law, this type of action must be commenced within 15 years after the date of actual possession by the owner, the date of the issuance of a certificate of occupancy, the date of abandonment of construction if not completed, or the date of completion or termination of the contract between the professional engineer, registered architect, or licensed contractor and his or her employer, whichever date is latest [s. 95.11(3)(c), F.S.].

The bill requires liability insurers to offer this additional coverage for contractors, subcontractors, architects, and engineers performing work on a public construction project under contract with a public agency.

### **Effective Date**

The bill provides an effective date of October 1, 2004.

## **IV. Constitutional Issues:**

### **A. Municipality/County Mandates Restrictions:**

None.

### **B. Public Records/Open Meetings Issues:**

None.

### **C. Trust Funds Restrictions:**

None.

### **D. Other Constitutional Issues:**

Although Florida law does not appear to specifically prohibit or restrict local governments from purchasing insurance for, or indemnifying, the local government's contractors or subcontractors who work on the local government's capital construction projects, the Attorney General opined that the School Board of Dade County was not authorized to purchase this type of consolidated insurance policy for the school board's



contractors or subcontractors who work on the school district's projects.<sup>10</sup> Section 10, Art. VII of the State Constitution prohibits the state, counties, or municipalities or any agency from using, giving, or lending its taxing power or credit to aid any private interest or individual. Currently, school districts, as well as other local governmental entities, are authorized to provide insurance for officers and employees of the district and their dependents. The Attorney General's opinion further stated that, "in the absence of statutory authority for such an agreement, governmental entities are prohibited from agreeing to indemnify private entities." Therefore, the school district "would appear to be precluded from extending insurance benefits to contractors or subcontractors who work on capital construction projects for the district."<sup>11</sup>

## V. Economic Impact and Fiscal Note:

### A. Tax/Fee Issues:

None.

### B. Private Sector Impact:

In a 1999 report, the U.S. General Accounting Office (GAO) found that, under a traditional insurance arrangement, contractors that have better safety records have a competitive advantage in obtaining contracts for construction projects over contractors with a safety record that is not as good.<sup>12</sup> The report explained that the safer contractor has lower insurance premiums, and this lower cost can be reflected in lower bids. Under and owner-controlled-insurance program (OCIP), this competitive advantage is lost because insurance is not part of a contractor's bid.

By restricting the authority of certain public agencies to purchase an OCIP and allowing contractors performing work on public construction projects (generally with an estimated total cost of less than \$75 million) to obtain traditional insurance, the bill may permit contractors to receive rebates from their insurers based on the contractors' safety records. Because the contractors' costs of insurance are typically paid by the project owner (i.e., public agency) as part of the contract, subsequent rebates received by the contractors from their insurers generate additional profits for the contractors.

The GAO observed that the use of OCIPs has allowed more disadvantaged businesses, minorities, and women contractors to bid on construction projects because these contractors have difficulty obtaining sufficient insurance to bid on large projects.<sup>13</sup> By restricting the use of OCIPs, the bill may impede the ability of disadvantaged businesses, minorities, and women contractors to bid on construction projects.

The bill also requires insurers to offer, at an appropriate additional premium, liability coverage for current or completed operations under an OCIP for a period beyond the

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<sup>10</sup> Op. Att'y Gen. Fla. 93-34 (1993).

<sup>11</sup> *Id.*

<sup>12</sup> GAO, *supra* note 1, at 12.

<sup>13</sup> *Id.*

period covered by the OCIP. Consequently, liability coverage would be available to contractors and subcontractors participating in an OCIP for current and completed operations.

**C. Government Sector Impact:**

The bill restricts the authority of certain public agencies (i.e., state agencies, political subdivisions, state universities, community colleges, and airport authorities) to purchase owner-controlled-insurance programs (OCIPs). By restricting the use of OCIPs, the bill reduces the ability of these public agencies to realize potential cost savings from the use of OCIPs for public construction projects.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

**VIII. Amendments:**

None.

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This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

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