Legal Issues with Obtaining Insurance for Large Transit Projects

DETAILS

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LEGAL ISSUES WITH OBTAINING INSURANCE ON LARGE TRANSIT PROJECTS

This report was prepared under TCRP Project J-5, "Legal Aspects of Transit and Intermodal Transportation Programs," for which the Transportation Research Board is the agency coordinating the research. The report was prepared by Eric Kerness, Kerness Consulting; Kurt Dettman, Constructive Dispute Resolutions; and James W. Evans, Jr., Albert Risk Management Consultants. James B. McDaniel, TRB Counsel for Legal Research Projects, was the principal investigator and content editor.

The Problem and Its Solution

The nation's 6,000 plus transit agencies need to have access to a program that can provide authoritatively researched, specific, limited-scope studies of legal issues and problems having national significance and application to their business. Some transit programs involve legal problems and issues that are not shared with other modes; as, for example, compliance with transit-equipment and operations guidelines, FTA financing initiatives, private-sector programs, and labor or environmental standards relating to transit operations. Also, much of the information that is needed by transit attorneys to address legal concerns is scattered and fragmented. Consequently, it would be helpful to the transit lawyer to have well-resourced and well-documented reports on specific legal topics available to the transit legal community.

The *Legal Research Digests* (LRDs) are developed to assist transit attorneys in dealing with the myriad of initiatives and problems associated with transit start-up and operations, as well as with day-to-day legal work. The LRDs address such issues as eminent domain, civil rights, constitutional rights, contracting, environmental concerns, labor, procurement, risk management, security, tort liability, and zoning. The transit legal research, when conducted through the TRB's legal studies process, either collects primary data that generally are not available elsewhere or performs analysis of existing literature.

Applications

The insurance market for large transportation projects is complex. Risk management plays a vital role in the planning, design, and construction of today's complex transit systems. Transit owners are more proactively exploring ways to manage risk and reduce corresponding costs and exposures. Some public transit owners are exploring enterprise risk management approaches as a more complete way to control overall risk exposures. With respect to insuring against risk, new types of insurance programs, including Owner Controlled Insurance Programs (OCIP) and Contractor Controlled Insurance Programs (CCIP), are being implemented, resulting in cost savings, promotion of safety, and claim reduction in the face of a consolidating insurance market.

This project identifies and discusses in detail the legal issues confronting transit agencies seeking to obtain insurance for large transit capital projects. Large projects include Federal New Starts projects and alternative delivery projects (design-build, design-build-operate-maintain, construction manager at risk, etc.), and may include large rolling stock acquisitions. The report discusses different types of insurance coverage required for large projects and the types of programs available, including OCIPs and owner's protective professional indemnity insurance, and the benefits, advantages, and disadvantages of such programs as compared to consultant- or contractor-provided insurance programs.

The digest examines how state law affects the ability to assign risk contractually; the current practices for drafting contract provisions to manage risk; competitive procurement and cost analysis issues; methods of obtaining comparative pricing for various insurance options; and the impacts of the various types of insurance programs on owner liability, project and contractor safety, and disadvantaged and small business enterprise project participation. The importance of industry practice is considered, as well as how best to design an insurance program to manage risks on specific types of projects.

This digest should be useful to transit attorneys, administrators, risk managers, project engineers, financial officers, and other staff that need knowledge of basic insurance information and how the industry works.

TRANSPORTATION RESEARCH BOARD
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LEGAL ISSUES WITH OBTAINING INSURANCE ON LARGE TRANSIT PROJECTS

By Eric Kerness, Kerness Consulting; Kurt Dettman, Constructive Dispute Resolutions; and James W. Evans, Jr., Albert Risk Management Consultants

I. INTRODUCTION

Today's modern transit systems are confronted with renewed financial challenges to meet the ever expanding need for public transportation. Transit systems must live within constrained budgets and are reluctant or unable to raise fares and other revenue. This has forced transit systems to face the economic realities of delivering good service to their customers while keeping aging systems functional and safe, and at the same time expanding existing systems to meet increasing demand.

On the positive side, transit agencies now have a much broader menu of project delivery systems to deliver complex transit projects, coupled with the willingness of the Federal Transit Administration (FTA)[1] to support new project delivery approaches. For example, construction manager/general contractor (CM/GC), design–build (DB), and public–private partnership (P3) approaches are all actively being considered, subject of course to applicable federal and state procurement laws, rules, and regulations.

Risk management plays a vital role in the planning, design, and construction of today's complex transit systems. Transit owners are more proactively exploring ways to manage risk and reduce corresponding costs and exposures. Some public transit owners are exploring enterprise risk management approaches as a more holistic way to control overall risk exposures. With respect to insuring against risk, new types of insurance programs, including Owner Controlled Insurance Programs[2] (OCIP) and Contractor Controlled Insurance Programs (CCIP), are being implemented, resulting in cost savings, promotion of safety, and claim reductions in the face of a consolidating insurance market.

To be effectively implemented, risk management and risk financing require a thorough understanding of both the risks to be transferred and applicable risk financing options. More specifically, understanding insurance products—one of the means of risk financing—impacts the manner that risk is allocated, contracts are drafted, and projects are managed.

This digest will provide an analytical guide for understanding legal issues affecting insurance for large transit capital projects. Although the focus of this digest is directed at large transit projects having construction value in excess of $100 million, it provides construction insurance information useful to the transit lawyer on any transit capital project.[3]

This digest will explore the general types of issues that transit lawyers will encounter, including risk assessment, appropriate risk allocation, and internal and external constraints that affect the allocation of risk. It will explore risk man-

[1] This willingness to try new project delivery approaches is also reflected in federally funded highway projects through the Federal Highway Administration (FHWA). *See* 23 U.S.C. § 635.309, 23 C.F.R. § 627 and UNITED STATES DEPARTMENT OF TRANSPORTATION, REPORT TO CONGRESS ON PUBLIC-PRIVATE PARTNERSHIPS (Dec. 2004) (available online at http://www.fhwa.dot.gov/reports/pppdec2004/, last accessed Mar. 2014) (hereinafter referred to as "U.S. DOT REPORT TO CONGRESS"), The Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU), Pub. L. No. 109-59, 119 Stat. 1144 (2005).

[2] A centralized insurance program under which one party procures insurance on behalf of most parties performing work on a construction project or on a specific site. Sometimes referred to as "wrap-ups," Controlled Insurance Programs (CIPs) are most commonly used on single projects, but other uses include contract maintenance on a large plant or facility or on an ongoing basis for multiple construction projects (sometimes referred to as a "rolling wrap-up"). Typically, the coverages provided under a CIP include commercial general liability (CGL), workers' compensation, and umbrella liability. CIPs offer a number of benefits, including greater control of the scope of coverage, potentially lower project insurance costs, and reduced litigation. CIPs can be purchased by the owner (Owner Controlled Insurance Programs or OCIP) or contractor (Contractor Controlled Insurance Programs or CCIP), or a combination of participating parties. We refer to these Controlled Insurance Programs as OCIPs, CCIPs, or the generic CIP in the balance of the digest.

[3] Operational, employee, and property insurance issues are beyond the scope of this digest.

agement approaches for large transit projects; explain the types of available programs, policies, and coverage; discuss controlled insurance program advantages and disadvantages; identify legal issues and constraints; identify procurement and management issues; and conclude with a series of case studies of representative approaches taken by transit agencies.

Preparation of this digest commenced with a review of relevant insurance guidebooks, studies, and reports, which are set forth in the footnotes of the digest. Initial interviews were conducted with representatives from the New York Metropolitan Transportation Authority, Los Angeles County Metropolitan Transportation Authority, New York State Department of Transportation, Massachusetts Bay Transportation Authority, Sound Transit, Washington Metropolitan Transportation Authority, American Public Transportation Association (APTA) Legal Affairs, and FTA. From APTA member listings, surveys were sent to 21 large transportation agencies to explore their approaches to risk management and insurance, project delivery systems, insurance procurement practices, and legal issues. The authors analyzed the 10 surveys that were returned.[4]

Survey results indicated that most of the agencies had engaged in design–bid–build and DB projects, while 6 of the 10 responders had undertaken construction manager/general manager project delivery. Generally, basic contract requirements obligated contractors to provide specified insurance coverages, which included builder's risk, general liability, and workers' compensation. Most often, the transit agency was added as an additional insured party to contractor-provided policies. Seven of the 10 responders have used OCIPs for large projects in excess of $100 million and one agency is using CCIPs. Agencies that used OCIPS cited certain benefits of OCIPs, including safety, loss control, public relations, claims management, increased opportunities for small businesses, guaranteed coverage for the duration of the project, and higher limits, cost savings, and broader insurance terms and conditions than contractors typically carry.

Contract insurance requirements were generally written by the risk manager and legal counsel. Many agencies use outside brokers selected through a competitive procurement process to provide advice on structuring insurance programs and procuring insurance in the marketplace. The survey responses were analyzed and further in-depth discussions were conducted with certain survey responders to elicit more detailed information that led to the Case Study section of this digest.

II. LEGAL ISSUES SURROUNDING PROJECT INSURANCE

The following are some of the general types of issues that transit lawyers will encounter regarding insurance for large transit projects. This is intended as just a general checklist and introduction to the topics that the transit lawyer will need to address, as each of the topics is covered in more detail later in this digest or in the Case Study section.[5]

A. Assessing and Allocating Risks

All large transit projects are inherently risky undertakings. Depending on the nature of the project and associated design challenges and construction methods, these risks can include environmental issues, permitting issues, impact on the built (and unbuilt) environment, construction means and methods, political issues, and funding challenges. The focus of this digest is to look at capital project delivery phase risks and risk mitigation strategies that can be employed, with a focus on insuring against those risks.

Risk Allocation Principles. The fundamental challenge for transit lawyers, working in tandem

[4] Surveys were returned by Washington Metropolitan Area Transit Authority (WMATA), San Diego Association of Government (SANDAG), Central Puget Sound Transit Authority (Sound Transit), New York Metropolitan Transportation Authority (NYMTA), Metropolitan Atlanta Rapid Transportation Authority (MARTA), Dallas Area Rapid Transit Authority (DART), Massachusetts Bay Transit Authority (MBTA), Los Angeles Metropolitan Transportation Authority (LAMTA), San Francisco Metropolitan Transportation Authority (SFMTA), and Tri County Metropolitan Transit District of Oregon (TriMet). A copy of the survey is included as Appendix A.

[5] In this section of the digest and in subsequent sections, readers will encounter language and terminology that is specific to the insurance and underwriting community. In general, we recommend that readers avail themselves of glossaries and technical resources available on the Internet. In particular, we think that transit lawyers and other readers will find the IRMI (International Risk Management Institute, Inc.) Glossary of Insurance and Risk Management Terms (http://www.irmi.com/forms/online/insurance-glossary/terms.aspx) very helpful in defining and understanding the terms used in this digest. Further, the IRMI site provides access and links to information for a broader understanding of certain technical topics.

with their engineers, construction managers, and technical consultants, is, first, to identify and classify potential risks; second, to develop risk mitigation strategies; and, third, to allocate that risk to the project participants (or others outside the immediate project parties; for example, in the case of insurance). The fundamental principle that should be employed in risk management is to allocate risk to the party or parties that are best able to 1) avoid the risk, 2) mitigate the risk, and 3) absorb the risk. It is when parties have allocated to them risks they cannot avoid, mitigate, or absorb that claims are generated, as parties seek to shift that risk to some other party or entity. The more risk is allocated to a party that cannot handle the risk, the more likely it is that the party will seek to shift the risk somewhere else, generating claims, added costs, and potential liabilities.

Risk Assessment Methods. The first step in a project-related risk assessment is assembling a cross-functional team that knows enough about the project to identify, classify, and quantify potential risks. The process of identifying risks is fairly straightforward, and can include general categories such as right-of-way, permitting, procurement, cost, schedule, and quality, etc. The second and more judgmental step is assessing and classifying those risks by probability and severity. The question for each identified risk is the likelihood of it happening and, if it does happen, the severity of the occurrence and resulting impact on the project. The project team must then rank them, with focus given to those of high probability of occurrence and significant impact on the project (typically, transit agencies focus on cost and schedule as the number one priorities).[6]

Risk Allocation Options. The first step in considering risk allocation is to determine whether there is a risk mitigation strategy that completely avoids the risk—obviously, if a risk does not occur then there is no need to worry about which party is going to mitigate or absorb that risk. So, for example, contract documents can include preconstruction investigations to avoid unknown risks or to establish the baseline against which unanticipated conditions can be measured for commercial responsibility purposes. This is a simple way to mitigate against the risk happening and, if it does, to be clear on which party has the risk for management or absorption purposes in bidding the project. The key factor here is that defaulting to broad, generic transfers of risk is often not the best option, even though it may appear superficially appealing to do so.

So, the options for allocating risk are: 1) commercially transfer that risk to the project party best able to manage or absorb the risk, or 2) finance that risk through insurance.[7] Although the focus of this digest is on the second option, transit lawyers should give equal time to evaluating the first option. Commercial allocation of risk is done through the contract documents. This involves classifying the risk; determining the party that is best commercially able to avoid, manage, or absorb that risk; and then clearly allocating that risk in the contract. This risk allocation is made through the commercial terms and conditions (for example, indemnity and standard of care provisions), and through the detailed specifications, plans, and drawings (for example, Geotechnical Baseline Report or prescriptive or performance specifications).

Financial risk transfer involves compensating someone outside of the direct project parties to accept a particular risk. It should be noted that the commercial allocation of risk discussed above to some extent involves risk financing, because it is presumed that the party to which the risk has been commercially allocated will have the financial wherewithal to manage or absorb that risk through its bid price or its company balance sheet. What we are referring to here is a pure transfer of that risk to another party, for a fee. For purposes of this digest, the risk financing mechanism focused on is the transfer of risk to insurance companies.

As discussed in detail below, the risk transferred to insurance companies is financed by paying a premium to them to accept the financial consequences of an insured loss.

Impact of Project Delivery Approach on Insurance Programs. The traditional delivery method

[6] The FTA guidance on risk assessment is captured in its Oversight Procedure 40, http://www.fta.dot.gov/documents/OP40_Risk_and_Contingency_Review_Rev._2May_2010MB.pdf, and the *Project Management Handbook*, which directs FTA Project Management Oversight Contractors (PMOCs) through reviews of various risk assessment, evaluation, and mitigation processes. Included among the risks are contractually allocated risks, insured risks, and risks covered by contingency. The guidance broadly defines risk well beyond insurable event risk covered by commercially available insurance.

[7] This digest focuses on risk financing through insurance; however there are other ways to finance risk, including project budget contingencies, credit facilities, allowances, and surety bonds.

on public capital projects is design–bid–build. The owner contracts with a designer to produce a biddable set of construction documents, and the owner then contracts with the contractor to build the project strictly in accordance with those construction documents. However, there is a trend toward alternative project delivery approaches, including CM/GC, DB, and P3. This digest does not go into detail on these project delivery approaches, which are described in detail in other sources,[8] but the transit lawyer needs to understand that each of these delivery approaches involves different contractual relationships and corresponding differences in risk allocation and risk financing. These, in turn, will drive the determination of risks on a particular project and the commercial and risk financing options for financing the allocation of those risks. Stated another way, the transit lawyer cannot apply the traditional design–bid–build risk allocation and financing approach to materially different allocations of risk inherent in these alternative project delivery approaches.

B. Lack of Knowledge About, or Understanding of, Insurance Coverages, Limits, or Structuring Options

Relationship Between Legal Liability and Transfer of Risk by Insurance. For the transit lawyer to effectively allocate risk and finance risk, he or she must have an understanding of the relationship between legal liability and the transfer of risk. Very simply put, the transfer of legal liability by contract does not automatically mean that insurance will be available to cover that risk. A good example is professional liability coverage. Many public contracts have broad transfers of risk to design professionals to produce biddable and constructible construction documents. However, professional liability insurance coverage typically covers only damages caused by the negligence of the design professional. Thus, if there are damages caused by design professional errors or omissions, but they do not fall below the applicable standard of care, there may not be professional liability insurance coverage for such damages. Under those circumstances, the risk is financed by the balance sheet of the design professional, not insurance.[9]

Impacts of Insurance Policy Forms, Coverages, and Structuring. The transit lawyer also must have basic knowledge about the differing forms, coverages, and structuring of insurance policies because that will impact the effectiveness of an insurance-based transfer of risk. Stated another way, the transit lawyer may believe at a general level that certain types of insurance have been mandated, but in the detail of the policy form, the type of coverage, or the structuring of the program, the actual insurance obtained may be different than expectations from the contract provisions.

The transit lawyer also should be aware of the applicable exclusions and other terms and conditions in the policies, which may be industry standard or highly customized. A typical example is where property and liability policies may describe coverage as "all risk." In practice, however, the coverage grant is defined by the extent to which certain exclusions apply in a loss situation. For example, an "all risk" property insurance policy may contain an absolute exclusion for losses relating to design error or have a limitation on damage caused by a specific peril such as storm surge or flood. The transit lawyer cannot know what he or she is buying without a thorough understanding of the actual insurance policies that are issued, by line of coverage.

C. Statutory or Regulatory Limitations that Affect Insurance Options

Statutory Liability Obligations and Limitations. In allocating risk, both contractually and from a risk financing perspective, the transit lawyer needs to determine whether there are statutes that impose liability or limit liability as to certain parties. These statutory requirements may trump

[8] *See* DANIEL DUFF, EDWARD J. GILL & G. KENT WOODMAN, LEGAL HANDBOOK FOR THE NEW STARTS PROGRAM 23–25 (Transit Cooperative Research Program, Legal Research Digest No. 30, 2010) (hereinafter referred to as Legal Research Digest No. 30); STEPHEN D. PALLEY, TIMOTHY E. DELAHUNT, JOHN S. SANDBERG & PATRICK J. WIELINSKI, CONSTRUCTION INSURANCE, A GUIDE FOR ATTORNEYS AND PROFESSIONALS 143 (American Bar Association, 2011) (hereinafter referred to as CONSTRUCTION INSURANCE).

[9] Although not a part of this digest per se, another example is the surety bond. A surety bond is not insurance. Rather, it is a guarantee of performance of the contractor, but the surety's performance under the bond is subject to all of the claims and defenses that the contractor would have had under the contract. Surety allocation of risk often revolves around commercial claim issues that may impact a contractor's ability to perform in accordance with the contract requirements. Thus, the transit lawyer should not assume that just because there is a surety bond in place, damages or losses caused by the contractor are automatically going to be covered if the surety bond is triggered by a default.

contract terms or insurance policies that do not comply with such requirements. A good example is the so-called "anti-indemnity" statute, which as a matter of public policy provides that a party cannot require another party to indemnify it against its own negligence. Any such indemnity is void as against public policy, and therefore would negate any contractual or insurance risk financing provision to the contrary.[10]

Statutory Insurance Requirements. The transit lawyer needs to ascertain whether applicable statutes mandate or prohibit certain types of insurance or insurance programs. Examples include workers' compensation insurance and OCIPs that may be dictated or limited by statute. In the first case, there are several states that require employers to purchase workers' compensation coverage from a monopolistic state fund and do not allow commercial alternatives. In the second case, certain states proscribe or limit the use of controlled insurance programs for general liability and workers' compensation on public projects.[11]

Statutory and Regulatory Procurement Requirements. Transit lawyers need to be aware of any applicable statutory or regulatory procurement requirements that can apply to brokerage services or insurance policies. Often these statutes and regulations provide for a uniform and transparent process that permits a competitive procurement that maximizes the public's interest. That said, brokerage services are often procured on a request for qualifications (RFQ) and request for proposals (RFP) basis, where the experience and capabilities of the broker are just as important as pricing for the services. The procurement of insurance on transit projects is usually done through the broker since the broker is licensed to seek insurance in what is a highly regulated marketplace. However, the transit lawyer needs to be aware of how broker services and insurance are procured, as there is a role for the transit lawyer in defining the need for and parameters of the services, compliance with applicable statutes and regulations on procurement, the terms of the procurement documents (including the form of contract and form of insurance policies), the selection process, and the entry into legal agreements with the broker and insurance carriers.

D. Internal and Organizational Constraints

Agency Approaches to Risk Management and Risk Financing. The transit lawyer will need to familiarize himself or herself with the risk management philosophy and approach of the transit agency. For example, does the agency have a risk manager or risk management department and, if so, what is its scope of responsibility and authority? Does the agency have a risk assessment process for its projects? Does the agency do risk assessments for purposes of securing federal funding and, if so, how does that type of risk assessment relate to risks that are to be allocated to other parties via contractual terms or risk financing options such as insurance?

Agency Policies, Precedents, and Practices. Most transit agencies have a myriad of internal policies, precedents, and practices with which the transit lawyer will need to become familiar. These policies, precedents, and practices can include a risk assessment process, approach to allocation of risk, statutory or regulatory requirements, standard form contracts, procurement requirements, and past experience with risk management-related issues, such as the structuring of insurance programs like OCIPs and CCIPs. Many times the specifics of these policies, precedents, and practices are driven by the agency's approach to risk management in general, the experience that the agency has had historically with certain types of risk allocation and risk financing, and the practices of the agency in procuring brokerage services and insurance policies.

Of particular importance is the persistence of old or out-of-date contracts used in design and construction, and related contracts. These vestigial contract models for such agreements and contracts often refer to nonexistent, antiquated, or unobtainable insurance products, causing immediate problems of compliance. Further, these same model contracts may approach risk allocation and risk-related provisions from an older and less efficient default perspective, which may conflict with the risk and insurance strategies as agreed among the contracting parties on a specific large project.

The transit lawyer must realize that there is no one "right way" to approach insurance programs. For example, as can be seen from the Case Study Section, transit agencies have materially different approaches to the way that they manage risk and implement insurance programs.

E. External Limitations or Prescriptions

Lender or Bondholder Requirements. Depending on the financing of the transit project, there may be financiers that impose requirements on the parties to insure against certain risks. The best example of this would be a public agency that

[10] *See infra* § III.C.

[11] *See infra* § V.B.

issues its own debt that is held by bondholders. In order to discharge its fiduciary obligations to bondholders, the agency may have to insure the assets that are being constructed as part of its capital program. Another potential type of project where external financiers play a role is a P3, where lenders may be financing the construction costs of the project.[12] Here, it may be less an owner agency issue and more a concessionaire issue, but the transit lawyer should nonetheless be aware of these relationships and inquire whether any inter-concession team insurance requirements impact the agency-driven insurance requirements.

Acceptability of Insurance Choices by Designers and Constructors. Although transit agencies, in theory, can impose insurance requirements on their designers and contractors as a matter of bidding requirements and contract terms, transit lawyers must be aware that unthinking imposition of insurance requirements on the parties delivering the project may have a collateral adverse effect on the project. For example, imposing broad indemnification requirements on designers outside of their professional liability policies exposes them to direct commercial risk that they may not be equipped to handle. If a transit lawyer is going to impose such requirements on designers, then the lawyer must also investigate the creditworthiness of the design firms because, in effect, the balance sheet of the designer is the risk financing that the transit agency has to back up the contractual indemnity. Another example is the use of an OCIP (discussed in detail in Section V.B) when a contractor normally uses its own insurance policies or has a CCIP. In this circumstance, there may be an unintended consequence that the contractor's bid price will be somewhat higher since it does not have the opportunity to realize the savings that could result from a safe CCIP project.

None of this is to say that a transit agency cannot dictate the insurance that it feels is required to protect its own interests. Rather, it is simply to recognize that the impact to designers' and constructors' commercial interests needs to be taken into account in the risk management assessment and the calculus of what type of insurance program the transit agency wants to implement and what its true overall cost will be (as reflected in bid or negotiated prices for design and construction services and deliverables).

Other Third-Party Requirements and Expectations that Impact Insurance. The transit lawyer should also be aware of third-party requirements and expectations that may impact risk allocation and corresponding insurance requirements. The most obvious of these are funding and regulatory agencies that play a role in the project. One example is the legislature and the public, who assume that if there is a loss on the project, the transit agency will not have to pay for it. Particularly in bodily injury or property damage situations, the first question the legislature and the public will ask is: "Is there insurance in place to pay for this loss?" Transit agencies need to be able to be in a position to say in response: "Yes, we understood that there was a risk of this type of event, but we have risk financing and insurance in place to cover it."

III. RISK MANAGEMENT APPROACHES FOR LARGE TRANSIT PROJECTS

A. Enterprise Risk Management

The authors acknowledge that the focus of this digest is obtaining insurance on large transit capital projects. Having said that, we believe it is instructive for the transit lawyer to approach the issue of insurable risk from an enterprise-wide or project perspective, considering the risk potential and consequences for all the participants in the project in the risk allocation, contracting, and insurance procurement processes. The most efficient purchase of insurance results from an enterprise risk management (ERM)[13] perspective. In other words, transit lawyers need to consider taking a holistic approach to risk identification, risk assessment, and risk financing. Risk assessment and risk allocation decisions should precede the decision about what insurance should be required or purchased. Understanding the exposures should drive the insurance purpose, rather than the availability of insurance products in the marketplace.

1. Types of FTA-Funded Projects

The nation's 6,000 transit agencies are engaged in numerous construction projects, which include:

[12] *See* U.S. DOT REPORT TO CONGRESS, *supra* note 1.

[13] Enterprise Risk Management (ERM) as an evolving discipline and an accepted governance practice has a broader application in both the financial institution and operating agency environment and includes consideration and treatment of a broad range of risks, including uninsurable ones. In particular, see the Committee of the Sponsoring Organizations of the Treadway Commission Web site (www.coso.org) for basics, an adopted framework, and ERM Thought Papers.

- Construction of new transportation/ intermodal centers, stations, and rail systems.
- Maintenance facility, track, and signal improvements.
- New and expanded fixed guideway systems.
- Rolling stock acquisitions.

FTA makes available more than $1 billion in federal funds for new and expanded fixed guideway New Starts Transit projects.[14] The FTA New Starts program is the method by which the FTA provides the funding of major capital improvements. The New Starts program involves fixed guideway systems, which include rapid rail, light rail, commuter rail, automated guideway transit, people movers, and exclusive facilities for buses and for high occupancy vehicles.[15] Basic requirements of the program include the following process: the project must emerge from a regional, multimodal planning process and then proceed through the project development phase, preliminary engineering, and final design, followed by a recommendation for funding by the FTA in its Annual Report of New Starts. If approved by FTA, the process culminates in the execution of the Full Funding Grant Agreement. Projects are evaluated and rated, giving comparable weight to the numerous criteria, which include mobility improvements, environmental benefits, cost effectiveness, operating efficiencies, transit-supportive land use and future patterns, economic development effects, reliability of forecasts, local financial commitment, environmental benefits, and cost effectiveness.[16] The New Starts program does not require any special insurance requirements. Federal regulatory constraints are discussed in this digest in Section III.D.

2. Delivery Methods

a. Design–Bid–Build.—The traditional delivery method, still commonly used by many transit agencies, is design–bid–build. This delivery approach is characterized by one contract between the owner and designer, under which the designer produces a "100 percent" designed set of specifications, plans, and drawings. Another contract is awarded to the lowest eligible and responsible bidder, which is required to build the project as specified in the time frame and at the fixed price that the contractor bid. At a general level, the allocation of design risk rests with the owner (and its designer), and the allocation of construction risk (means and methods) rests with the contractor. Typically, the design is quite prescriptive, so that the contractor has no discretion but to build the project as directed by the owner, using the designer-produced construction documents. Many claims that arise under design–bid–build contracts revolve around whether the owner has the risk if the project, as designed, does not work (the so-called *Spearin Doctrine*[17]), or whether and to

[14] *See* Legal Research Digest No. 30, *supra* note 6, at 1, for up-to-date FTA grants; *see also* http://www.dot.gov/grants/15105.html (last accessed Apr. 2014).

[15] *Id.* at 8.

[16] *Id.* at 8–11.

[17] The seminal case establishing the basic allocation of risk between owners and contractors for the adequacy of design on which construction responsibility rests is United States v. Spearin, 248 U.S. 132, 39 S. Ct. 59, 63 L. Ed. 166 (1918). In *Spearin*, the contract called for the contractor to build a dry dock. Part of the scope of work included relocating a 6-ft sewer. After the sewer was relocated, a heavy rainstorm backed water up into the sewer, breaking it and flooding the dry dock. It turned out that there was an existing dam not shown on the contract plans that contributed to the flooding and failure. Ultimately, the work was not completed, but the contractor sought damages for the value of the work it did perform. In finding for the contractor, the court established the fundamental liability differences between owners and contractors for constructability risk:

> Where one agrees to do, for a fixed sum, a thing possible to be performed, he will not be excused or become entitled to additional compensation, because unforeseen difficulties are encountered. Day v. United States, 245 U.S. 159, 38 S. Ct. 57, 62 L. Ed. 219 (1917); Phoenix Bridge Co. v. United States, 211 U.S. 188, 29 S. Ct. 81, 53 L. Ed. 141 (1908). But if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications. MacKnight Flintic Stone Co. v. Mayor of New York, 160 N.Y. 72, 54 N.E. 661 (1899); Filbert v. Philadelphia, 181 Pa. St. 530, 37 A. 545 (1897); Bentley v. State, 73 Wis. 416, 41 N.W. 338 (1889). See Sundstrom v. New York, 213 N.Y. 68, 106 N.E. 924 (1914). This responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work, as is shown by Christie v. United States, 237 U.S. 234, 35 S. Ct. 565, 59 L. Ed. 933 (1915); Hollerbach v. United States, 233 U.S. 165, 34 S. Ct. 553, 58 L. Ed. 898 (1914), and United States v. Utah, Nevada, and California Stage Co., 199 U.S. 414, 424, 26 S. Ct. 69, 73, 50 L. Ed. 251, 255–256 (1905), where it was held that the contractor should be relieved, if he was misled by erroneous statements in the specifications.

For a complete analysis of legal issues associated with performance specifications, *see* MICHAEL C. LOULAKIS, LEGAL ASPECTS OF PERFORMANCE-BASED SPECIFICATIONS FOR HIGHWAY CONSTRUCTION AND MAINTENANCE CONTRACTS (Transit Cooperative Research Program, Legal Research Digest No. 61, 2013) (hereinafter referred to as Legal Research Digest No. 61).

what extent the contractor assumed the risk as part of its means and methods. These claims, however, often revolve around commercial allocation of risk, as contrasted with insurance allocation of risk. Most often the latter types of claims involve some sort of property damage or bodily injury, since that is the type of occurrence or loss that insurance more typically covers (as contrasted with commercial risk).

b. CM/GC.[18]—CM/GC[19] is a method that expands the conventional role of the constructor into acting as both construction manager and constructor. The owner still enters into a separate contract with a designer to produce "100 percent" designed construction specifications, plans, and drawings. In the first phase of the CM/GC process, the construction manager (CM) is generally selected on the basis of qualifications, past experience, and other "best-value" considerations, using a combination of qualifications and experience evaluation factors. During the design phase, the CM works closely with the designer and provides input regarding design options, scheduling, pricing, means and methods, and other factors that help the designer design a more constructible and cost-effective project. In the second phase of the process, at approximately 60 percent to 90 percent of design completion, the owner and CM negotiate a guaranteed maximum price (GMP) or lump sum price (LSP) for construction and delivery of the project based on the now-defined design, scope, and schedule. If this price is acceptable to both parties, the CM changes into the general contractor (GC), and the owner and GC execute a contract for construction services.

By allowing an owner to engage a CM during the design process, the contractor is able to work closely with the designer and provide constructability and value engineering input, leading to a better defined design and scope of work. This also allows the now project-knowledgeable contractor to provide an equally better defined and more reliable GMP for the scope, duration, and cost of the project based on a final design on which it provided input. In theory, there should also be a corresponding decrease in risk of unknowns, since the CM/GC contract creates a single source of responsibility for construction cost and schedule risk through the GMP. However, even under the CM/GC approach, final design responsibility, if prescriptive design methods are used, will still rest with the owner (and its designer).[20]

c. Design–Build.[21]—DB is a method of project delivery in which a contract is executed with a single entity (the DB contractor) to provide both design and engineering and construction delivery services for a fixed price. The DB contractor is generally selected on a best value basis (qualifications, price, and other factors). The contract in this approach typically progresses through two phases: 1) completion of a higher level of design (60 percent or more), prior to 2) fixing the price and then finalizing the design and completing construction. However, a DB contractor can also be procured initially on a competitive-bid basis of an LSP, where the level of design could be as little as 10 percent (conceptual) or as much as 30 percent (preliminary engineering).

Owners benefit in DB from reductions in the cost and time to complete projects because design and construction can be fast tracked and sequenced in parallel so that materials and equipment procurement and construction work begin sooner. The owner also benefits from reducing the procurement cycles that are typically required in selecting a designer and then preparing fully designed bidding packages. Furthermore, it has been demonstrated that contractors and designers, working as an integrated team, can produce less expensive and better designed structures and facilities. This also expands opportunities to use innovative construction technology, accelerated scheduling, and improved means and methods that are incorporated into the final design. Moreover, because the DB contractor is solely responsible for the completed project, the DB contractor also is motivated to advance a quality project throughout the design and construction process.

The DB process results in a fundamental shift of risk to the DB contractor, which now has re-

[18] *See* Legal Research Digest No. 30, *supra* note 8, at 24, for a description of Construction Manager at Risk under the FTA New Starts Program.

[19] The construction manager/general contractor (CM/GC) delivery method is also called the Construction Manager at Risk (CMAR) method by state law in some states. A complete discussion of CM/GC can be found in DOUGLAS G. GRANSBERG & JENNIFER S. SHANE, CONSTRUCTION MANAGER-AT-RISK FOR HIGHWAY PROGRAMS (National Cooperative Highway Research Program Synthesis No. 402, 2010) (hereinafter referred to as Synthesis No. 402).

[20] *See* Legal Research Digest No. 61, *supra* note 17, for a full exploration of the allocation of risks and liabilities as between prescriptive and performance specifications.

[21] *See* Legal Research Digest No. 30, *supra* note 8, at 23, for a description of DB under the FTA New Starts Program.

sponsibility for both design and construction. This has corresponding impact on the risks that the owner will need to risk finance, either through commercial terms (relying on the balance sheet of the DB contractor, which is usually the lead contractor, and its designer), or through insurance that generally the DB contractor will need to maintain.

d. Public–Private Partnerships.[22]—A typical P3 includes a master agreement, referred to here as the comprehensive or concession agreement (CA), between the public partner (owner) and the private partner (concessionaire or developer). Within the CA there may one or more requirements for the concessionaire to perform: project development, project financing, DB delivery, operations and maintenance (O&M), and capital asset replacement.[23] To work best, P3s are structured to share risk and reward between the public partner and the private partners. A project structure should be established that integrates *all* the necessary elements of the project into one endeavor: planning, environmental permitting and compliance, financing, procurement, design, construction, user fee setting, operations, maintenance and capital asset replacement, and "hand back" requirements.

The owner is best served working through a single, accountable "at risk" entity (the concessionaire) representing the interests of the entire project and delivering it with the optimum balance of planning, design development, construction costs, delivery schedule, operations, and lifecycle costs. Underneath the concessionaire there are often major contracts and subcontracts with a DB contractor, prime subcontractors, an operator, and, possibly, a major equipment supplier. In addition, there will be financial lenders that are backing the concessionaire—the financial lenders will have a direct interest in the costs and timing of delivery and operation of the facility since it provides the revenue stream for financing the project construction and operational costs that the lenders are underwriting.[24]

Although it may appear superficially that all risk can be transferred to the concessionaire, the design and construction risks inherent in any large capital project still exist, and the transit lawyer will need to consider how those risks are being allocated and financed, since all of that will be built into the pricing of the CA and will need to be managed during the course of the project. Although the direct liability of the owner may be reduced by contract, the interests of the owner in the appropriate identification, allocation, management, and financing of those risks must still be a priority.

e. Equipment Purchases.—Transit lawyers will recognize that the purchase of equipment, particularly rolling stock acquisition, presents a separate set of insurance challenges. There are exposures to the equipment during the manufacturing, fabrication, testing, and delivery phases, as well as exposures to the liability losses arising out of design, manufacturing, testing, and delivery activities. Complicating the risk analysis in the case of rail cars is the infrequent, large-scale, and one-off nature of the procurement process for such a customized product. Further, rail cars and similar units are often repurposed and transferred from one agency to another.

The risk allocation and insurance requirement aspects of rail car acquisition are effectuated through the development of the RFP documents, including technical specifications, and the resulting purchase agreements. The property, irrespective of who has a legal interest at the time of loss, can be insured throughout the manufacturing, testing, and delivery phases. The transit lawyer will need to ensure that designers and manufacturers carry appropriate professional and products liability coverage, as well as general liability coverage.

Typical coverages involved in equipment purchases, whether carried by the transit agency or the seller, include:

- Property coverage for damage to the equipment during the manufacturing, fabrication, renovation, modification, testing, and delivery process. Coverage can be provided on a nonstandard installation floater or similar floater policy. Particular attention should be paid to any testing exclusions. Depending on the form of coverage used, extensions may be available to include consequential or resultant damage such as extra expense or revenue loss from damage to the equipment and inability to deliver on time. Any uninsured or uninsurable exposures should be

[22] *See* Legal Research Digest No. 30, *supra* note 8, at 24–25, which describes design-build-finance and design-build-operate-and-maintain P3s.

[23] It should be noted that this digest focuses on designing and building transit capital projects and does not address operations and maintenance and capital asset replacement issues. However, the transit lawyer should be aware that these additional phases have risks that will need to be allocated both by contract and with insurance.

[24] *See* U.S. DOT REPORT TO CONGRESS, *supra* note 1.

allocated in the purchase and sale agreement or similar procurement document.

- Liability coverage for injuries suffered by third parties (including the transit agency's employees) due to design or manufacturing errors or omissions. Coverage could be found in either 1) general liability or umbrella liability policies, including any products and completed operations extensions, or 2) in professional liability policies. Both of these approaches are described in more detail elsewhere in this digest.
- Two additional, but related, exposures may be treated by risk financing approaches. One is the delay exposure, when the equipment cannot be put into revenue service for reasons other than damage to the equipment. The other is an efficacy exposure, when the equipment fails to meet performance specifications. In some rare cases, manufacturers have provided specialized efficacy insurance policies. In others, contract terms have been guaranteed under performance and payment bonds (which are beyond the scope of this digest).

B. Risk Allocation Approaches[25]

1. General Principles for Risk Allocation

The most common advice on effectively managing risk is to apply the following guiding principle: "Risk should be allocated to the party that is best able to avoid the risk, manage the risk, mitigate the risk, or absorb the risk" (referred to herein as "Risk Allocation Principle"). The corollary to this principle is as follows: "If the Risk Allocation Principle is not followed, it is more likely that that risk will occur, that the occurrence will cause some adverse effect, and that the party that cannot handle that risk will seek to shift the risk to some other party on the project" (referred to herein as "Risk Allocation Corollary"). The result of the Risk Allocation Corollary is that when the risk event occurs and there is a bad result, there will be a claim made to shift the consequences of the risk occurrence—this triggers the project parties to start expending project resources battling over which party will ultimately bear the consequences of the risk.

2. Current Practices for Drafting Contract Provisions

Unfortunately, project parties spend a lot of resources drafting contracts that identify a myriad of risks and then seek to shed or transfer those risks to other parties, in the perhaps mistaken assumption that the contractual transfer of risk in itself somehow avoids the risk (to the risk-shedding parties). This behavior is compounded by the advent of alternative project delivery methods, such as DB and P3, where there is a tendency by public owners to attempt to shed as much risk as possible by transferring blanket responsibility to the DB team or the P3 concessionaire. In turn, the contractor on a DB team may seek to make a corresponding blanket risk transfer to its designer and subcontractors, and likewise a P3 concessionaire may seek to do a blanket risk transfer to the DB team or operator. This "flow down" transfer of risk may look good on (contractual) paper, but in reality violates the Risk Allocation Principle and creates the Risk Allocation Corollary, with its attendant bad consequences.

3. Retained Risk

If one follows the Risk Allocation Principle, it may make sense to retain risk—if the retaining party is in the best position to avoid, manage, mitigate, or absorb the retained risk. A good example of retained risk is the classic differing site condition provision, where the owner retains the risk for site conditions that are different than those shown on the contract plans and drawings.[26] The theory behind this retained risk is that, if there are accurate plans and drawings, then there should be a reasonably small likelihood of the risk occurring. But if it does, the owner (presumably having some contingency funds for "known unknowns") will pay only for the actual cost of addressing the differing site condition. If the owner had transferred this risk to the contractor, the contractor (assuming proper bidding practice) would have included some money in its bid for the potential cost of differing site conditions. By retaining this risk, the owner is applying the Risk Allocation Principle: it is in the best position to avoid the risk by having its designer prepare accurate plans and drawings. If the risk does not happen, the owner pays nothing; if the risk does happens, the owner is paying only for actual costs, not paying up front to transfer that risk to the contractor through its bid price.

Another strategy of introducing risk retention is through deductibles or self-insured retentions in various insurance policies. These are typically

[25] *See* CONSTRUCTION INSURANCE, *supra* note 8, at 1–7.

[26] 23 C.F.R. § 635109, by way of example, requires the incorporation of differing site condition provisions in all federally aided highway low-bid contracts.

used to control the cost of insurance by not transferring high frequency, low severity losses to the insurance company. These retentions are dealt with in greater detail in Section VI.B of this digest.

4. Contractually Transferred Risk

Here we are addressing commercial allocation of risk. That is, risk is being contractually transferred to another party that finances the risk out of the contract proceeds or its own balance sheet. Thus, the owner needs to assure itself that the party accepting the risk has the financial wherewithal to backstop losses that might occur from that risk. Contractual transfer of risk is a smart choice if the owner uses the Risk Allocation Principle; that is, risk should be allocated to the party best able to avoid, mitigate, manage, or absorb the risk. However, if the owner contractually makes a blanket shedding of risk to another party, then it may raise the specter of the Risk Allocation Corollary, notwithstanding the apparent transfer of the risk by contract.

A classic example of this is when the owner includes geotechnical information in bidding documents, then disclaims their accuracy and puts the burden on the contractor (in a constrained bidding period) to do a complete site investigation, and then gets into a claim situation when the contractor encounters an unknown condition that was not in, or is different from, the geotechnical documents. The contractor has to finance the additional costs from its own resources, even if it makes a claim for reimbursement from the owner. Although in theory the owner has the better contractual argument, it is not iron clad if the contractor, in bidding the project, reasonably interpreted the geotechnical documents, was unable to do its own site investigation due to bidding constraints, or there is a differing site condition provision that opens the door to the contractor's claim, notwithstanding the owner's blanket disclaimer. However, even if the owner wins the contractual battle, it may be a pyrrhic victory if the contractor cannot finance the additional costs attendant to the contractual transfer of the risk and the project itself suffers the consequences (that is, potentially lesser quality or delay in delivery).

C. General Legal Issues that Impact Insurance Programs

1. Standard Indemnification Provisions

Transit agency lawyers should have a thorough understanding of the different forms of indemnification and the statutory restrictions placed on these types of provisions. This knowledge must be supplemented with the knowledge about the insurability (or noninsurability) of indemnification risk through liability coverage and applicable statutory restrictions.

One popular risk transfer mechanism is the use of indemnity clauses. Indemnity clauses transfer risks from one party (the "indemnitor") to another party (the "indemnitee"). Indemnity obligations can vary in kind, scope, and amount, and their meaning and application depend on the applicable jurisdiction in which they will be enforced.

In addition to indemnification, additional insured status offers another viable risk transfer mechanism discussed in Section V.A of this digest. While indemnity clauses transfer risk from one party to another for certain specified losses, additional insured clauses transfer risk from one party to another party's insurance company, giving that party status as an insured for certain losses.[27]

Some indemnity provisions are implied by law without an express written indemnity agreement, while others are expressed in contract provisions. In practice, indemnity provisions have several ranges depending on the scope of the indemnification and the degree of fault attributable to the indemnitor. Recognized indemnity provisions include common law, limited form, intermediate form, and broad form.

Common Law Indemnity. Common law indemnity is implied by law without express written agreement. Common law indemnity covers indemnification for losses only when the indemnitor is 100 percent at fault. Common law indemnity is an equitable doctrine that generally requires lack of fault on the party seeking the indemnity.

Limited Form Indemnity. Limited form indemnity provides coverage for losses "to the extent" of the indemnitor's negligence. For example, the standard American Insurance Association (AIA) indemnity clause found within its general conditions is a typical example of this clause and has been widely adopted in the construction industry. Section 3.18 of the AIA standard indemnification clause provides:

> To the fullest extent permitted by law the Contractor shall indemnify and hold harmless the Owner, Architects, Architects' consultants and agents, and employees of any of them from and against any claims, damages, losses, and expenses including but not limited to attorney fees arising out of or resulting from the performance of the Work, provided such claim, damage or loss or expense is

[27] *See* CONSTRUCTION INSURANCE, *supra* note 8, at 143.

attributable to bodily injury, sickness, disease or death, or to an injury to or destruction of tangible property (other than the Work itself), but only to the extent caused by negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts or expenses is caused in part by a party indemnified hereunder. Such obligation shall not be construed to negate, abridge or reduce other rights or obligations of indemnity which would otherwise exist as to a party or person described in this section 3.18.[28]

The principle behind this clause is that the indemnitor is required to indemnify the indemnitee for the indemnitee's liability caused by the indemnitor, but not for the liabilities caused by others. These principles are not easy to apply and often require intensive fact and fault analysis.

In California, the indemnity provisions for the Crenshaw/Los Angeles International Airport (LAX) Transit Corridor are a representative example of an indemnity provision currently in use by transit agencies:

43.1 Indemnification for Non-Design Professional[29]

To the fullest extent permitted by law, the Contractor shall indemnify, defend, and hold harmless LACMTA, its subsidiaries, and any of their respective members, directors, officers, employees and agents ("Indemnified Parties"), from and against any and all claims, actions, demands, costs, judgments, liens, penalties, liabilities, damages, losses, and expenses (including but not limited to any fees of accountants, attorneys or other professionals), arising out of, in connection with, resulting from or related to any act, omission, fault or negligence of the Contractor or any of its officers, Authorized Representative, employees, Subcontractors, Suppliers, or any person or organization directly or indirectly employed by any of them in connection with or relating to, or claimed to be in connection with or relating to, the Work, the Contract, or the Project including without limitation to any costs or liability arising out of, in connection with, resulting from or related to:

43.1.1 The personal injury to or death of any person (including employees of any Indemnified Parties) or for damage to or loss of use of property (including property of LACMTA); and

43.1.2 LACMTA's reliance upon the use of data or other information furnished or delivered by the Contractor pursuant to the Contract. The duties specified above shall apply even in the event of an act, omission, fault or negligence whether active or passive, of the Indemnified Parties and without requiring payment thereof by the Indemnified Parties first. However, Contractor shall not be responsible for indemnifying an Indemnified Party for liability resulting from said Indemnified Party's sole negligence, willful misconduct, or for that portion of liability directly attributable to Indemnified Parties' active negligence provided such active negligence is determined by agreement between the Parties or by the findings of a court of competent jurisdiction.

43.1.3 Further, to the fullest extent permitted by law, the Contractor shall indemnify, defend, and hold harmless Indemnified Parties from and against any and all claims, actions, demands, costs, judgments, liens, penalties, liabilities, damages, losses, and expenses (including but not limited to any fees of accountants, attorneys or other professionals) caused or alleged to have been caused by the passive negligence of the Indemnified Party, without requiring payment thereof by the Indemnified Parties first, in connection with or relating to, or claimed to be in connection with or relating to, the Work, the Contract, or the Project, including without limitation to any costs or liability arising out of, in connection with, resulting from or related to:

A. The personal injury to or death of any person (including employees of any Indemnified Parties) or for damage to or loss of use of property (including property of LACMTA); and

B. LACMTA's reliance upon the use of data or information furnished or delivered by the Contractor pursuant to the Contract.

Intermediate Form Indemnity. Intermediate indemnity covers losses caused in whole or in part by the negligence of the indemnitor. Under this approach even if the indemnitor is almost, but not completely, at fault the indemnitor is still responsible. Some state anti-indemnity laws prohibiting broad form indemnity may permit the intermediate form. This can result in an inequitable circumstance where the intermediate indemnity language can be triggered when the indemnitor is only 3 percent negligent.[30]

Broad Form Indemnity. Broad form indemnity provides indemnification for all liabilities regardless of whose negligence caused the liabilities. It provides coverage for all losses even when the indemnitee is 100 percent negligent. Broad form requires the indemnitor to save and hold harmless the indemnitee regardless of which party created the liability.

Importance of Statutory Limitations. Thirty-nine states have enacted statutes barring or limiting indemnification provisions, while 17 prohibit indemnification provisions for the indemnitee's sole negligence.[31] Many states have enacted legislation that declares broad form indemnity void as it is against public policy. In addition some state anti-indemnity statutes apply to both broad form and intermediate form indemnity agreements. The rationale supporting the justification behind

[28] *Id.* at 179.

[29] Request for proposals (RFP) for Crenshaw/LAX Transit Corridor at 126–27 (on file with authors).

[30] *See* CONSTRUCTION INSURANCE, *supra* note 8, at 146.

[31] *Id.* at 147.

the prohibition is that it may lessen the incentive to provide a safe construction site.

A typical anti-indemnity statute in California provides:

> *Provisions, clauses, covenant, or agreement* contained in, collateral to, or affecting any construction contract and that *purport to indemnify the promisee against any liability for damages* for death or bodily injury to persons, injury to property, or other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents servants, or independent contractors who are directly responsible to the promisee or for defects in design furnished by those persons are against public and *are void and unenforceable.*[32] (Emphasis added.)

It is important that drafters of indemnity provisions and insurance provisions have a clear understanding of whether specific state statutes limit or prohibit the transfer of risk through indemnity provisions, and whether that transferred risk is indeed covered by insurance.

Transit lawyers also should be aware of statutory requirements[33] that may limit tort liability to specific fixed amounts and place limitations on pain and suffering, as well as providing sovereign immunity protection to the public owner. There are several considerations. The first is whether such limitations apply to the transit agency. The second is whether the limitation applies to the activities involved.[34] A third is whether the existence of insurance defeats the limitation or immunity. A fourth is whether the agency is exposed to derivative actions through required indemnification of employees or other parties.[35]

Subrogation and Indemnity Provisions. The standard commercial general liability (CGL) insurance policy provides coverage for the indemnity provision. The coverage is part of the standard form but is provided in a circuitous manner as an exception to exclusion. The exclusion states that insurance does not apply for bodily injury or property damage by reason of assumption of liability in a contract or agreement. But this exclusion states that it does not apply to a contractual agreement. The definition of insured contract includes the indemnification clause so the exclusion does not apply and the standard CGL provides the indemnification coverage.

Another insurance principle that transit lawyers should be familiar with is subrogation. Generally speaking, subrogation occurs when a party's insurer pays for loss that was caused by or was the responsibility of another party. The insurer that pays the loss is then subrogated to the rights of the insured and may pursue direct legal action against the responsible party.

In construction contracts, subrogation claims often are waived in the contract provisions. Standard form agreements have been developed to include waiver of subrogation language to enable parties to look to their own insurance or specific insurance for certain claims without resorting to litigating fault or causation. General subrogation language specifies that project participants agree to waive all rights against the others to the extent covered by insurance. These waivers have been upheld and determined to be a valid risk transfer mechanism. It is important to transit risk managers and lawyers that the applicable insurance policies include an affirmative waiver of subrogation provision that acknowledges these waivers and that the parties on the project agree to waive their rights of subrogation in the event of a paid loss.

D. Federal Regulatory Constraints

The FTA, one of the 10 modal administrations of the United States Department of Transportation, provides financial assistance to develop new transit systems and improve, maintain, and operate existing systems. The public transportation systems include rail transit, commuter rail, passenger ferry boats, buses, and vans.

FTA issues a series of master agreements, certificates, circulars, guidance, and best practice manuals that contain insurance requirements. Section 20, Insurance, of the standard FTA Master Agreement provides that at minimum, recipients will comply with the insurance requirements normally imposed by their state and local laws and regulations, except as the federal government determines otherwise in writing. It further references compliance with flood insurance provisions

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[32] CAL. CIV. CODE § 2782.1.

[33] *See* LARRY W. THOMAS, STATE LIMITATIONS ON TORT LIABILITY OF PUBLIC TRANSIT OPERATIONS (Transit Cooperative Research Program, Legal Research Digest No. 3, 1994), for examples of the date of publication, http://onlinepubs.trb.org/onlinepubs/tcrp/tcrp_lrd_03.pdf (publication has not been updated).

[34] Certain states have discretionary function exceptions to state liability. *See* National Conference of State Legislatures Web site (http://www.ncsl.org/research/transportation/state-sovereign-immunity-and-tort-liability.aspx#Table).

[35] In Massachusetts, for example, certain freestanding authorities, including specified transit agencies, have been included within the tort limitation under MASS. GEN. LAWS ch. 258. *See* MASS. GEN. LAWS ANN. ch. 258, §§ 1, et seq.

of the Flood Disaster Protection Act of 1973[36] for projects having insurable cost of $10,000 or more.

FTA Certifications and Assurances do not directly specify insurance requirements but do reflect cost principles.

FTA C5010D Grant Management Requirements, which provide guidance for federal assistance requirements, refer to the same provisions of 49 Code of Federal Regulations (C.F.R.) Part 19.31 set forth above.

Recipients of federal grants must comply with the provisions of the Master Agreement, which provide that project costs be reasonable and adhere to the allowable costs regulations prepared by the Office of Management and Budget, Circular A-87 Part 225, Cost Principles for State, Local, and Indian Tribal Governments, which covers awards carried out through grants and cost reimbursement contracts.[37] The Master Agreement also requires that recipients be subject to an annual audit pursuant to 49 C.F.R. Parts 18 and 26.

Other federal provisions include 2 C.F.R. Part 230, Section 23, Insurance, which provides that the types, extent, and cost of insurance coverage must be in accordance with the governmental unit's policy and sound business practice. The provisions provide guidance for contribution to reserves for self-insurance programs, including workers' compensation, unemployment compensation, and severance pay.[38] They also include provisions on accounting records and requirements for reasonable estimates for self-insured liabilities, etc. The regulations also specify the documentary requirement for self-insurance funds,[39] but do not mandate specific insurance coverages.

In addition, FTA Third Party Procurement Guidelines do not provide insurance requirements, but do provide the opportunity to obtain responses to insurance questions.[40] In summary, transit officials should be aware that insurance costs must be reasonable and that they are subject to FTA annual audit requirements.

[36] Pub. L. No. 93-234, 87 Stat. 975 (1973).

[37] FTA Master Agreement (MA) (19), Oct. 1, 2012, at 60–61. *See* http://www.fta.dot.gov/documents/Appendix_A_Legal_Capacity_Documents_Master.pdf (last accessed Apr. 2014).

[38] Cost Principles for State, Local, and Indian Tribal Governments (OMB Circular A-87), 70 Fed Reg. 51,910, at 51918 (Aug. 31, 2005), to be codified as 2 C.F.R. pt. 225.

[39] *Id.* at 51,923.

[40] Frequently asked questions may be found at http://www.fta.dot.gov/about/13057.html.

The best resource for FTA insurance guidance and discussion is reflected in FTA's *Best Practices Manual*, Chapter 6, Procurement Object Types–Special Considerations, at pages 50–56. The *Best Practices Manual* alerts recipients to comply with state insurance requirements, which generally require workers' compensation, builder's risk, general liability, railroad protective, automobile, and errors and omissions, etc. The manual also urges consideration of wrap-up[41] policies for large projects over $100 million, and indicates that the wrap-up approach has been used with excellent results.[42] It discusses the numerous advantages of wrap-ups, which include cost savings in workers' compensation premiums, enhanced disadvantaged business enterprise (DBE) participation, reduction of the cost of settlement of claims, coordination of safety issues, and assurance that all contractors and subcontractors have adequate insurance coverage. The manual relies on the General Accounting Office (GAO) report on wrap-ups.[43] According to this GAO report, wrap-ups can save project owners up to 50 percent on the cost of traditional insurance, or from 1 percent to 3 percent of a project's construction costs depending on the size. Barriers to implementation include several states having systems that prevent wrap-up for workers' compensation and the additional cost of staff to create and administer a viable wrap-up program.[44]

E. State and Regulatory Constraints Affecting Ability to Assign Risk Contractually

1. Legal Liability—Strict Liability or Comparative Negligence

Transit insurance professionals should have a basic understanding of the following legal terms and basic tort law concepts that can impact insurance programs. To begin, public owners may be

[41] A "wrap-up" is a colloquial reference to a CIP. Depending on the sponsor, a "wrap-up" can be either an OCIP or a CCIP. As noted previously, the authors would encourage readers to consult the IRMI online Glossary of Insurance and Risk Management Terms found at http://www.irmi.com/forms/online/insurance-glossary/terms.aspx.

[42] FEDERAL TRANSIT ADMINISTRATION, BEST PRACTICES MANUAL, at 52. *See* http://www.fta.dot.gov/grants/13054_6037.html.

[43] U.S. GENERAL ACCOUNTING OFFICE, TRANSPORTATION INFRASTRUCTURE: ADVANTAGES AND DISADVANTAGES OF WRAP-UP INSURANCE FOR LARGE CONSTRUCTION PROJECTS (1999).

[44] *Id.* at 53.

liable for the negligence of their contractors and employees. Negligence is generally defined as failure to exercise the care a reasonably prudent person would exercise under the same circumstances that led to the injury. In order to prove negligence the plaintiff must prove a duty on the part of the defendant, that the defendant breached the duty, and causation and damages.[45]

Defenses to allegations of negligence may include asserting that the plaintiff contributed to the loss. This contributory defense has generally been replaced by the theory of comparative negligence. Contributory negligence is defined as the common law doctrine that states that if a person is injured due to his or her negligence or that negligence contributed to the accident, then he or she would not be able to recover damages from another party that supposedly caused the accident. Under this rule a severely injured party who is only slightly negligent would not be able to recover against a very negligent defendant. The basic unfairness of this result has led juries to ignore this rule, and numerous states have adopted a comparative negligence standard in which the relative negligence percentage by each person is used to determine the damage recovery.[46]

Comparative negligence is a partial legal defense to what a plaintiff can recover in a negligence claim based upon the degree to which the plaintiff's negligence contributed to the injury. When this defense is asserted, the fact finder or jury must decide on the plaintiff's percentage of negligence as compared to the combined negligence of all other parties.

California, for example, has adopted a pure comparative negligence system whereby a jury assigns a percentage of liability of fault to each responsible party and then apportions the award accordingly. Under this system the plaintiff's award is reduced by the percentage of its fault. For joint and several liability situations where there is more than one tortfeasor, the remaining liability (after deducting plaintiff's comparative negligence) is split between the parties depending on the nature of the damages.[47] Contrasting to this is Massachusetts, which has adopted a modified comparative fault by statute: if the negligence of the plaintiff is 50 percent or less then his or her recovery is reduced pro rata, and if the plaintiff's negligence is greater than 50 percent then recovery is barred.[48]

Neither contributory negligence nor comparative negligence should be confused with joint and several liability, which generally holds two or more defendants responsible for all the damages sustained by the plaintiff. New York law, for example, allows joint and several liability such that one party may be held liable for the entire amount of provable damages caused by all liable parties. In Massachusetts a defendant who pays more than his pro rata share may seek contribution from the other responsible defendant or defendants, while in New York if the defendant is 50 percent or less liable, the contribution for noneconomic damages (pain and suffering) is limited to its proportionate share.[49] Practical reasons generally dictate, when faced with a defense of comparative negligence, a joinder of all potentially culpable defendants to the litigation because the plaintiff's negligence will be balanced against the combined negligence of all the defendants.[50]

Standard of Care. Failure to adhere to the applicable standard of care is an important element in tort litigation. Although a transit owner has coverage for design errors and omissions, it may be denied recovery if the designer adheres to the applicable standard of care. Standard of care is defined as the exercise of watchfulness, attention, and prudence that a reasonable person would exercise under the circumstances that led to the injury. If a person fails to meet the standard of care, it is considered negligence and damages resulting

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[45] *See* THOMAS, *supra* note 33.

[46] Contributory negligence is defined as proving that by the greater weight of evidence not only was the plaintiff negligent, but also that the negligence was a proximate cause and direct efficient cause of the accident. Estate of Moses v. Sw. Va. Transit Mgmt. Co., 273 Va. 672, 643 S.E.2d 156 (2007).

[47] AMERICAN BAR ASSOCIATION COMMERCIAL TRANSPORTATION LITIGATION COMMITTEE, COMPARATIVE/CONTRIBUTORY NEGLIGENCE AND JOINT AND SEVERAL LIABILITY, A STATE BY STATE SUMMARY 10 (2009), http://axilonlaw.com/wp-content/uploads/2012/04/50_State_Compendium_-Final_reduced_size.pdf (hereinafter referred to as ABA State by State Summary); *See also* Li v. Yellow Cab Co., 13 Cal. 3d 804, 532 P.2d 1226, 119 Cal. Rptr. 858 (1975), and Safeway Stores v. Nest-Kart, 21 Cal. 3d 322, 579 P.2d 441, 146 Cal. Rptr. 550 (1978).

[48] ABA State by State Summary, *supra* note 47, at 41; *see* MASS. GEN LAWS C. 231B § 1-4.

[49] ABA State by State Summary, *supra* note 47, at 41 and 64. *See also* N.Y.C.P.L.R. § 1411,1401, 1601.

[50] Black's Law Dictionary defines comparative negligence as a plaintiff's own negligence that proportionately reduces the damages recoverable by the defendant; also called comparative fault. BLACK'S LAW DICTIONARY 1062 (9th ed. 2009).

from it may be claimed by the injured party. Whether the applicable standard of care has been breached is determined by the trier of facts and is usually phrased to the fact-finder in terms of what a reasonable prudent person would have exercised under the circumstances.[51]

2. New York State Labor Law Liability

New York law provides an excellent example of how state law affects insurance exposure. There is little debate that construction in New York has historically been subject to a litigious environment. In New York, while construction workers are protected by workers' compensation laws, workers who suffer an injury in a construction accident may commence a tort action against the general contractor and/or the owner of the construction site.[52]

New York is currently the only state with a law that makes employers and owners strictly liable for worker injuries on the job site. Labor Law Section 240, also known as the "Scaffold Law," makes the contractor on the site and the owner of the property liable for workers' injuries as a result of inadequate or missing safety equipment at elevated work sites. The section provides that contractors and owners provide scaffolding, ladders, slings, and other devices that are secured and braced and have a safety rail. The statute is designed to protect those employees working at elevated heights and also employees working on the ground from the danger of falling objects.

The statute imposes absolute liability on owners and general contractors regardless of fault of the plaintiff.[53] This means that the injured worker does not have to show that the contractor/owner was negligent or that the contractor/owner intended to harm him or her. The New York courts interpreting Labor Law Section 240 observe that the required safety devices (scaffolding hoists, braces, etc.) evidenced legislative intent to protect workers from special hazards limited to specific gravity-related accidents, such as falling from heights or being struck by falling objects.[54] In 2009 the New York Court of Appeals (New York's highest court) expanded the scope of elevated related hazards to situations where a worker was neither felled nor injured by a falling object, but by injury flowing from the application of laws of gravity.[55] In order to prevail, the plaintiff need only prove that the statute was violated and the violation was the proximate cause of injury. Further, if the worker's action was the proximate cause of the accident there is no Section 240 liability.

In addition, strict liability is imposed by New York Labor Law Section 241(6), Construction, Excavation and Demolition, which mandates that owners and contractors provide reasonable and adequate safety equipment for anyone employed in construction, excavation, and demolition.

Both Sections 240(1) and 241(6) impose vicarious responsibility on the owner and contractor, whether they supervise or control the work site directly or delegate that to others.

Further, New York Labor Law Section 200 codifies the common law obligation of reasonable care in the maintenance of the work site. It specifies that the contractor, owner, and employer each have the duty to provide a safe place to work and the general duty to protect the health and safety of workers by requiring that the work sites be constructed, equipped, arranged, operated, and conducted so as to provide reasonable and adequate protection to the lives, health, and safety of all persons employed therein or lawfully frequenting such places. Unlike Sections 240(1) and 241(6), there is no vicarious liability, so that the owner can be liable only if it is in control of the work.

The aforementioned New York statutes creating strict liability situations for the owner and contractor have contributed to the increased cost of insurance premiums in New York and resultant increased project costs. A study conducted by the Cornell University Department of Policy Analysis and Management and the State University of New York Nelson A. Rockefeller Institute of Government concluded that the law resulted in more accidents and cost the construction and real estate industries $3 billion a year in additional costs.[56]

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[51] *See* Black's Law Dictionary defining negligence as the failure to exercise the standard of care that a reasonably prudent person would have exercised in a similar situation. BLACK'S LAW DICTIONARY 1061 (8th ed. 2004), and Feiser v. Kan. State Bd. of Healing Arts, 281 Kan. 268, 130 P.3d 555 (2006).

[52] N.Y. LAB. LAW §§ 200, 240, and 241(6).

[53] The statute does exempt single and two family homeowners, unless they exercise control of the work, and professional engineers and architects so long as they are not directing the work being performed. N.Y. LAB. LAW § 240 (1).

[54] Ross v. Curtis-Palmer-Hydro-Elec. Co., 81 N.Y.2d 494, 618 N.E.2d 82, 601 N.Y.S.2d 49 (1993).

[55] Runner v. N.Y. Stock Exchange, 13 N.Y.3d 599, 922 N.E.2d 865, 895 N.Y.S.2d 279 (2009).

[56] Daniel Geiger, *Obscure Law Drives Up Building Costs*, CRAIN'S NEW YORK BUSINESS, Feb. 19, 2014, available at http://www.crainsnewyork.com/article/

In 2012, for example, insurance brokers indicated a 10 to 20 percent increase in premiums in practice policies with increased minimum primary CGL limits, in addition to almost doubling OCIP rates.[57]

3. Acts of God—Force Majeure

Another legal issue is the question of to what extent is the insurer, owner, or contractor responsible for damages caused by so-called "Acts of God" or "Force Majeure." Understanding Acts of God has become extremely important in view of the extensive damage caused by modern hurricanes and storm surges. An Act of God is generally defined as an extraordinary and unexpected manifestation of the force of nature arising from inevitable necessity, which cannot be prevented by reasonable foresight and care.[58]

The significance of an Act of God defense is that when it is the sole cause of damage, it exempts defendants from liability from negligence.[59] The Act of God (or force of nature) defense allows a defendant to avoid liability. The issue of what is an Act of God is now of increased relevance based on the issue of responsibility for damages occasioned by Hurricane Sandy. Hurricane Sandy was a 100-year storm with a storm surge of 9 ft above normal, producing winds in excess of 90 mi per hour. Was this storm so unprecedented in violence and fury that defendants could not have made preparations to prevent and mitigate the catastrophic effects? Perhaps the concept of a 100-year flood is by definition speculative and unpredictable. But what weight is to be given to Governor Andrew Cuomo's statement that, with climate change coming, "we have a 100 year flood every two years now."[60]

4. Caps on Liability

Caps on liability provide the transit owner with another tool to allocate risk. The question for transit lawyers is whether owners should allow caps on liability to limit exposure from potential lawsuits that may arise? Limitation of liability clauses are contract provisions that limit the amount of exposure a party faces in the event a claim is made or a lawsuit is filed. If the provision is enforceable, the clause can "cap" the potential damages to which the contracting party is exposed. Limitation of liability clauses typically limit the liability to one of the following amounts: 1) the compensation and fees paid under the contract; 2) an agreed-upon amount of money liquidating the claim; 3) available insurance coverage; or 4) a combination of two or more of the above.

Such caps or limitations can be viewed as tools for efficiently allocating risk. An example is executing a waiver of subrogation relative to recoveries under property policies, which reduces the need for certain parties, such as constructors or designers, to carry high levels of liability for damage to the work or for resultant damage, which might reduce the professional liability exposure and the amount of coverage carried.

Limitation of liability clauses have been enforced in many states. Certain states have determined that they are unenforceable because, being contracts of adhesion, the parties did not have opportunity to freely negotiate them, and thus they are void as a matter of public policy. In general, these provisions are enforceable if they are not ambiguous or unconscionable; the party's intentions are expressed clearly; one party does not have unequal bargaining power; and there is no policy or statute prohibiting their enforcement.[61] The clause can be valuable in limiting exposure, but the transit lawyer must be aware of its enforceability within his or her jurisdiction.

5. Workers' Compensation Requirements

Workers' compensation statutes require employers to either get approved or licensed as a self-insured employer or obtain workers' compensation insurance to pay for injuries for all employees. In most cases workers' compensation insurance is generally considered the injured workers exclusive remedy against the employer. As noted previously, the commercial alternatives may be proscribed by a monopolistic state fund require-

20140219/REAL_ESTATE/140219844/obscure-law-drives-up-building-costs (last visited Apr. 14, 2014).

[57] Willis Group Holdings blog Web site, Construction Practice Blueprint, New York Labor Law (Oct. 2012), at 7, accessible at www.willis.com (last accessed Mar. 2014).

[58] 38 AM. JUR. *Negligence* § 7,649.

[59] Meyer Bros. Hay & Grain Co. v. Nat'l Malting Co., 124 N.J. L. 321, 11 A.2d 840 (1940).

[60] *See* Eric Noll, *New York Governor Andrew Cuomo Worries About More Storms Like Sandy*, ABC News Blog, Oct. 30, 2012, http://abcnews.go.com/blogs/headlines/2012/10/new-york-governor-cuomo-worries-about-more-storms-like-sandy/ (last accessed Apr. 2014).

[61] *See* Fox Alarm Co. v. Wadsworth, 913 So. 2d 1070 (Ala. 2005), and City of Dillingham v. CH2M Hill Northwest, Inc., 873 P.2d 1271 (Alaska 1994).

ment. The basic form includes the following components:[62]

Part A Coverage (Referred to as Workers' Compensation)

Coverage to the employer for an employee's bodily injury by accident or by disease (including death) provided 1) that the injury occurs during the policy period, 2) the injury is caused or aggravated by the conditions of employment, and 3) benefits are required to be paid pursuant to state workers' compensation law.

Part B Coverage (Referred to as Employer's Liability)

Part B provides coverage for injury that is not covered by workers' compensation law if the injury arises in the course of employment during the policy period and is caused or aggravated by the conditions of employment or arose out of the course of employment.

A claimant need not establish fault or negligence, provided he or she can establish an employer and employee relationship and that the injury arose out of the course of employment. In general terms, these benefits are the worker's exclusive remedy against the employer for his or her injuries. Compensation benefits include medical benefits and indemnity payments to compensate the employee for lost earnings or earning capacity. In the majority of states, employer tort liability is also subject to a judicially created exception from workers' compensation immunity in cases that involve intentional harm. If it can be demonstrated that the injury resulted from intentional, willful, or deliberate acts or omissions, a common law tort action may be maintained.[63]

Employee liability coverage, known as Part B coverage, normally is written in combination with a workers' compensation policy. It is "gap filler" that insures an employer's liability for a worker injury where the standard workers' compensation requirements do not apply. Part B coverage is triggered by bodily injury caused by accident or disease. Unlike Part A coverage, Part B employee liability coverage requires proof of fault in a tort action. The accident must typically take place during the policy period or the disease must be the result of exposure during the policy period.[64]

[62] CONSTRUCTION INSURANCE, *supra* note 8, at 119.

[63] *Id.* at 126.

[64] *Id.* at 128–29.

IV. INTRODUCTION TO INSURANCE AND RISK FINANCING SOURCES FOR TRANSIT AGENCIES

In this section of the digest we have used language and terminology that is insurance- and risk management-specific. We recommend that readers refer to one of the many glossaries and technical resources available on the Internet.[65]

A. Preliminary Considerations

Before we survey the various exposures to loss and the possible insurance treatments that apply to them, it is important to place the role of insurance (whether contractually required or discretionary) in context relative to managing construction project risk.

Insurance is just one of the tactics used in a construction risk management strategy. Complicating the role of insurance is the diversity of sources for the coverage—some will be purchased by the owner (transit agency) and some will be provided by the various contracting parties (designer, contractor, etc.). Some insurance will be purchased specifically for the contemplated project, and some will be provided as part of an ongoing or operational insurance program.

There are some other preliminary considerations for transit lawyers.

- Ultimately, the owner pays for the cost of insurance directly or indirectly. These costs are sometimes buried in overhead and sometimes charged as a separate reimbursable expense. So, the decision to require unnecessary, redundant, or excessive coverage has a financial impact on the owner even though, on its face, insurance appears to be "furnished by others" if so required by contract.
- As mentioned above, insurance alone is not a panacea for construction risk and exposures. The hierarchy of construction risk management can be viewed as including 1) a primary reliance on good provider selection; 2) the secondary strategy of appropriate, integrated, and consistent contractual risk allocation provisions; 3) proactive risk control (pre-loss loss prevention and post-loss claims management); and 4) an appropriate and

[65] Specifically, we recommend the IRMI (International Risk Management Institute, Inc.) Glossary of Insurance and Risk Management Terms found at http://www.irmi.com/forms/online/insurance-glossary/terms.aspx. Transit lawyers and other readers should find the resources there very helpful in defining and understanding the terms used in this digest.

economically efficient risk financing plan, including, as one element, the right insurance components. Construction risk management starts in the planning stage and needs to be a part of every phase thereafter, through project closeout.

• A corollary to the last point is that insurance availability or the willingness to provide higher limits should not influence the selection process. The fundamental criterion should be selecting the best qualified and responsible party.

• The types and limits of insurance coverage may be constrained by state and federal statutes and regulations, as previously discussed. A thorough appreciation of public procurement, public construction, and related statutory and regulatory requirements is fundamental.

• Consistent and logical risk allocation is important in both the indemnity and insurance requirements in those contracts. One of the complexities of a public construction project is the interplay among the various contracts (e.g., owner's project manager, design professionals and their consultants, construction manager, and various subcontractors). The complexity is compounded by the application of the various statutory requirements. Added to the mix is the likelihood that the actual terms and conditions of the various insurance components will vary from participant to participant and not dovetail exactly with the contractual requirements.[66]

• Finally, safety and loss prevention are essential to a successful construction project, irrespective of the level of insurance. Owners should assign the responsibility for construction risk management to the party or parties with control over the risk as part of the risk allocation in the underlying contracts.

B. Overview of Exposures to Loss

Transit agencies face five major categories of insurable loss exposure typical of any public infrastructure construction project:

• Physical damage to project and owner's property, including some consequential or time element losses. This includes the project itself, as well as existing properties in the case of renovations, repairs, additions, or new construction in proximity to other structures.

• Injury to third parties, including injuries to workers and employees, and bodily injury or property damage sustained by third parties arising out of the project or its site. This includes damage to property owned by others and injuries sustained by the public.

• Increased costs or damages due to breaches of professional duty, or professional errors or omissions. This could include errors or omissions on the part of the owner's project managers, architects, engineers, other design or engineering consultants, and DB entities.

• Increased costs or damages due to contractor or subcontractor default or inability to perform.

• Increased costs or damages due to the discharge or existence of contaminants or pollutants. The source of the contaminants may be preexisting site conditions (known or unknown) or accidental discharges during construction.

Insurance and Risk Financing Resources. Risk financing relates to the activities a transit agency undertakes to provide funding in the event of loss. Risk financing is concerned with providing funds to cover the financial or economic consequences of unexpected losses affecting a transit agency. For many, the concept of risk financing begins and ends with insurance. However, in reality, for transit agencies and the parties with whom they contract, the scope of available and appropriate risk financing techniques is very broad, encompassing both external and internal financing and service resources.

Another way of categorizing the approaches involves 1) risk transfer (insurance); 2) risk retention[67] (e.g., retentions or deductibles under insurance policies, "self-insurance," or captive insurance companies); or 3) risk pooling (e.g., group captives, joint purchasing authorities). Most sophisticated organizations employ a variety of techniques customized to their particular exposures, financial resources, and external or legal requirements.

Traditionally, transit agencies have handled risk by transferring it to commercial insurance companies through the purchase of an insurance

[66] For example, indemnity agreements often cover a broad range of liabilities, while industry-standard CGL policies respond to bodily injury, property damage, and personal injury arising out of an accident or an occurrence. Similarly, design professionals are often asked to indemnify owners or other parties for a broader range of liabilities than those insured in a design professional liability policy that respond to negligent errors or omissions. *See* discussion *supra* § II.B for some additional examples.

[67] *See* GEORGE L. HEAD, ESSENTIALS OF RISK MANAGEMENT, Vol. 1 and 2 (Insurance Institute of America, 1997), as well as his writing on IRMI, www.irmi.com (use search engine).

policy or, alternatively, by retaining the risk and allocating funds to meet expected losses through formalized programs. Examples of such formalized programs are "self-insurance" or "captive insurance." Self-insurance in this context is more formal and disciplined than assuming risk in an insurance policy through a deductible or so-called self-insured retention. It usually entails dedicated funding and accounting recognition, like a replacement account or a "self-insurance account." A captive[68] is a special type of insurance company set up by a parent company, trade association, or group of companies to insure the risks of its owner or owners.

Commercial insurers represent the best known source for owners and contractors to transfer risk. They are licensed and regulated firms formed specifically for insurance operations. The transfer vehicle is the purchase of an insurance policy, a contract under which the insurer agrees to pay for specified losses the insured may suffer, up to specified amounts, under conditions specified in the policy contract, in exchange for the payment of a premium. The insurer aggregates premiums to pay for losses, to deliver risk management services, to develop capital for catastrophic losses, and to earn a profit.

Similar loss protection or coverage can be obtained through group pooling arrangements, organized as group captive insurance companies, joint purchasing authorities, risk retention groups, pools or trusts, and other alternative structures.

In certain extreme cases, the federal government can be a source of external risk financing. Following a Presidential declaration of a disaster, the Federal Emergency Management Agency (FEMA) or, more recently, the FTA, can provide public assistance (FEMA) or emergency relief (FTA) to transit agencies suffering program-eligible losses as the result of a declared disaster.[69]

The range of internal risk financing resources runs the gamut from the simple retention of loss, funding losses through operating funds, through the formal, identifying and funding for certain loss potentials, to the extremely formal, creating a single parent captive insurance company.

Similarly, transit agencies and the various contracting parties in a large project can use both internal resources and external resources to assist with the risk management, risk financing, and insurance program. Internal staff may include dedicated risk management staff or safety staff, as well as related specialists in engineering or capital projects departments.

External resources include insurance brokers or agents that place coverage and provide related support services, including controlled insurance program (CIP) administration, loss prevention services, and claims services. Other external resources include consultants in various disciplines, including general independent risk advisory, claims, safety, and legal services. Claims handling can be provided by so-called third-party administrators (TPAs), who may or may not be associated with the insurers or insurance brokers involved.

V. TYPES OF AVAILABLE PROGRAMS, POLICIES, AND COVERAGES

This section surveys the insurance coverages and commonly available insurance products and insurance programs available to a transit agency in the current marketplace, with an emphasis on describing the exposures intended to be covered, the principal coverage terms, and the advantages/disadvantages of the product or program approach.

Insurance Approaches: Conventional Versus Controlled. There are two basic strategies to designing an appropriate risk management and insurance program. In the traditional or conventional program, each of the contracting parties, as well as the owner, can provide agreed-upon coverage. The alternative is to have one party, either the owner or the general contractor, procure, maintain, and control insurance-specific identified coverage and services for all the parties.

There are three primary areas of insurance that are often procured and maintained in a controlled[70] or coordinated program. These are 1) property in the course of construction or builder's risk, 2) workers' compensation and various liability coverages, and 3) design professional's errors and omissions coverage.

In the first case, each contracting party is responsible for obtaining its own coverage as re-

[68] At this time, we are aware of two transit agencies that have formed captive insurance companies for part of their insurance needs. The Port Authority of New York and New Jersey and New York's Metropolitan Transportation Authority have both created single parent captives and are actively retaining risk.

[69] 49 U.S.C. § 5324, as amended by MAP-21, authorizes a Public Transportation Emergency Relief Program.

[70] Insurance- and risk management-related terms found in this section are defined in the IRMI Glossary available at www.irmi.com (use search engine).

quired under the contracts. Each designer or contractor provides the insurance and the cost of that insurance is part of the contract bid or cost. Once the contract is signed between the contractor and owner, the cost is subject to change only if it is part of a change order agreed to by the contractor and owner. The contractor retains the risk that its actual costs may exceed the contract cost and benefits if actual costs are less than expected. The owner retains the risk that coverage is insufficient to pay losses or fund the contractual indemnity. Monitoring insurance coverages is a significant burden. The traditional approach is fragmented, uncoordinated, and difficult to verify.

- When the owner purchases the insurance under a coordinated program, it may be sponsored and controlled by the owner (OCIP), the contractor/construction manager (CCIP), or a partnered approach (Partner Controlled Insurance Programs). In an OCIP,[71] the program design frequently incorporates an element of risk retention, in which the owner can share in the benefits of good loss experience or be penalized by poor loss experience. This risk taking may reduce the cost paid to the insurer in hard dollars, but introduces variability in the ultimate cost. A coordinated insurance program provides an opportunity to control both the administrative and cost elements of a large construction project insurance budget.
- The advantages of these programs derive from the economies of scale in purchasing coverage for the owner, general contractor or contractors, and all subcontractors. This approach allows the owner to 1) obtain coverage that contractors and subcontractors might not otherwise be able to purchase, and 2) purchase this coverage at a more competitive cost. It also provides for consistent and comprehensive project management through the coordination of loss control, safety, security, claims processing, and other risk management activities.

A. Lines of Coverage[72]

1. Commercial General Liability

Third-Party Liability (General, Automobile, and Umbrella Liability) and Workers' Compensation Coverages. These coverages are generally referred to as casualty coverages. They address a wide range of third-party exposures. From an underwriting perspective, each of these exposures constitutes a separate division of insurance, but from the owner's perspective the similarities in treatment warrant considering them together. Insurance textbooks would treat personnel loss exposures (workers' compensation and employer's liability) separately from general liability exposures, but the risk treatments are usually delivered in a combined program by either the owner or the contractor. Therefore, we treat them together here.

General liability exposures arise from an individual's or entity's legal obligation for damages sustained by third parties for bodily injury or property damage that are the result of that insured party's negligence. In construction projects, that liability can arise from design or construction activities. It can also arise from site conditions and activities on surrounding ways or properties. It can result from the completed operations or from products' exposures after project completion.

The exposed parties include everyone involved in the project, including the owner, the entire design team, the contractors and subcontractors, and others such as the owner's project manager, owner's representative, or construction manager.

The usual mechanism for covering this exposure is the CGL policy. This covers the insured for liability and defense related to 1) bodily injury, 2) property damage, and 3) personal injuries arising from occurrences or accidents.

The typically excluded exposures are 1) liabilities arising out of the use of automobiles, aircraft, or watercraft; 2) liability for injuries to employees sustained while in the course of that employment; and 3) losses arising out of the exercise of professional judgment or in providing professional services.

The operation of automobiles or motorized construction vehicles presents an exposure for the same kind of bodily injury and property damage claims as the general liability. These are characterized as *automobile liability* exposures.

The liability for injuries to employees is treated differently from an insurance standpoint. Employers in almost every jurisdiction are obligated to either obtain statutory *workers' compensation* coverage or qualify as a licensed self-insured employer. This "no fault" scheduled compensation is considered the sole remedy for injured employees relative to their employers.

However, under certain circumstances, injured employees can assert liability claims against

[71] A detailed description of OCIPs and other controlled programs follows in § V.C.

[72] A summary exhibit matching insurable exposures with various commercially available insurance products is contained in App. B.

other parties for their injuries, including, for example, other contractors or subcontractors who may have caused or contributed to the injury, owners for site conditions or security issues, or design team members for errors or omissions. This presents a general liability exposure to those particular parties who may have recourse against the employer under a contractual indemnification. It is generally referred to as the *third-party over exposure*.

Catastrophic bodily injury or property damage losses can strain the limits of coverage found in underlying insurance policies. One method for assuring significant liability protection in the face of such a loss is to purchase an *umbrella or excess liability* policy or policies. Such an arrangement supplements the underlying limits for general liability, automobile liability, and employer's liability as well as other scheduled coverages, such as aviation or nonowned aircraft liability or marine or watercraft liability coverages, where such exposures exist.

The Risk Financing or Insurance Treatment Options Include:

• *Traditional/Conventional Program of Contractor-Provided Coverage*. Here each contracting party is required to carry specific limits of *general liability*, *automobile liability*, and *workers' compensation*. Sometimes, an *umbrella or excess liability* coverage requirement is added. Additional requirements are imposed by contract to include 1) scope or breadth of coverage; 2) financial integrity minimums for acceptable insurers; 3) notice of cancellation or change provisions; 4) extensions of coverage for other parties (e.g., additional insured status); or 5) documentation of compliance, such as certificates of insurance.

• *OCIP*.[73] OCIPs apply to larger scale projects and include coverage for the owner, enrolled contractors and consultants, and enrolled subcontractors of various tiers. The coverage provided typically includes *workers' compensation*, *general liability*, and *umbrella liability*. Sometimes pollution liability is also provided. The same OCIP broker may also procure errors and omissions coverage or builder's risk coverage, but those insurance policies are usually separate placements. There are a number of advantages and drawbacks associated with OCIPs. They all flow from the size, complexity, and loss-sensitive financial plan associated with the OCIPs. It is likely that a transit agency will encounter an appropriate opportunity to use an OCIP (or other controlled insurance program) in large projects, as the accepted minimum size of a project is $100 million or greater with direct labor of $25 million or more.

• *CCIP*. CCIPs have become more prevalent in recent years as many larger general contractors and construction managers have created their contractor-controlled versions. These mirror the OCIP concept but are managed and organized primarily for the benefit of the contractor. There are two versions. CCIPs can be characterized as "rolling" and be available for many projects with varying owners and applied to a wide range of projects in terms of both size and building type. The others are CCIPs that are implemented on an ad hoc basis for a specific and often large project. Transit agencies may see a CCIP offered in larger projects or where they engage a larger contractor or design-builder.

• *PCIP*. A recent permutation of the CIP concept in the public sector is a so-called Partner CIP where the gains from bulk purchase, targeted safety efforts, and aggressive claims management benefit both the owner and the contractor on a scheduled arrangement. The same effect may be achieved under either an OCIP or a CCIP with some gain-sharing or an incentive program.

• *Owner's and Contractor's Protective Insurance*. This is an older approach to providing insurance protection to the owner for losses arising out of the activities of contractors or others acting on the owner's behalf. In the 1970s, this previously separate coverage was melded into most general liability policies, which is the case today. Some underwriters still offer the coverage, and some contractors and their brokers represent it as an additional layer of protection for the owner. Some owners[74] continue to require the coverage in their standard construction contracts. In most cases, the coverage is redundant and potentially causes problems with the other insurance clauses found in other liability policies, which treat the possibility of more than one liability insurance policy as being primary. The result is having to

[73] There are many resources in the literature describing OCIPs and CCIPs and their advantages. *See* footnotes in subsequent section.

[74] In some jurisdictions, where the courts have followed a so-called "horizontal exhaustion" theory of applying insurance limits, owners have sought to address potential contribution from their operational insurance by requiring OCIP coverage. This topic is beyond the scope of this digest, but is treated extensively in the literature. For an example, *see* http://www.irmi.com/expert/articles/2007/rawls07.aspx.

contribute limits from different insurers, complicating defense representation.

• *Railroad Protective Liability.* Construction operations on or around a railroad right-of-way may require a specific liability policy known as railroad protective liability. Railway operators may impose certain conditions through an easement or other agreement. Certain underwriters make the coverage available to their contractor clients as either a separate policy or an endorsement to the general liability policy. Owners may need to secure the coverage as well.

The primary treatment of the owner's exposure to third-party liability losses is to transfer it to the contracting parties that control the risk. This is accomplished by appropriate indemnity and similar limitation of liability clauses in the various contracts. This protection is primarily funded by the program of insurance required of the contracting parties through the various design and construction and service contracts. The contingent funding source would be the assets of the indemnifying party.

• The secondary treatment of the owner's exposure is the insurance protection it enjoys from 1) its operational insurance program, 2) its insured status under either an OCIP or a CCIP, or 3) any additional insured status[75] under a designer, contractor, or consultant liability policy.

• Covered parties can include every party involved in the project. The means for obligating the various parties is through the contract's indemnity and insurance terms. Each contracted party should have requirements for the types of coverage to be carried, the limits to be carried, and other conditions, regardless of whether the chosen vehicle for coverage is 1) the traditional contractor-provided method, or 2) a controlled insurance program.

Limits to be required in the contracts depend on the risk assessment related to the project. For workers' compensation, all contracting parties should be required to carry coverage discharging their statutory obligation, which for large contractors may include licensed self-insurance. While there are certain minimum thresholds for liability and automobile liability, the required limits reflect the surrounding exposures, the extent of exposure to the public, the complexity and duration of the project, and similar factors. Higher limits may be secured through a combination of primary policies (general liability and automobile liability) and excess policies (umbrella liability).

The costs of this coverage are passed on to the owner in the various contracts, either as part of overhead or as a separate reimbursable expense. In many cases, a transit agency will have no knowledge of those costs and little or no control over them. One exception to this is when higher limits, such as above $25 million for commercial general and umbrella liability, or specialized coverage, such as railroad protective or watercraft liability, is required. In such cases, the contracting party may explicitly identify the additional costs in their bids or proposals, either on a firm basis or as an estimate, allowing the agency to decide if the additional expense is warranted by the additional protection. When alternative approaches are available, the risk management assessment process should compare the various costs and benefits of the alternatives.

• One frequent issue transit officials are confronted with relates to whether all subcontractors should be subject to the same insurance requirements, including liability limits, as the general contractor or construction manager. There are contractors and their advisors who recommend that all tiers of subcontractors, irrespective of trade, size of contract, or hazard, carry the same limits of coverage. This approach may be unnecessary, adding to the owner's cost without significant additional protection to the owner and limiting the pool of qualified subcontractors. The owner could decide that the matter of the limits to be carried by subcontractors is between the contractor and its subcontractors and is primarily a business decision for their negotiation. The owner is protected by the indemnity (and potentially through corresponding insurance) from the GC or CM that is responsible for the losses caused by its subcontractors. To the extent that the indemnity from the GC or CM is enforceable and backed by sufficient insurance, additional insurance carried by the subcontractors has little additional protection value, since the additional limits are priced at primary layer prices and the costs are passed on to the owner through the contract. If a high limit for catastrophic events is the goal, it is cheaper to buy a single high limits tower of coverage.[76]

[75] There is discussion of the efficacy of the "additional insured" status in § V.B of this digest.

[76] As noted earlier, there are jurisdictions that impose a "horizontal exhaustion" approach to coordinating available limits for upstream and downstream contracted parties. In these cases, there is some merit to requiring subcontractors of every tier to carry specified

• General liability and umbrella or excess coverage should be written on a so-called *occurrence form*, which responds to occurrences during the policy period regardless of when they are presented to the insurer. The alternative, known as the *claims made form*,[77] responds to claims made while the policy is in force, subject to other restrictions such as a retroactive date. This form is more difficult for a transit agency to verify and manage and is infrequently offered.

• It is likely in today's insurance market that general and umbrella liability will be written with some sort of policy aggregate on the limit. Endorsements are available to most contractors that convert the policy aggregate to one that applies to each project or location. This should be required at a minimum in the general liability policy. In its absence, the assessment of the risk may dictate a higher limit requirement. In such cases the umbrella limit can off set this limitation.

• Most CGL policies have a broad coverage grant. They typically respond to the insured's legal liability for bodily injury, property damage, and personal injury liability, however incurred.[78] That means it responds to those liabilities 1) directly incurred through the insured's activities; 2) vicariously imputed through the conduct of agents, contractors, or others employed on the insured's behalf; and 3) assumed by contract. As a result, transit officials do not have to look for separate or endorsed coverage for contractual liability[79] or owner's and contractor's protective (vicarious coverage for the actions of others)—the coverage is already included in the CGL policy.

General liability and umbrella or excess liability policies are akin to "all risk" policies, but the real test of the breadth of protection afforded by one of these policies is to understand the exclusions in place. This requires first-hand knowledge of the actual insurance policy. The owner has two options to understand the contractor's coverage: 1) transit agencies can require copies of the policies and review them, or 2) they can require disclosure of the relevant exclusions prior to entering the site or disclosure on the required certificates of insurance.

Many organizations routinely require all contractors or consultants to add the organization as an additional insured under a wide range of insurance policies. This often appears to be required without much thought as to the function of the additional insured protection. In fact, while there has been much discussion and writing about being an additional insured,[80] the extent of coverage has changed over time and may have limited value to a transit agency. In practice, the only two coverages where a transit agency can expect to be added as an additional insured are CGL and umbrella or excess liability policies. We suggest the following considerations:

• Agencies should consider not seeking additional insured status on *workers' compensation* policies. First, underwriters will resist doing so. Second, there may not be real protection from doing so. The transit organization is not the employer in the case of workers' compensation.

• Agencies should not seek additional insured status on *professional liability policies. Under normal circumstances the transit agency* does not owe any professional duty to third parties in the case of professional liability. In fact, some argue that being an additional insured under a design professional liability policy might impair coverage for a claim made by the owner. So, there is no benefit to the agency.

• Transit agencies can insist on appropriate and clear indemnity agreements in their favor, supported by reasonable and broad insurance protection, including contractual liability coverage from the contracting parties, as the primary layer of protection.

• Transit agencies may require *additional insured* status under *general and umbrella or excess liability* policies. However, they should be aware that coverage is generally limited to losses arising

liability limits, and such requirements benefit the prime contractor as well.

[77] On the other hand, professional liability coverage is exclusively provided on a claims made form. This requires additional requirements in the contract to assure that coverage is in place when claims are likely to be made. See the professional liability discussion later in this digest in § V.A.3.

[78] Coverage is conditioned by the terms of the policy, which includes the notion of an accidental or unexpected injury arising out of an "occurrence" or accident.

[79] Contractual liability refers to bodily injury, property damage, or personal injury liability assumed under contract. It does not refer to claims for a breach of contract.

[80] An indepth treatment of the evolving and controversial use of additional insured status as a risk treatment is beyond the scope of this digest. From an insurance perspective, one of the more authoritative sources is Donald S. Malecki & Jack P. Gibson, *The Additional Insured Book* (International Risk Management Institute, 2014).

out of the negligence of the named insured, so there likely will be no coverage to the agency in the absence of a contractor's negligence.[81] Additional insured status is not a substitute for an owner's own general liability policy or an enforceable and financially supported indemnity.[82]
• When an owner decides to use an OCIP or a CCIP, the various contracts should contain consistent language outlining the coverages to be carried and the limits provided by the contractors in the absence of the OCIP or CCIP. There are three reasons for this. First, there are certain coverages, such as automobile liability and workers' compensation/general liability, for off-site activities that typically are not included in the OCIP/CCIP. Second, there will be some contractors, in larger projects or under alternative project delivery approaches, that are not enrolled in the OCIP/CCIP. Third, conditions change and the OCIP/CCIP may be canceled or not implemented. Consistent terms provide an appropriate fallback position.

In *Alpha Const. and Engineering Corp. v. Insurance Company of the State of Pennsylvania*,[83] the plaintiffs, consulting engineers, sought coverage for an accident occurring on the transit project. The Maryland Transit Administration (MTA) OCIP provided general liability, workers' compensation, and excess liability coverage for all contractors and subcontractors that were performing work at the contract site. The court determined that, although the plaintiffs might appear to be named insureds under the owner's CGL policy, they were excluded from coverage by an endorsement. The court found that the plaintiffs were not enrolled in the MTA OCIP program and in addition, pursuant to the term of the contract, the consulting engineers were required to obtain their own workers' compensation coverage.

Damage to Property in the Course of Construction and Consequential Loss

In every transit construction project, there is the potential for damage to property. The exposed property includes:

- The work or project itself.
- Owned, rented, or leased real and personal property (or contents).
- Tools, equipment, and temporary structures.
- Construction materials and other components, both on and off site, that are intended to become part of the project.

There are various ownership or insurable interests exposed, including:

- The owner's.
- The lender's (if such project financing is used).
- The contractor's and subcontractors'.
- Those of the other parties on site.

The property is exposed to all the same perils or causes of loss as existing structures, such as fire, wind, water, etc. It also is exposed to increased peril, such as collapse, human actions, design defect, and construction error or faulty workmanship.

Risk Financing or Insurance Treatment Options

The typical options for insuring the property and consequential loss exposure include:

• *Extension of Entity's Existing Property Insurance Coverage*. In this case, the owner/agency would use an existing operational property policy to provide the coverage. This approach requires the transit agency to extend the operational insurance policy or program to cover property damaged in the course of construction with appropriate limits and coverage terms. When faced by repair, renovation, or addition projects, this can be the preferable approach, as it reduces the potential for an uninsured loss if different underwriters are insuring common elements of the loss.
• *Stand-Alone Builder's Risk Secured by Owner/Entity*. In this option, particularly where a transit agency's property policy cannot or does not apply to the course of construction risk, the agency could secure a separate builder's risk policy specific to the project. This may be an acceptable alternative when the project is a separate and new structure.

[81] Among the many restrictions added to both industry-standard (ISO) and individual insurer (proprietary) endorsements over the years is language that limits coverage to insured liabilities that are "caused" by acts or errors of the Named Insured, precluding any coverage for the negligence or strict liability of the Additional Insured.

[82] Additional Insured endorsements are not all alike. There are many versions of the endorsement published by ISO with different dates, and many insurers issue their own proprietary versions. Assuming the scope of Additional Insured Status without analyzing the actual endorsement language is unwise. Typical limitations include damage to the insured's property, restricted products and completed operations coverage, cross suits (additional insured versus named insured) exclusions, and explicit professional liability exclusions.

[83] 601 F. Supp. 2d 684 (2009).

• *Contractor-Provided Stand-Alone Builder's Risk*. In certain cases, a contractor may provide a separate builder's risk policy, covering both the contractor's and the owner's interests, with terms and conditions tailored to the specific project. Careful attention to the terms and conditions, including the breadth of protection afforded to the owner and the lenders (if any), is important.

• *Contractor-Provided "Master" Builder's Risk Coverage*. Some larger general contractors and construction management firms have blanket programs with an underwriter covering all their projects, subject to common terms and conditions. While this may be an acceptable alternative, transit agencies should be attentive to the coverage period and limits and breadth of coverage, to be sure it meets the needs of their specific project.

In deciding among the various alternatives, transit agencies should weigh the costs and benefits each approach provides. In reviewing those factors, transit agencies can consider the following:

• Limits should be sufficient to cover the probable maximum loss (PML) from an insured loss. This is particularly important when an existing structure is being renovated. The limit should apply to each loss. For stand-alone builder's risk placements, the policy should be written on a *completed value* basis with an amount sufficient to capture the completed value after all change orders. Transit agencies may wish to avoid the alternative, the *reporting form*, to avoid the possibility that sustained damages exceed the amount reported, resulting in uninsured damages.

• Loss valuation should be *replacement cost* for all damaged property, and, in the case of existing structures, not apply on an *actual cash value* basis, where a deduction for physical depreciation and deterioration can leave a significant shortfall in a recovery.

Perils to be covered should be *all risk of loss*, including *earthquake* and *flood*[84] where a transit agency determines it is needed, as opposed to the *named perils* form. The earthquake (or earth movement) and flood coverage will carry an annual aggregate payment limitation. The breadth of coverage under this all risk form is determined by the exclusions contained in the form, so some analysis of the exclusions is recommended.

The usual exclusions include:

- War and nuclear hazards.
- Governmental action.
- Wear and tear, vermin, and wet and dry rot.

Terrorism can be excluded from coverage. However, certain public construction projects, such as terminals, stations, tunnels or bridges, may be considered targets. In such cases, public officials should decide to purchase terrorism coverage.

• Interests covered should match the requirements of the various contracts, including any lender or financing agreement. Where the interests are not completely aligned with the risk allocation in the contract, one party may opt to obtain supplementary coverage. Examples include contractors securing *installation floaters* for materials and equipment off site before installation.

Coinsurance should be 1) waived by the so-called *Agreed Amount*[85] clause, or 2) deleted from the policy. This will eliminate any penalties (deductions) as a result of underinsurance.

Deductibles should be reasonable relative to the ability of the responsible party's financial abilities. Further, that responsibility should be clearly and consistently articulated in the contracts.

• Transit agencies should consider making a single party responsible for securing coverage for property in the course of construction and that responsibility should be clearly articulated in the appropriate contract or agreement.

[84] Insurance companies use exclusions and other conditions to limit their exposure in extreme events. One recent exclusion/limitation introduced in the insurance industry has been to treat windstorm or named windstorm loss, which may or may not include resulting storm surge. Policies often contain a sub limit for such losses. Also, in certain states, such as California (earthquake) and Florida (flood or windstorm), commercial carriers may exclude coverage for these perils completely, which requires transit agencies to secure separate policies from public sector or governmental sources.

[85] A so-called Agreed Amount clause assures that there is no reduction in a loss recovery because of a failure of the policyholder to insure to value. A coinsurance provision requires the policyholder to insure to some percentage, such as 90 percent, of the replacement cost and reduces a recovery proportionately to the extent of underinsurance. The "agreed amount" stipulates that whatever limit is purchased meets or exceeds the coinsurance requirement.

The option to extend an operational property insurance policy to cover property in the course of construction may be attractive to transit agencies for a number of reasons. Beyond assuring a consistent loss adjustment in the case of loss, the terms and conditions offered by an underwriter with a longer relationship with the transit agency are likely to be more favorable. Further, the organization will understand and control those terms and conditions.

One of the typical exclusions under any of the options is for loss from faulty work, defects, errors, and omissions. However, this exclusion is usually limited to the cost of correction and not a resultant loss. Where such resultant damage is covered, the owner will have a direct recovery from the property carrier and will not have to rely on the design professional liability except for the cost of correction. For example, if because of a design error or faulty workmanship a building collapses, most property policies cover the collapse damage and exclude only the cost of the design error or the faulty workmanship. Similarly, if a faulty installation of electrical equipment results in a fire damaging the entire project, most property policies would be expected to cover the fire damage and exclude the cost of the improper installation.

- Most property policies, including the four options enumerated above, allow an insured party to waive the insurer's rights of subrogation in writing prior to a loss. This allows an owner to waive its rights to recover from the contractor or designer if they caused the damage. The waiver of subrogation clause is almost universal and carries no premium charge, so a transit agency can lower the contractor's risk (and presumably the cost of that risk) by executing the waiver. This preserves the contractor's *general liability* coverage, which may be subject to a policy aggregate for other losses.

Doing the same for the designers may preserve the limit of its professional liability coverage for the uninsured portions of the damage. However, transit agencies should verify that the property policy permits a waiver in the case of design professionals. Recently, some builder's risk policies have eliminated the insured's ability to waive its rights against the designer.

- Officials should assess the exposure to consequential loss, such as additional expenses to complete a project after a delay or damage and additional expense incurred to meet the expected use of the structure or lost revenue, and secure appropriate *time element*, *business interruption*, or *income* coverage.
- Builder's risk policies or commercial property policies should allow for occupancy or testing at the facility during the course of construction without any impairment of coverage.

2. Professional Liability

Professional Liability or Errors and Omissions. Professional liability or errors and omissions[86] coverage addresses the specialized exposures arising out of the exercise of professional judgment or skills. In public construction projects, specific parties have professional liability exposures. Under the normal design–bid–build approach, the architect and consultants have a fairly discrete professional liability exposure.

In the alternate project delivery systems, such as DB, the responsibility for professional services and the resultant liability for errors and omissions may be shared by the DB entity or team.

Owners will need to address the professional liability risk for consultants in their roles as 1) owner's project managers or owner's representatives, 2) designers and their consultants, 3) certain engineers, and 4) DB entities and teams. The exposures to loss may differ by degree, but they do not differ by kind. The insurance and risk treatments are similar for all these professionals.

The exposures arise from three types of activities:

- Design functions.
- Management functions.
- Payment authorization functions.

In theory, the duties (and therefore the exposures) are owed to a variety of parties, including the:

- Owner.
- Contractors and subcontractors.
- Other design professionals and consultants.
- Workers on site.
- Surety companies.
- Neighbors.
- Other third parties.

[86] The professional liability of design professionals, including architects, engineers, and their professional subconsultants, is covered under insurance policies that are characterized in a number of ways, including professional liability, design professional liability, architects and engineers errors and omissions coverage, and other variations of this theme. In this digest, we use the terms interchangeably.

The above list is roughly in order of the distribution of claims frequency, with owners the most likely to bring claim and other third parties the least likely.

The extent of the liability exposure is defined by the interaction of 1) the law, 2) the scope of services, and 3) the contract between the owner and the professional. So, for example, the statute of limitations and statute of repose affect the liability exposure, as do contractual conditions such as the standard of care clause, the indemnity clause, and the limitation of liability clause.

The Conceptual Risk Financing or Insurance Treatment Options Available Include:

- *Reliance on Indemnity Without Insurance*. In some cases, owners will rely on the indemnity provision in the contract to make them whole for breaches of professional duty and assume that the professional has the financial means to back up the indemnity.
- *Reliance on So-Called "Practice Policy."* Architects and engineers and related consultants will carry professional liability for their professional activities. These policies, which typically are renewed annually, are referred to as "practice policies." These professionals will usually carry some modest limit of coverage, depending on insurance market conditions, owner requirements, and the extent and nature of their practice. Such policies are in place for 1 year to cover claims made within the policy year arising from the professional practice and all its client engagements (these are so-called "claims made" policies).
- *Purchasing a Project-Specific Errors and Omissions Program*. On some larger and more complicated projects, owners will require higher limits dedicated to the specific project. These policies tend to cover the entire design team, including all subconsultants. The coverage is customized to the project and may run up to 10 years. The premiums for such programs are high. Typically, these "project policies" are sometimes used on public projects greater than $250 million in construction cost or where there are high hazard design challenges or other considerations.
- *Arranging an Owner's Professional Liability Protection Program*. Certain insurance companies, reacting to market pressures on "project policy" approaches, have developed a first-party alternative for owners. The common brand name for such coverage is "Owner's Protective Professional Insurance." It provides indemnity to the owner over the professional's "practice" policy. The economics of such coverage usually restrict its use to larger and more complicated projects.

The Nature of Professional Liability Insurance, Owner Understanding, and Expectations

One important consideration for owners is the application and efficacy of the required insurance. That a designer or design-builder secures the required professional liability coverage does not guarantee that coverage applies whenever the owner thinks there has been an error or omission. A fundamental understanding of the coverage and how it works should frame an owner's expectations appropriately. The key elements are:

- Design professional (errors and omissions) liability coverage is negligence-based. A successful claim must establish 1) a duty of care owed to the claimant,[87] 2) a breach of that duty by the insured party, 3) injury or damage as the proximate result of the breach, and 4) damages that are allowable under the law. Professional liability coverage is clearly not a guarantee or warranty of a project being successfully completed on time and on budget, and providing the expected value.
- The coverage trigger is "claims made." This requires that the claim of loss be made while the insurance policy is in force. As a result, the contracted professionals should carry coverage continuously well after completion of the project.
- The limits on such policies are annual aggregates for all defense and damages resulting from all claims made during the policy period. The limits are shared among all claimants until exhausted. As a result, the limits are often characterized as a "wasting asset" since the defense and damages costs erode the policy limits as they are incurred. Further, project owners are not usually made aware when the limits have been impaired or exhausted. This is of particular concern with respect to practice policies since those are subject to claims from the design professional's entire book of business.
- The coverage is subject to all the terms and conditions of the insurance contract, which is outside the control of the owner. These include the exclusions (such as warranties or guaranties) and claim reporting requirements.

[87] A brief discussion of standard of care is contained in § II.E.1 of this digest.

3. Pollution or Environmental Impairment

In this section, we are concerned with two somewhat distinct issues: 1) projects involving remediation of existing known pollutants or contaminants from land or buildings, and 2) exposures that arise from the release or escape of pollutants or contaminants at or from a construction project.

In the second instance, the pollution conditions could result from project activities that cause a sudden escape of existing pollutants, a discharge of chemicals that are brought onto the site by the contractor or subcontractor in connection with its work, or the escape of pollutants caused by an accident involving a vehicle transporting contaminants from the project site. Generally speaking, there is very limited coverage in an agency's insurance or a contractor's insurance for such losses, which would include bodily injury sustained by third parties at or on the construction site, off-site bodily injury or property damage, and on-site or off-site cleanup costs.

4. Remediation Projects

Typical options for insuring loss arising out of remediation projects include:

- *Owner-Procured Coverage.* In this case, the owner/agency would purchase coverage for pollution liability losses arising from known conditions at or from the site. This includes purchase of "remediation cap" coverage for cleanup of existing conditions under which the owner/agency is insured in the event the costs for remediating known site conditions exceed a specified threshold. Such coverage can be very expensive and involve a very large self-insured retention and/or co-insurance or participation provision.
- *Contractor-Provided Coverage on Site-/Project-Specific Basis.* In this case, the contractor procures the insurance to protect itself from liability for pollution loss from its activities at the location at which remediation activities are taking place. For example, on asbestos or lead abatement work, the owner/agency would look to the contractor to provide insurance at sufficient limits. Such coverage is generally available in the commercial insurance marketplace, and virtually all contractors engaged in such activities carry appropriate limits of protection.

5. New Construction/Renovation Projects

Typical options for insuring pollution liability loss arising out of projects involving new construction and/or renovation include:

- *Contractor-Provided Coverage on Site-/Project-Specific Basis.* For this work, the contractor procures the insurance to protect itself and, if contractually required, the owner/agency for pollution loss from its activities at a specific project location. A contractor could be required to provide evidence of contractor's pollution liability coverage for its work on a specified project at limits dedicated to the project. This would cover all operations at or from the site but could exclude loss arising out of preexisting conditions, if known to the owner/contractor, and any off-site work of the contractor.
- *Contractor-Provided Coverage for All Contractor Work.* This is similar in scope to the site-/project-specific basis, but would cover all of the contractor's work for the transit agency.

In deciding among the various alternatives, the transit agencies should weigh the exposure to financial loss from sudden accidental or gradual release of pollutants from a project site and the costs and benefits each approach provides. Agencies should consider the following factors:

• As with the exposures to other third-party liability losses, the most appropriate treatment of the pollution or environmental impairment risk is to transfer it to the contracting parties (abatement contractor, general contractor, etc.) that control the risk through appropriate indemnity clauses in the agreements.

• Limits depend on the liability exposure related to the project. As stated above, the majority of hazardous substance abatement contractors carry liability insurance at limits commercially available in the insurance marketplace. Many general contractors also carry contractor's pollution liability insurance at limits of $1 million to $5 million depending on their tolerance for the cost of this insurance and their ability to pass the charges for the coverage back to their client owners. Many of the contractors' pollution liability policy forms automatically include the contractor's client owners as insureds.

• While some of the contractors' pollution liability forms are written on an "occurrence basis," it is probable that owner-procured insurance and insurance issued to abatement contractors apply on a "claims made" basis.

• If the owner/agency will be purchasing the insurance for the project, care must be taken in making sure that the policy provides appropriate protection for all of the intended exposures and losses, as pollution liability policies vary from insurer to insurer, unlike workers' compensation, automobile liability, or general liability insurance.

• To the extent the risk involves transporting significant concentrations of hazardous substances off site for disposal or treatment, the contractor or transporter should provide evidence of coverage for pollution liability arising out of the transportation and disposal of such substances.

B. CIPs: A Detailed Review

1. CIP Definition and Description

What Is an OCIP?—A Working Definition.[88] For purposes of this digest, we have defined an OCIP as a consolidated insurance program, using master insurance policies and supported by common and consistently applied services, protecting a project owner, construction manager, contractors, and other parties against workers' compensation, general liability, and excess or umbrella liability claims. In addition to these three coverages, OCIPs may provide pollution or environmental liability, marine liability, or aviation liability coverage, although it is our experience that such instances are rare. OCIPs do not typically provide automobile liability protection.

In some cases, OCIPs may be characterized as including other coverages, such as builder's risk

[88] The authors consulted a wide range of materials in the literature treating OCIPs and CCIPs, including GARY BIRD, THE WRAP-UP GUIDE (International Risk Management Institute, 1990, 1993, 1995, 2000); DAVID L. GRENIER, OWNER CONTROLLED INSURANCE PROGRAMS, PART 1 (Construction Management Finance Association Building Profits, Sept./Oct. 2000). *See* http://www.smacna.org/pdf/management/OwnerControlledInsuranceProgramsPart1.pdf; DAVID L. GRENIER, OWNER CONTROLLED INSURANCE PROGRAMS, PART 2 (CFMA Building Profits, Jan./Feb. 2001); WRAP-UP/OCIP IN CONSTRUCTION RISK MANAGEMENT, Vol. II, ch. IX (International Risk Management Institute, 2005); FEDERAL HIGHWAY ADMINISTRATION, GUIDE TO FHWA FUNDED WRAP-UP PROJECTS (2003), available at https://www.fhwa.dot.gov/programadmin/contracts/052303.cfm; CLIFF J. SCHEXNADER & SANDRA L. WEBER, OWNER CONTROLLED INSURANCE PROGRAMS (National Cooperative Highway Research Program, Synthesis No. 308, 2002). *See* http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp_syn_308.pdf. U.S. GENERAL ACCOUNTING OFFICE, TRANSPORTATION INFRASTRUCTURE ADVANTAGES AND DISADVANTAGES OF WRAP-UP INSURANCE FOR LARGE CONSTRUCTION PROJECTS (1999), http://www.gao.gov/archive/1999/rc99155.pdf. The FTA Web site addresses some FAQs on wrap-up insurance. *See* http://www.fta.dot.gov/13057_6245.html. FTA also provides guidance in its *Best Practices Procurement Manua*l in § 6.6. *See* http://www.fta.dot.gov/funding/thirdpartyprocurement/bppm/grants_financing_6189.html#BM6_6. FHWA provides more comprehensive guidance at its Web site. *See* http://www.fhwa.dot.gov/programadmin/contracts/wrap.cfm, http://www.fhwa.dot.gov/programadmin/contracts/wrap02.cfm, and http://www.gao.gov/archive/1999/rc99155.pdf. *See also* LYNDON B. LITTLE, OCIP AND PROFESSIONAL LIABILITY: WHERE THE POLICY HOLDER IS NOT THE INSURED, Carrington and Coleman (2010), available at http://www.ccsb.com/pdf/Publications/Insurance/OCIP_and_Prof_Liability.pdf.

(property under construction) or design professional's errors and omissions, but strictly speaking, they do not.[89] While these policies may be procured through the same process and insured by the same insurer or brokered by the same broker, they are typically separate transactions and not part of a single rating plan.

OCIPs do not include any form of surety, such as payment and performance bonds. In some cases, the broker administrator may use the leverage of the OCIP to set up a favorable bonding support program, particularly for DBE firms, but the rating plan and bond placement are separate from the OCIP.

One other typical characteristic of an OCIP is that the ultimate cost of the OCIP is determined by a combined rating plan. This plan can sometimes be considered "guaranteed cost," where the ultimate cost is subject only to changes in exposure, usually measured by payroll. However, most plans are "loss sensitive" where the ultimate cost is a function of the project's loss experience. The ultimate cost will not be known until all claims are closed or the insurer "commutes" or terminates the rating plan. The timing horizon and duration of an OCIP, as well as the resulting uncertainty about the ultimate cost, contrast with the traditional contractor-provided model.

The Evolution of OCIPs. "Wrap-ups" have been around for 50 or so years. The first OCIPs involved project owners procuring consolidated coverages for a single project at a single site involving a single prime contractor. These OCIPs dominated the field until the late 1980s, when several variations appeared.

Contractors came to appreciate the potential for increasing their own profits by assuming the responsibility (and savings) of consolidated programs. These CCIPs made a contractor's pricing more competitive and/or created an additional profit center.

As the number of brokers and insurers interested in OCIP programs increased and owner sophistication increased, OCIPs were designed to accommodate multiple projects and multiple sites, sometimes over a long period of time. These programs became known as "rolling wrap-ups" and included ongoing maintenance programs, long-term capital improvement plans, and interdepartmental construction.

Currently, programs involving multiple owners, such as through inter-local insurance trusts or municipal pools or joint purchasing authorities, are being explored. These programs would cover many sites, projects, and contractors.

2. Advantages: Three Areas of Control and the Question of "Savings"

There are three areas of improvement a well-designed OCIP can deliver to the transit agency. All three of these improvements may result in a reduction of cost or generate "savings"[90] for the owner:

- Improved insurance coverage and protection.
- Enhanced contract and construction management.
- Superior and targeted services, including claims handling and safety.

The literature suggests that the primary goal of any OCIP is control and the protection and coordination that control brings. Most authors emphasize that cost control or "savings," if achieved, is a secondary concern. This, however, is a well-maintained fiction because few, if any, OCIPs proceed in the public sector unless there is some financial justification for the effort.

Examples of how these improvements are achieved include:

1. In the area of *improved coverage*, there are higher limits of coverage. This benefit is threefold. First, it assures that adequate limits are available in the event of a catastrophe. Second, it provides economies[91] in securing those limits by

[89] *See* OFFICE OF THE INSPECTOR GENERAL, COMMONWEALTH OF MASSACHUSETTS, A REVIEW OF BIG DIG PROFESSIONAL LIABILITY INSURANCE COVERAGE (June 2005), in which the authors erroneously refer to the professional liability coverage as part of the OCIP; *see* http://archives.lib.state.ma.us/bitstream/handle/2452/35331/ocm61524772.pdf?sequence=1.

[90] The three areas of "savings" are proposed by advocates for OCIPs. We acknowledge that it is difficult to establish an exact savings amount, as there are a number of assumptions involved in the financial analysis because a transit agency cannot do program comparisons based on price on every project.

[91] Liability coverage is typically written in layers and may have quota share participation in each of the layers. The pricing per million of limiting upper layers is typically a fraction of the cost per million in the lower layers. In assembling a lower layer of excess or umbrella liability coverage, the total cost for a large aggregate limit will be lower than purchasing a similar amount of limits priced in the first layer if procured by each contractor from its insurers.

eliminating the requirement that individual contractors or subcontractors secure higher limits at redundant cost. Third, by eliminating the requirement that individual contractors or subcontractors provide their own limits at their cost, the public entity is more likely to achieve its DBE or regional contractor goals. The ability to secure reasonable limits of insurance will no longer be a barrier to the participation of small or minority firms.

2. An OCIP also creates an opportunity to place broader and consistent coverage for all contractors and subcontractors. For example, a single liability program may include pollution or marine liability coverage, which may not be available to individual construction firms. Likewise, the leverage of a larger premium mass often results in fewer exclusions and more favorable policy language.

3. In the area of *contract administration*, all otherwise acceptable bids meet contractual requirements. Also, the design of the OCIP with a single liability program and single workers' compensation program in place makes the verification of required insurance much easier. The project owner will not need to track many policies with differing terms and conditions, effective dates, limits, and cost bases. The continuity of carrier eliminates much of the confusion that comes with claim activity involving more than one construction entity. Coverage uniformity and claim handling should result in reduced management costs. Also, under an OCIP, the owner can control much of the potential for litigation among contracting parties. The cost of cross litigation and the substantial defense costs that accompany it are eliminated. This results in both savings and a reduced need to monitor and manage the various cross suits.

4. As discussed above, the OCIP approach may support DBE or regional employer goals of the project owner by eliminating the ability to meet the insurance requirements as a determinant in selecting otherwise qualified firms.

5. In the area of *service*, there are potential benefits over traditional programs. Improved productivity may result from improved safety. Skilled workers remain on the job, or return to the job more quickly, and morale is improved. Further, the improved safety[92] applies to all levels of contracting parties, including smaller firms without formal programs in place. To a certain extent, an OCIP provides a transfer of management ability and technology to smaller businesses.

Financial Advantages: Sources of Savings. Another way to look at the financial advantages is to review the sources of savings. The cost savings result from three areas:

- Economies of scale and market leverage from a larger purchase, reducing insurance costs.
- Reduction of overhead or mark-up costs and duplication in contractor costs.
- Reduction of loss costs through safety, claims management, and elimination of uninsured losses.

Added to these sources of savings is the increased control the owner has over cash flow.[93] Nonetheless, determining the realized savings will be very difficult because of the many factors influencing costs and cost estimates. Some of these will be estimates that cannot be established with complete certainty because of the variability of insurance programs and outcomes.

Potential Disadvantages: The Right Resources Can Help. Experience and the literature suggest that there are some potential disadvantages to an OCIP. Among those identified are the following:

1. Under certain circumstances, an OCIP rating plan can be more costly than traditional programs where individual contractors supply required limits. These cases usually involve cost plus programs with high maximum premiums. They may also involve a concurrent issue with loss control and/or claims-handling issues. In the current market, the number of insurers and brokers interested in OCIP business almost guarantees that an acceptable rating plan can be obtained.

2. Some suggest that contractor resistance to OCIP diminishes the pool of bidders, as certain

[92] A transit agency could achieve similar improvements in safety programs through required contractor safety programs. However, the financial benefit of reduced claims experience would likely not benefit the owner as it would in an OCIP.

[93] The net cash flow would include an offset for deposits, escrowed loss funds, or other collateral that is sometimes required in an OCIP. Insurers' collateral requirements have changed over time and are a function of the rating plans in place for loss-sensitive programs. At one extreme, insurers may rarely require 100 percent collateral deposited in an insurer-controlled fund. More typical is some agreed-upon escrow account with funds equal to several months of loss payments. Some insurers require additional security through general indemnities, letters of credit, or similar instruments.

large firms decline to quote because the insurance component of their bid contains additional profit, or their own insurance programs provide a known scope of broad coverage. Contractor experience and familiarity with OCIPs may lessen this resistance. In fact, the number of CCIPs is growing, as large contractors move to capture the same benefits (and revenues) that owners enjoy under an OCIP. However, in our experience, there is no apparent decrease in the number of qualified contractors interested in public construction projects where OCIPs are contemplated. On the other hand, contractors with established "rolling" CCIPs are inclined to prefer CCIPs to OCIPs since they benefit from the latter.[94]

3. In large transit projects where very high limits of liability, e.g., higher than $100 million, are required due to the risk assessment or contractual requirements, having an owner and contractors in the market seeking those limits simultaneously for both OCIP and CCIP approaches can cause capacity and market access problems with adverse results. Transit agencies should 1) determine which approach will be used before brokers approach insurance companies for quotations, or 2) do price comparisons based on conceptual or estimated costs.

4. There is some concern that there will be a redundancy in cost, if not in coverage, as certain contractors are either unable or unwilling to identify all appropriate credits in their insurance charges or eliminate duplicate coverage. While this is always a concern, most brokers providing OCIP management services have both the experience and the systems to handle both concerns. While 100 percent capture of credits may not be realized, most of the coverage duplication can be avoided. Careful preparation of the bidding documents and the coordination of an experienced OCIP administrator and the contract manager will help minimize duplicate costs.

5. Some critics point to the duration of the close-out of the project as a disadvantage. Because of the time that it takes to close out all remaining claims after completion of a project and to make appropriate adjustments with the insurers, management must devote administrative time to the wrap-up for a period of time after construction is completed. However, experienced administrators can assume this responsibility and relieve the public project owner of most of the attendant burden.

6. Other contractor concerns are that OCIP coverage is not as broad as the contractor's own program and that disruption of a contractor's own program leads to higher costs. Contractors have argued that an OCIP exposes them to more risk. In practice, a well-designed OCIP can mitigate the coverage risk.

Project Candidates for OCIPs. Almost any substantial construction project is a candidate for an OCIP. At a threshold of about $50 million in hard construction costs within a 3-year period, a transit agency owner could consider an OCIP, although the financial benefits are small at that level. Once a project exceeds $100 million in construction costs, the economics present an opportunity for savings. Other characteristics of a good OCIP project include:

- Projects in which multiple construction managers, design-builders, or prime contractors are working at a single or contiguous site, also known as having a co-location exposure.
- Multiple contractors involved, usually five or more contractors or subcontractors for the project.
- A number of separate construction contracts.
- Mixed project delivery methods (e.g., DB and design–bid–build).
- Labor-intensive projects with "unburdened" construction payroll in excess of $20 million.
- Complicated or "high risk" construction.
- An environment where an owner can positively motivate contractor safety practices.
- Management and owner commitment to safety, loss prevention, and claims management.

Criteria for Success. The criteria for a successful OCIP are simple. Proper understanding and planning are key elements. Management commitment and responsibility are also critical. Attention to detail, management, and oversight are also necessary. Finally, the transit agency must marshal appropriate resources from within and

[94] The rise in the number of institutional rolling CCIPs, where large contractors have large limits of coverage in place with one or more insurance companies with long policy periods, creates some challenges for owners. Insurance company pricing for a continuing stream of large projects over time is likely to be better than for one-off projects, making CCIP business more attractive to them than OCIP business. Further, because CCIP insurers have already committed limits or capacity to a contractor, insurance market capacity for OCIPs involving those contractors on certain projects may be reduced or nonexistent, making it impossible to secure both a CCIP quotation and an OCIP quotation on the same large project.

outside the agency. Characteristics of successful OCIP projects include many of the following:

- An owner–administrator–contractor partnership and commitment.
- A program design that supports the needs of both the owner and contractors.
- Good communication and information management.
- Properly communicated procedures and documentation.
- Good, clear contracts, agreements, and incentives.
- A realistic and formalized safety program.
- Periodic, scheduled performance review and monitoring.

Owner Responsibility. While one could argue that many of the insurance-related specialized skills and resources are available from outside sources and that using them wisely is often more efficient, the transit agency remains responsible for the management of the process and the program. In other words, an owner cannot delegate all the responsibility to the broker/administrator or insurer. To realize the added value of the OCIP, the transit agency must manage the program effectively. That requires a commitment to the program and the resources necessary to manage it. In the absence of sufficient internal resources, many agencies opt for the CCIP alternative. They still need to verify that coverage and cost are proper, but the enrollment, safety, and claims management oversight are the responsibility of the contractor sponsoring the CCIP, or all contractors in the case of a traditional program.

Even if it uses outside professional assistance, the transit agency must manage these critical elements:

- Program design and planning.
- Service and insurance procurement and contracting, including brokerage/administration.
- Contractor (construction) selection and contracting (including bidding).
- Contractor enrollment and communications.
- Safety program management and communication.
- Program administration, maintenance, and close-out.

For example, one of the keys to success of an OCIP is a coordinated and effective safety program for the entire project. The transit agency cannot completely delegate this responsibility to the broker/administrator or insurer(s), but instead must maintain an oversight responsibility, since it will have a direct impact on the owner's cost. The responsibility to maintain a safe work site remains the obligation of the employer (contractor), and the construction contract should clearly articulate that obligation. However, enhanced safety, either in the form of project-wide safety standards or resources (e.g., training or inspection), can be provided by the owner or its administrator or insurer. Further, the transit agency has to be aware of claims activity to minimize the ultimate cost. The agency may benefit by retaining control over claims instead of entrusting this to the contracted administrator or insurer.

Required Skills and Experience. OCIP administration involves two broad areas of service, in a brokerage capacity and in an administrative or management capacity. Traditionally, both skill sets were contracted for from a single entity, usually a national or large regional insurance broker. However, because the skills are discrete, excellence in one area does not guarantee excellence in the other. Increasingly, owners are considering the service requirements separately, evaluating the experience and capabilities of proposing service providers against two sets of criteria.

The first area involves the design, underwriting support, marketing, and placement of the insurance components of the OCIP. This includes the periodic maintenance of the program through remarketing, continuing negotiations with underwriters, handling of billing and premium development, and certain close-out functions.

In the second area of managing the OCIP, a broker/administrator must provide certain administrative services for the OCIP to be successful. These services include, but are not limited to, the following:

- Procedures and manuals.
- Pre-bid communications.
- Pre-bid conferences.
- Construction bid cost analysis, evaluation, and support.
- Preconstruction conferences.
- Contract assistance and verification.
- Program maintenance.
- Program closeout.

VI. MANAGEMENT AND PROCUREMENT ISSUES

The following discussion of procurement and management issues focuses on 1) OCIPS, 2) CCIPs, and 3) Project Errors and Omissions

Programs. Some of the issues discussed will apply to other insurance elements in a large transit capital project.

In the area of program administration, the use of a controlled insurance program approach reduces some of the burden a transit agency would otherwise have in a traditional contractor-provided program, particularly in the area of verifying compliance with insurance requirements in a large number of contracts and for multiple lines of coverage. With a controlled insurance program (OCIP or CCIP), the program administrator, usually an insurance broker, typically has a responsibility to provide verification of program-provided coverage (especially workers' compensation and liability coverage) to both the 1) enrolled or insured parties, and 2) program sponsor or beneficiary, i.e., the transit agency. Also, the program administrator's scope of services usually includes collecting evidence of coverage; verifying it for those required insurance policies that are not part of the OCIP or CCIP, such as automobile liability, some specialized liability, or property coverage; and reporting on the compliance with contract requirements to the owner transit agency.

A. Insurance Program Administration

One of the central elements of a transit agency's insurance administration program is verifying insurance coverages. After the risk allocation process has concluded and the resulting risk assignments and decisions have been incorporated in the project contracts as insurance responsibilities and requirements, it is important to establish that all the requirements have been met and continue to be met during the entirety of the project. As noted in the following sections, some of this administrative burden can be outsourced to insurance brokers administering OCIPs or CCIPs. The documentation of coverage includes the following:

- *Certificates of Insurance.* Certificates of insurance (COIs) are often issued by the placing brokers or the insurance company, but may also be issued by the policyholder in certain circumstances. The actual form of the COI differs from insurance company to insurance company using one of two approaches. Most COIs are issued on industry-standard ACORD[95] forms. Others are proprietary to the insurers or the placing broker. The general purpose of COIs is to communicate the basic coverage information and to verify that coverage was in effect at the date of issuance. There are two important caveats for transit lawyers relying on COIs for coverage verification. First, the issuer has limited responsibility to notify the certificate holder of changes, although some agencies have been successful in getting some acknowledgment of changes within certain time frames from the issuers. Second, the COI does not confer any rights to the certificate holder as only the actual policy language governs the terms and conditions of the coverage. There may be language in the COI suggesting otherwise, but in most cases, that language is nonbinding.
- *Insurance Policies.* Insurance policies are the primary source for coverage verification. Often, the underlying construction and design policies may give the owner the right to request a certified copy of the insurance policies that comply with the contractual requirements. Transit lawyers should note that insurance policies are specialized contracts and that careful reading of the policy, including all the endorsements and project-specific language, is important. While many policies will be based on an industry-standard form, such as an Insurance Services Office (ISO)[96] form, coverage can be significantly changed by endorsement or specific fill-in language. One value of the ISO forms is the wealth of legal precedent in coverage interpretation. Much of the language has been tested in court. On the other hand, some insurers use proprietary forms of their own or ones suggested by their brokers. These so-called manuscript forms need to be reviewed in detail. Transit lawyers may not find any court interpretation of these forms.
- *Insurance Policy Conditions.* As transit lawyers or their advisors review insurance policies, whether purchased by the agency or obtained by the contracting parties, particular attention to policy conditions is critical. One area of review is how a policy applies deductibles or self-insured retentions. It is important that the policy language describe a methodology of imposing deductibles that is consistent with the risk allocation and contractual assignment for the project.

Another area of review is whether an insurance policy allows for one party to waive its rights of subrogation against another. Transit lawyers should look at this particular area as a two-pronged test. First, the insurance policy should allow for the policyholder to waive its rights of

[95] Published and copyrighted by the ACORD Corporation.

[96] Published by the Insurance Services Office (ISO).

subrogation.[97] Secondly, the waiver must be affirmatively stated in the underlying construction or design contract. Simply having an insurance policy that allows a waiver of subrogation does not execute the waiver.

B. Procurement of Insurance

1. Public Sector Challenges

Public sector OCIPs and CCIPs present some challenges not found in the private sector.

- The emphasis on process and open competition makes the public OCIP more process driven, particularly in the area of procurement as discussed below.
- The constraints on funding, cash flow, and budgeting also affect program design and the rating plan. This area is complicated by the underwriting community's perception of its opportunities to profit. For example, a going concern with operational insurance needs, e.g., a transit agency or authority, can present a long-term opportunity for an underwriter. A one-off project sponsored by a state that does not purchase insurance normally does not. Underwriters factor this into their pricing and security requirements.
- Legal considerations and regulations regarding public construction contracts and contractor selection introduce an additional emphasis on process and often limit options available to the organization.
- In Oklahoma, an OCIP was challenged by the independent insurance agents who sought to enjoin the Oklahoma Turnpike from proceeding with an OCIP program for the construction of four new turnpikes. The court, in *Independent Insurance Agents of Oklahoma v. Oklahoma Turnpike Authority*[98], determined that OCIPs were not public construction contracts requiring procurement under Oklahoma's Public Competitive Bidding Act. The court also noted that a typical OCIP is designed to reduce the cost of insurance premiums, and it allows for a coordinated risk management and safety program for workers and visitors to the construction site. It further noted that an OCIP provides for insurance premium rebates to the policy owner for good construction safety records. In upholding the Turnpike's OCIP program, the court noted that the OCIP was beneficial, because it provided better coverage and higher limits for less money than could otherwise be obtained, in addition to a safety plan of unusual merit.
- The need to build consensus and understanding among a wider range of constituents puts a greater burden on management to "sell" the OCIP idea and to regularly communicate the performance of the OCIP.
- The loss-sensitive or retained exposure element of the typical rating plan presents specific funding and accounting issues, particularly involving federal money.
- There may be public policy, political, regulatory, or funding pressures to close an OCIP earlier than a private sector sponsor would normally close an OCIP. This may force some economic choices that are counterproductive. This challenge requires attention to an exit or closure strategy and may affect the program design and implementation.

These and other public sector considerations are seen in the typical action plan discussed below.

2. Typical Action Plan: Selected Implementation Issues (OCIP Specific)

While the theory behind a successful OCIP is simple, the execution required for success can be complex. Public sector processes and considerations can complicate implementation further. The following discussion of a typical action plan highlights some of those public sector considerations. It also assumes a luxury not often found in the "real life" public arena—the absence of time constraints and the ability to implement the program in an ideal order. Often, this is not the case.

The actions take place in four time periods. These are 1) a pre-bid planning and design phase, 2) a predeployment–preconstruction phase, 3) the active construction phase, and 4) the close-out phase.

During the *pre-bid planning and design phase*, the transit agency may conduct *a feasibility study*. The purpose of the study is nominally to explore the options for construction risk financing and to decide if an OCIP makes sense financially. However, the most important function such a study may fill is educational. It informs the project owner's governing board, management, and constituents about the elements, expected benefits and costs, and other considerations regarding an OCIP. It can be used to promote discussion and decision and to define the expectations of each of

[97] Most insurance policies, particularly property insurance policies, allow the policyholder to waive its rights of subrogation 1) in writing, and 2) prior to a loss.

[98] 1994 OK 69, 876 P.2d 675 (1994).

the concerned groups. Another activity during this phase is the development of *an action and staffing/resource plan*, as well as *a procurement plan*.

Having adopted the OCIP concept and the action plans, the project owner then begins the procurement process. *Decisions are made about which entities will provide what services and the manner of conducting the various procurements.*

- The first decision concerns whether a single broker/insurer team will provide all the services on a "bundled" basis or whether brokerage, administration, and other services may be "unbundled."
- The second decision relates to the manner of procuring the insurance components and possibly the services. The choices are sometimes referred to as "the single broker" or "conceptual" and "the multiple broker" or "competitive" approaches.

Single Broker/Conceptual. In the first model, a single broker is selected, based on qualifications (RFQ) and possibly a fee proposal, and that broker approaches a number of insurance companies for proposals. In this model, the insurer is then selected based on an evaluation of cost, program design, and coverages.

Multiple Broker/Competitive. The second involves qualifying two or more brokers through some process, assigning insurance companies to each of the participating brokers, and selecting the broker/insurer team based on cost and coverage considerations.

Both approaches have their advocates, and both approaches work. Often, local considerations and preferences make one approach superior to the other. Generally speaking, the first approach assures that the transit agency selects the best-qualified broker/administrator and avoids the possibility that a low insurance cost may be delivered by an inferior service provider. The second approach assures that there is verifiable competition underlying the selection. It takes some of the appearance of subjectivity out of the process. Whichever procurement approach is chosen, it must be based on identified selection criteria heavily weighted to the experience of the staff assigned to the team. It is advisable to hold pre-proposal meetings with the various insurance underwriters to assure that they understand the project, the project owner, and management's commitment.

Once the OCIP team is selected, the public owner needs to *execute an appropriate contract* with the various parties, particularly the broker/administrator. This will spell out the responsibilities of the various parties and serve as the basis of future performance evaluation. It also sets the groundwork for the communication and coordination required in a successful OCIP.

Next, in the pre-bid phase, the broker/administrator and other OCIP team members formulate a *communication plan* and *begin the contracting process*. This may involve pre-bid conferences for the participating contractors, preparation of bid documents and contracts, development of OCIP manuals, decisions regarding who will be eligible to enroll in the OCIP, and what coverages will be required outside the OCIP. It is at this time that the owner affirms the safety responsibility of the various contractors through the language of the contract and the OCIP manuals.

The question of which contractors will be covered or enrolled is a practical one. In most cases, some contractors will be excluded, particularly those who are not on site, involved in hauling or fabrication off site, or involved in small subcontracts in particularly hazardous trades. This decision will have an effect on the way the insurance requirements are stipulated in the construction contract.

Another decision made during the pre-bid or pre-contracting phase is *how insurance costs are to be reflected in the construction bids (if bid) or estimates (if negotiated).* This is one area where local ordinances or state law may constrain the agency. In bidding situations, the two options are the so-called "bid-deduct" and "add-alternate" approaches. While the consideration of their advantages and disadvantages is beyond our present scope, where law allows the second approach, it consumes less administrative time. Advocates of the first approach argue that it provides a clearer picture of the "savings" achieved by the OCIP. In our experience, the second requires "a leap of faith" by the public agency. In neither case is there complete certainty to the amount of "savings" resulting from the program.

During the *pre-deployment phase*, the OCIP team, primarily through the efforts of the administrator, binds the coverage, enrolls the participating contractors, completes the plan education activities, and distributes the appropriate manuals. At this time, the safety plan is designed, including imposing safety obligations on all contractors, developing a written owner's safety plan, exploring a possible incentive plan, and establishing a process for verifying and assuring compliance.

During the *construction phase*, the activities include 1) maintaining the insurance program; 2) conducting safety training, support, and auditing;

3) verifying outside coverage, payrolls, claims, and other information from enrolled contractors; 4) working with insurers and other service providers on safety, claims, and coverage issues; and 5) reporting performance and results to the governing board and management.

In the final phase, *project close-out*, insurance cost bases are audited, contractor cost reductions are verified, losses and claims are resolved, performance reviews and audits are completed, and final reports are issued. If the early planning and service procurements were done well, and periodic construction phase monitoring and necessary corrections were undertaken, then this phase can proceed with little problem.

As previously outlined, there are two basic procurement models for obtaining an OCIP that follow typical approaches used by transit agencies to procure their operational insurance coverages. The complexity and uncertainties of cost elements complicates the procurement, often making the basis of award a matter of judgment ("best value") rather than lowest demonstrated cost. When done right, the OCIP itself is negotiated before the prime construction and design contracts are awarded, which leads to problems in evaluating the costs of one approach against another or one proposal against another.

- The fixed cost components are a function of payroll or contract cost, which may not be known for some period of time, particularly in DB and other alternative delivery models.
- The variable components, especially the losses and loss adjustment expenses, will not be known for some time after completion of the project, subject to maximum and minimum rating plan premiums, which are a function of payroll (itself a variable factor).
- There may also be deductibles outside the rating plan that are the responsibility of one party or another and must be treated in the contract documents.

In the case of a CCIP, the construction manager or prime contractor has the responsibility of obtaining the coverage for the benefit of the project partners, including the owner. Again, the specification of the CCIP and its programmatic details, such as limits, coverages, deductibles, and parties protected, are spelled out in the proposal documents as performance specifications rather than detailed prescriptive specifications. After award, the CCIP sponsor may approach the insurance market to obtain a CCIP program with the appropriate coverages and limits, subject to the underwriting and pricing demands of the insurance companies.

3. Procurement Processes

There are various procurement methodologies available to transit agencies in arranging various required insurance and related risk financing services. These vary by the program approach chosen by the agency.

Coverage obtained by the agency can negotiate with an incumbent insurance broker or insurer. This is a typical option for builder's risk coverage.

Conceptually, coverage may also be procured through one of a number of competitive approaches, including:

- Appointing a *single broker* to negotiate pricing and coverage of an insurance program for the agency. In our experience, this approach is rarely used in the public sector. None of the survey respondents indicated a preference for this model.
- Using an RFQ or RFP process to select a single broker that in turn conducts a competitive bid for specified coverages[99] in the commercial marketplace, approaching a variety of commercial insurers directly or through intermediaries, such as excess and surplus lines brokers. In our experience, we find this approach to be most prevalent in the public sector for large projects where an owner has decided to implement an OCIP. The survey respondents that use OCIP seem to indicate a similar preference for the single broker model.
- Using an RFQ or RFP process to select two or more insurance brokers, assigning them specific insurance companies to approach, issuing detailed specifications, and evaluating responses for the best policy or program. We do not find this model used very often for OCIP coverage, due to limitations in market capacity and the limited number of lead insurers. For some other coverages, there might be a large enough market to accommodate more than one broker in the marketplace.
- Inviting a number of brokers to participate in a general bidding process, assigning markets, is-

[99] These include builder's risk, primary general liability, lower layer umbrella liability, and workers' compensation. Higher levels of excess or umbrella liability may be subject to market capacity constraints that prevent securing firm competing quotations for significant limits. For higher limits, where capacity and cost are the primary determinants, the broker's role includes identifying, negotiating, and placing the limits at the best available terms.

suing specifications, and evaluating responses in order to select the best proposal or proposals. While this approach is sometime used in the public sector for very small projects, it is not suited to larger, specialized projects such as transit construction.

For coverages that are required of other parties, the transit agency has little or no control over the procurement of the insurance. Instead, it relies on the insurance requirements contained in the construction procurement documents and the various contracts.

- This requires that the level of performance requirement be detailed enough to assure that the successful designer, constructor, DB firm, or other third party secures coverage that is appropriate and compliant with the insurance requirements at a reasonable cost to the owner.
- Depending on the project delivery model, those costs may or may not be part of the selection decision.
- The approach to obtaining the insurance is directed by the third party.
- The result is that the transit agency has no ability to effect its disadvantaged business enterprise (DBE) programs, or to craft insurance policies or products to dovetail with the agency's own insurance or negotiate improvements to benefit the agency or the public.
- The procurement of a CCIP program focuses on the DB entity or the prime constructor or construction manager, depending on the delivery approach. The CCIP model does afford a single point of contact for evaluating and verifying coverage and presumably provides broader and lower cost coverage than the traditional everyone-brings-their-own-coverage model.

4. Cost Analysis in Procurement

Transit lawyers will find that cost analysis for design- and construction-related insurance is a complicated and sometimes very opaque process. There are a number of elements contributing to this complexity and adding to the uncertainty of insurance costs.

- *Exposure Base Uncertainty.* Most insurance policies are priced as a function of some exposure base, most typically 1) payroll for workers' compensation and general liability, 2) replacement cost values at risk for builder's risk, and 3) construction costs and/or professional fees for professional liability. Initial premium costs are based on projected exposures, which may vary greatly from the actual exposures. This introduces a projection uncertainty. Another example is found in DB situations where the construction means and methods may be left to the DB organization, and the payroll, number of contractors, and their identities, all of which may drive insurance costs, may be unknown for some time.
- *Loss Sensitive Rating Plan Uncertainty.* In the case of CIPs for workers' compensation and general liability, the rating plans are loss-sensitive, i.e., the premium consists of certain fixed price components and certain variable (losses) costs. Loss projections are used to determine initial premiums and payment plans, subject to adjustments as losses are reported and resolved.
- *Placement Timing and Market Conditions Uncertainty.* Owners may estimate the cost of OCIPs or builder's risk programs well before the actual insurance is placed. Constructors, designers, and DB organizations may project insurance costs for CIPs, traditional insurance programs, design professional liability, and other insurance as part of their proposals before they actually arrange the insurance. This timing difference introduces uncertainty regarding the market conditions that affect price. Similarly, if the term of the project is long, there is a strong likelihood that insurance programs may need to be renewed mid-project, subject to potential changes in the marketplace affecting both price and breadth of coverage.

Policyholders, whether the owner or the contractors and designers, need to rely on their advisors, e.g., insurance brokers, insurance consultants, or owner representatives, for guidance on cost estimates. Insurance companies and brokers may have proprietary insurance products or programs where they are reluctant to share details of pricing or coverage design until the programs are bound. This, coupled with an understandably conservative perspective on cost estimation, leads to increased opacity in cost presentations.

5. Contingent Commissions

In October 2004, New York Attorney General Elliot Spitzer commenced a civil litigation against Marsh & McLennan, Inc., and Marsh, Inc. (collectively "Marsh"), alleging that they cheated major corporate clients by rigging bids and collecting huge contingent commission fees by steering business their way. The allegations involved fraudulent business practices and conspiracy to

restrain trade and commerce. The companies involved with Marsh included American International Group, ACE Ltd., Hartford Financial Services Group, and Munich-America Risk Partners. It was alleged that these participants paid improper fees and rigged bids, including their agreement to pay Marsh a billion dollars in so-called "contingent commissions" to steer them business and shield them from competition.[100]

By way of background, insurance brokers receive two types of commissions. The first is a flat commission calculated from a percentage of the premium amount an insured pays for the policy. Second, on top of these upfront commissions, insurance companies pay an incentive commission, commonly referred to as a contingent or supplementary commission. Under this arrangement, the insurance company pays a bonus to the broker that is calculated based on business growth and profitability. In other words, the more business the broker places with an insurer and the fewer claims the policyholder successfully files, the more the broker collects.[101]

Brokers who participated in this arrangement had a clear direct conflict of interest between their clients' interest in settling legitimate insured claims and the broker's interest in the insurance carrier being more profitable (in part because it reduced its payout on claims).

In the Marsh litigation, Spitzer alleged that this incentive commission contributed to a widespread practice of bid rigging, where brokers solicited fake bids for consumers with deliberately less favorable terms than the bid offered by the insurance company paying the highest commissions, resulting in billions of dollars of additional commissions. The complaint further alleged that the Marsh business plan had been to increase the contingent commission by steering clients to favored insurance companies that paid higher commissions.

After commencement of the suit, Marsh replaced its Chairman and Chief Executive, several employees were suspended, and a former Marsh broker pled guilty to criminal charges for his part in the alleged bid rigging of insurance contracts. In January 2004, Marsh agreed to pay $850 million to settle the investigation, and the firm issued a public apology, calling its conduct unlawful and shameful. The money was to serve as restitution for clients of Marsh's insurance brokerage firm who were allegedly cheated by Marsh brokers. The settlement included a commitment by March 2004 to a new business model that shunned contingent commissions and other payment arrangements that created conflicts of interest.[102]

This litigation and resultant settlement with Marsh highlights the clear conflict-of-interest situations created by contingent or supplemental fee arrangements. Consumers rely on brokers as experts, and brokers can prey on this reliance by creating compensation structures that conflict with their duties to clients. London-based Willis was one of the first brokerages to reject contingent or supplemental commissions. Although some of the major insurance brokers no longer accept contingent commissions, the practice still exists for smaller agents and brokers. Full disclosure of these contingent fee arrangements, by whatever name they are known, to the insurance consumer is warranted. The lack of transparency in these fee arrangements is something that transit lawyers should be aware of and explore when using brokers to place and manage insurance programs.

VII. CASE STUDIES

A. Los Angeles County Metropolitan Transit Authority Case Study

1. Description of Los Angeles County Metropolitan Transit Authority Organization

The Los Angeles County Metropolitan Transit Authority, commonly referred to as LA Metro, serves as the transportation planner and coordinator, designer, builder, and operator within a 1,433-sq-mi service area in California. Nearly 9.6 million or one-third of California residents live, work, or play within the geographic area.[103]

- Description of LA Metro Large Transit Projects.

LA Metro's construction program includes numerous billion dollar projects, including the Crenshaw/Los Angeles International Airport

[100] Complaint (copy on file with authors).

[101] *See* ACE Insurance Contingent Commission Whitepaper, available at http://ace-insurance-litigation.com/ace-ina-bad-faith/contingent-commission-whitepaper (last accessed Mar. 2014).

[102] *MMC Settles Spitzer Charges for $850 Million*, BUSINESS INSURANCE, Jan. 31, 2005, available at http://www.businessinsurance.com/apps/pbcs.dll/article?AID=999920004957 (last accessed Mar. 2014).

[103] *See* http://www.metro.net/about/agency/mission/ (last accessed Mar. 2014).

Transit Project ($2.058 billion) to build an 8.5-mi light rail line, stations, fixed guideway, new rail cars, and rail maintenance yards, scheduled to open in 2019. Other major transit infrastructure include the B Metro Gold Line Foothill Extension, Metro Rail Exposition Corridor Phase 2, Purple Line Extension ($2.4 billion), Regional Corridor Connector ($1.3 billion), I-405 Sepulveda Pass Improvement Project ($1.1 billion), and Gold Line Foothill Extension ($741 million).[104]

2. LA Metro Project Delivery Systems

LA Metro uses the traditional design–bid–build approach in its construction program, but it has also adopted DB, design–build–operate–maintain (DBOM), and P3. Under the traditional design–bid–build contract, LA Metro requires that the contractor provide standard insurance coverage meeting specified limits. For large DB transit projects, the designer and contractor are linked to a single tower of limits that covers both parties for general liability exposure. In a DBOM or P3, project insurance limits are adjusted to reflect the time frame and operating exposure.

3. How Is Risk Administered?

Contract risk is administered by obtaining requisite insurance coverage and by requiring LA Metro contractors to agree to indemnity provisions contained in the contract documents.

4. Who Writes the Provisions and Administers the Insurance Program?

The risk allocation provisions are drafted by the risk manager and general counsel, but the Risk Manager is responsible for drafting the insurance contract provisions.

5. Insurance Requirements and Coverages

For a large transit project, LA Metro requires a contractor to develop a CCIP with project-specific limits. The CCIP wrap-up insurance covers the contractor's subcontractors or other entities for which the contractor may be legally or contractually responsible. The CCIP also provides that its insurance shall be available for the benefit of LA Metro and other contractually indemnified parties. It also requires that LA Metro and other indemnified parties be included as named insured on all policies, except workers' compensation and professional liability.

For the LA Metro project, CCIP is required to provide the following insurance coverages:

1. CGL coverage for the contractor and contractor-related entities and indemnified parties, with a minimum limit of $2 million combined single limit[105] per occurrence, $4 million general annual aggregate limit, and $4 million products/completed operations aggregate. The insurance shall be written on an occurrence form and shall be no less comprehensive and no more restrictive than the coverage provided by ISO form CG 00 01 07 98 or equivalent, with exclusions only as are typical for a construction project of this magnitude.
2. Statutory Workers' Compensation and Employer's Liability in conformance with the laws of the state with minimum Employer's Liability limits of $1 million per accident for bodily injury by accident,[106] $1 million per employee for bodily injury by disease and $1 million policy limit for bodily injury by disease, and auto liability insurance limits of $10 million combined single limit.
3. Contractor Pollution Liability (CPL) insurance of no less than $40 million per occurrence and $40-million aggregate dedicated to the project, inclusive for the entire period of construction. The CPL policy shall provide coverage for cleanup costs, third-party bodily injury, and property damage resulting from pollution caused by contracting operations. The indemnified parties shall be named insureds on the CPL policy.
4. Environmental Impairment (Pollution) Liability Site Coverage Insurance. Upon LA Metro's completion of appropriate environmental documents and within 60 days of LA Metro's issuance of a change order, the contractor shall bind an Environmental Impairment Liability Site Coverage policy covering the environmental risks, including the clean up and remediation of unexpected hazardous substances from the project. The term of the policy shall be not less than 15 years, and the indemnified parties shall be named

[104] Program Management Project Budget and Schedule Status, Construction Committee, 9/113 (as of 2014).

[105] A combined single limit applies a single dollar limit to any combination of bodily injury and property damage claims arising out of a single accident or occurrence, in contrast to so-called split limits where a policy provides separate limits for bodily injury claims and property damage claims in a single accident.

[106] An idiosyncrasy of workers' compensation coverage language is that the employer's liability coverage grant affords limits that are specific and aggregate for "bodily injury by accident" and "bodily injury by disease." These refer to the cause of the injury to the claimant.

as insureds on the policy. The change order will reimburse the contractor only for insurance premiums.

5. Umbrella or Excess Liability Insurance limits shall be not less than $250 million, which will provide coverage at least as broad as the primary coverage set forth above, including employer's liability, CGL, and comprehensive auto liability in excess of the amounts set forth previously. The indemnified parties shall be named additional insureds on the umbrella excess policy.

6. Professional Liability Insurance shall include project-specific liability coverage of not less than $35 million per claim and aggregate. The professional liability coverage shall provide coverage on a primary basis and shall protect against any negligent act, error, or omission arising out of the design, engineering, project/construction management, or oversight activities with respect to the project. The policy shall have a 10-year extended reporting period, and the total term of the policy shall not be less than 10 years. It shall also provide an indemnified party endorsement or vicarious liability endorsement for the indemnified parties.

7. Builders Risk Insurance must be a blanket policy on an "all risk" and flood basis for the project and include maximum coverage for the replacement values thereof for all risks, with a minimum limit of $250 million, plus "soft cost expense cover." LA Metro may elect to purchase bona fide earthquake coverage at its option and expense of not less than $50 million per occurrence. The deductible and self-insured retention shall be no greater than 5 percent or $250,000, whichever is less.

6. How Are Insurance Services Procured?

Insurance is not generally procured by LA Metro, but it relies on its contractors to meet and provide the insurance requirements set forth in their contracts.

7. Unique Features of LA Metro Insurance Approach

LA Metro prefers CCIP insurance programs instead of OCIPs. LA Metro has determined that due to documented savings, CCIPs are the preferred approach for DB, DBOM, or P3 projects in excess of $100 million. LA Metro prefers CCIPs, because it believes that contractors are best suited for loss control since they are directly involved and have the legal liability for injuries on the project. Contractors are in a better position to administer the insurance program, control their safety program, and to handle claims and loss control since they have a vested interest in the outcome. It also enables contractors with good safety programs and records to gain competitive advantages in the procurement, resulting in lower bids. In LA Metro's experience, CCIP premiums tend to be 10 percent less expensive than OCIP premiums. Further, large transit projects attract large contractors who have ongoing rolling CCIP capability, thus eliminating the need for LA Metro to create an OCIP from scratch and avoiding the attendant OCIP administrative costs and lengthy close-out requirements.

LA Metro had a difficult experience with termination of a prior OCIP. [107]

LA Metro is convinced that CCIP programs eliminate coverage disputes and complaints. They also enable small contractors and DBEs to gain insurance and coverage. LA Metro indicates that an OCIP would be considered for smaller projects involving multiple prime contractors that are co-located on the project site.

8. LA Metro Legal Issues

Section 7105 of the California Civil Code prevents public agencies from requiring their contractors to repair or restore damages in excess of 5 percent of the contract amount if they are determined to be caused by Acts of God. An Act of God is defined as an earthquake in excess of 3.5 on the Richter scale or tidal waves. Thus, LA Metro retains the risk of earthquake damages and has the option to pay the premium for an earthquake damage insurance policy.

In addition, Section 2792 of the California Civil Code also prohibits construction contract clauses that indemnify the public owner from the sole negligence or willful misconduct of the owner.

[107] During tunneling construction of the Red Line, portions of Hollywood Boulevard subsided and created house-size sink holes, which led to hundreds of homeowner's lawsuits. LA Metro hired outside counsel to defend itself against the damage claims. LA Metro-insured Argonaut contended that LA Metro drove up litigation and claim costs and terminated the MTA insurance policy. In 1996 LA Metro filed suit against Argonaut seeking $100 million in damages and accusing Argonaut of fraud, bad faith, and extortion for canceling its policy covering Red Line construction. Argonaut counterclaimed, seeking reimbursement from the unpaid deductible and other costs. In 2006 the MTA agreed to pay Argonaut $45 million, ending 9 years of litigation. *See MTA Agrees to Pay $45 Million to Settle Suit over Subway* at http://articles.latimes.com/2005/aug/25/local/me-mta25 (last accessed Mar. 2014).

Such provisions are against public policy and void and unenforceable. The code mandates that an owner cannot be indemnified for the owner's active negligence.

B. New York Metropolitan Transportation Authority Case Study

1. Description of Organization

The New York Metropolitan Transportation Authority (NYMTA) manages public transportation in the New York City metropolitan area, including New York City subways and public bus systems. The NYMTA is a public benefit corporation of the State of New York and is composed of transit agencies that include the Long Island Railroad, Metro North Commuter Rail Company, Staten Island Rapid Transit Operating Authority, Metropolitan Suburban Bus Authority, First Mutual Transportation Assurance Company, MTA Bus Company, and MTA Capital Construction. Affiliates of the NYMTA include New York City Transit Authority, its subsidiaries, and the Triborough Bridge and Tunnel Authority.[108]

2. Description of Large Transit Projects

Major expansion projects include the East Side Access, which will provide a new eight-track station beneath Grand Central Terminal ($8.24 billion); Second Avenue Subway ($4.4 billion), which will reduce congestion and provide better access to mass transit for residents of the East Side of Manhattan; and Number 7 Line Extension ($2.4 billion), which will provide a 1.5-mi extension and new station in one of Manhattan's newest neighborhoods. The $1.4-billion Fulton Transit Center will serve 300,000 daily customers and provide access to 12 subway lines and 25,000 ft of retail space.[109]

3. Project Delivery Systems

MTA currently uses the traditional design–bid–build and DB delivery systems.

4. How Is Risk Administered?

Contract risk is administered by requiring insurance coverage and requiring its contractors to provide indemnity protection provisions contained in the contract documents. On certain larger transit projects, MTA has instituted an OCIP program, which will be discussed later in this case study section.

5. Who Writes the Provisions and Administers the Insurance Program?

The risk manager and lawyer are responsible for the drafting of the contract risk provisions. The risk manager has the primary responsibility for drafting insurance contract provisions.

6. Insurance Requirements and Coverages

The MTA requires its contractors to maintain, at a minimum, workers' compensation, CGL, and commercial automobile liability insurance. Routine construction projects also mandate that the MTA and the contracting agency be named as additional insureds on the policies. In general, coverage requirements range from $1 million to $5 million combined single limit for injuries to persons (including death) and damages to property.

For mega projects, MTA subsidiary First Mutual Transportation Assurance Company (FMTAC) provides an OCIP, which provides coverage for general liability, workers' compensation, railroad protective, and builder's risk.[110]

FMTAC, a captive insurance company, is also able to provide insurance coverage for flood and earthquake damage, which became critical due to the damages caused by Hurricane Sandy. The company insures property damage claims with respect to the perils of flood and earthquake in excess of a $25 million per occurrence self-insured retention, subject to an annual $75-million aggregate. The total program limit has been maintained at $1.075 billion for any one peril.

All losses resulting from acts of terrorism are excluded from this policy. With respect to terrorism, FMTAC is reinsured by the United States Government for 85 percent of the "certified" losses as covered by the Terrorism Act of 2007 (TRIA). The remaining 15 percent is covered by an additional reinsurance policy with Lexington Insurance Company.[111]

C. Construction-Related Insurance Coverage

FMTAC provides an OCIP program for the $6-billion East Side Access Project through an

[108] Report of Examination of the First Mutual Transportation Assurance Company as of 12/31/10, at 14.

[109] MTA Capital Program available at http://web.mta.info/capital/esa_alt.html (last accessed Apr. 2014).

[110] N.Y. INS. LAW § 2504 (McKinney 2000) generally prohibits wrap-up insurance for public construction in New York unless certain exceptions are met. NYMTA rail projects are exempted from this prohibition.

[111] First Mutual Transportation Assurance Company 2011 Annual Board Meeting, May 25, 2011, at 15–16.

agreement with Liberty Mutual. The agreement insures third-party contractors and NYMTA and all of its subsidiaries up to $300 million for workers' compensation and general liability. The insurers required FMTAC to hold the collateral and loss funding for the first $500,000 per occurrence.[112]

A similar OCIP is in effect for the $2.5-billion Second Avenue Subway Project, insuring workers' compensation and general liability for third-party contractors of the MTA and subsidiaries, up to $500 million per occurrence, subject to a $1-million deductible. The OCIP requires FMTAC to post collateral for all losses and related workers' injuries. In 2011 and 2012, $23 million was set aside.[113]

In addition, FMTAC entered into a Builders' Risk insurance program for various MTA 2012–2014 combined capital program OCIPs with limits of $50 million per occurrence and a $25,000 contractor deductible. FMTAC also purchases from ACE a Builder's Risk policy with limits of $50 million per occurrence, with a $250,000 deductible.

Kemper Insurance Company issued excess and professional/environment liability policies with respect to work performed on the East Side Access Project. The MTA has two such policies: the first policy has limits of $4 million in excess of $2 million for liability on an occurrence basis, and the second policy is for professional and environmental coverage with a limit of $50 million on a claims made basis.[114]

1. How Are Insurance Services Procured?

FMTAC utilizes a best value selection process to select the administrator of the OCIP program. Evaluation of the proposer's safety program and its safety consultant are integral parts of the selection process. Administrative costs range from 7 percent to 9 percent.[115]

2. How Is Insurance Purchased?

For routine construction projects, insurance is not generally procured by the NYMTA, as it relies on its contractors to meet and provide the insurance requirements set forth in their contracts. For the Metropolitan Transportation Authority Capital Construction (MTACC) mega projects, FMTAC provides the OCIP program and has a CCIP program for the Seven Line Expansion.

- Unique Feature of NYMTA Insurance Approach

FMTAC was created to engage in the business of acting as a pure captive insurance company under Section 7005, Article 70 of the New York Insurance Law. Its mission was to continue to meet, develop, and improve the insurance and risk management needs as required by NYMTA. It should be noted that NYMTA is a huge transit operation, having more than $360 billion in assets and incurring more than $70 million in insurance premiums in 2013, and is able to structure its insurance program to secure the necessary coverage.

NYMTA and FMTAC are component units of the State of New York. FMTAC is approved to insure the risks of NYMTA and its family agencies. A captive insurance company is a special purpose insurance company formed primarily to underwrite the risks of NYMTA. A captive cannot sell insurance to the general public and can only underwrite the risks of its parent organization and related entities. FMTAC engages in an underwriting process whereby it reviews and evaluates risk for potential coverages, sets premium rates, and writes insurance policies. It operates a claims management system to handle claims that result from the policies written, and does its own financial management and compliance reporting. For underwriting, it operates as an insurance company and sets its rates for the insurance risks it chooses to underwrite. FMTAC gives NYMTA significantly greater control over its risk management program by developing tailored coverage and stabilizing insurance budgets through its own underwriting, and provides direct access to wholesale reinsurance markets. NYMTA, through FMTAC, is able to keep premiums level and predictable by entering into long-term insurance transactions and thus reduces the influence of insurance market fluctuations.

FMTAC is managed by a Board of Directors. The captive is managed by Marsh Management

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[112] First Mutual Transportation Assurance Company 2013 Annual Board Meeting, Sept. 18, 2013, at 18; Report of Examination of the First Mutual Assurance Company, at 4–5, http://web.mta.info/mta/news/books/docs/FMTAC.pdf.

[113] First Mutual Transportation Assurance Company 2013 Annual Board Meeting, Sept. 18, 2013, at 18.

[114] *Id.*

[115] Interview with Laureen Coyne, Director of Risk Management, NYMTA (Aug. 2013).

Services, licensed by the New York Department of Financial Services.[116]

Recently, FMTAC played a vital role in recovering from damage caused by Hurricane Sandy. Hurricane Sandy made landfall with a record storm surge of nearly 14 ft, which produced flooding in low-lying areas near the East River. The Brooklyn Battery Tunnel and seven East River subway tunnels were flooded, putting a halt to New York City commuter rail service and causing $5 billion in damages. Through FMTAC, NYMTA had insurance to cover $1.05 billion in damages,[117] with the remaining damages to be paid through assistance from the federal government. Further, in July 2013, FMTAC secured $200 million in reinsurance protection to help pay for future repairs for damages to its infrastructure in the event of future destructive storm surges similar to those experienced with Hurricane Sandy.[118]

3. Legal Issues

Section 5-322.1 of New York General Obligation Law declares that any agreement exempting owners and contractors, or holding them harmless from liability for negligence, are void and unenforceable. As discussed previously in Section III.E.2 of this digest, New York's strict liability Scaffold Law requires another layer of general liability for contractors and taxpayers and adds millions of dollars to the cost of public projects. Some governmental agencies and contractors maintain that the cost of the insurance can often be double that of other states. By way of example, there are estimates that the insurance cost added $200 million to $400 million to the cost of the $5 billion replacement of the Tappan Zee Bridge. The legal exposure issues that increase insurance costs are estimated at 50 percent more than in New Jersey.[119]

New York law generally prohibits the adoption of OCIPs for public construction projects, but exempts transit agencies[120] from this prohibition.

D. Massachusetts Bay Transportation Authority

1. Description of Organization

In terms of daily ridership, the Massachusetts Bay Transportation Authority (MBTA) remains the nation's fifth largest mass transit system. It serves a population of 4,817,014 (2010 census) in 176 cities and towns with an area of 3,249 sq mi in the Boston area and Eastern Massachusetts. It maintains 183 bus routes, 2 of which are Bus Rapid Transit lines; 3 rapid transit lines; 5 light rail (Central Subway/Green Line) routes; 4 trackless trolley lines; and 13 commuter rail routes. The average weekday ridership for the entire system is approximately 1.3 million passenger trips.

The Board of Directors has seven members, appointed by the Governor and serving coterminous with him or her. One member is the Secretary of Transportation, who serves as the Chairman of the Board. The two additional members are from outside the MBTA district. An advisory board, consisting of one official or his or her designee from each of the communities in the MBTA district, reviews the program for mass transportation, which is the MBTA's long-range planning document. The advisory board also reviews the authority's annual operating budget. In addition, the advisory board reviews and provides comments on the authority' s draft capital improvement plans and fare increases. The cities and towns pay an "assessment" consisting of their proportionate share of the MBTA's net deficit. The state government pays the largest share of the annual deficit. Fare box revenues currently cover about 31 percent of the authority's total annual operating expenses.

2. Description of MBTA's Largest Transit Projects

The largest capital projects that the MBTA is currently undertaking include the following:

- The Government Center Station Project includes improvements to the Green Line Station and Blue Line Station. Project scope includes redundant elevators, new escalators, raised

[116] Report of Examination of the First Mutual Transportation Assurance Company as of 12/31/10, June 29, 2012, at 6–7.

[117] Bestwire, blog posted on Dec. 14, 2012, *MTA: Insurances to Cover $1.075 Billion in Hurricane Sandy Damage*, http://www.programbusiness.com/News/MTA-Insurance-to-Cover-1075-Billion-in-Hurricane-Sandy-Damage.

[118] MTA Secures 200 Million Insurance Protection, MTA Web site, available at http://new.mta.info/press-release/mta-headquarters/mta-secures-200-million-insurance-protection-future-sandy-storms (last accessed Mar. 2014).

[119] Interview with Laureen Coyne, Director of Risk Management, NYMTA (Aug. 2013).

[120] N.Y. INS. LAW, § 2504 (McKinney 2000) prohibits wrap-up insurance contracts for public construction contracts with certain exceptions. MTACC railroad projects are exempted from this prohibition.

platforms, new power systems, a unit substation, improved egress, Americans with Disabilities Act (ADA) compliance, and code and safety updates. The current total budget is approximately $130 million, with a projected schedule of approximately 3 years.

- The Green Line Extension Project includes an extension of the Green Line to Tufts University. It includes track and signal upgrades, new stations, new light rail cars, and a maintenance and operations facility. The current total budget is approximately $1.3 billion, with a projected schedule of approximately 6 years.
- The Fitchburg Track and Signal Replacement Project, Fitchburg Line Bridges Project, and the South Acton Commuter Rail Station Project include improvements to the existing track, addition of new track and interlockings, upgrading of track and signal systems and other elements of the existing line, improvement or replacement of bridges, and improvements to an existing commuter rail station. The total budget for the project is approximately $172 million, and the projected schedule for all Fitchburg Line elements to be completed is approximately 3 years.

3. Description of Project Delivery System Used

The majority of the MBTA's capital projects use the design–bid–build method of project delivery. The MBTA has used DB on two projects, Wonderland Parking Garage and Revere Transit, and is currently using DB on the Merrimack River Project. The MBTA is using its first CM/GC project delivery approach on the Green Line Extension Project.

4. How Risk Is Assessed and Managed

Contract provisions related to insurance are reviewed by the MBTA risk manager, with minimum insurance limits determined as it relates to scope of work. Standard minimum requirements are set for a majority of contracts. Indemnity provisions are reviewed and revised in conjunction with the MBTA legal department.

5. Who Writes Contract Provisions Regarding Allocation of Risk?

Construction contracts are written by MBTA Design and Construction in conjunction with MBTA Legal.

6. Who Administers the Risk Management Program?

The MBTA risk manager is responsible for the MBTA insurance program. MBTA Design and Construction handles the risk management analysis for construction projects.

In its standard specifications, the MBTA requires that the contractor furnish the following types of minimum insurance and minimum limits:

- Comprehensive general liability (GL) with limits of not less than $1 million per occurrence and $1 million per aggregate, including contractual liability covering the subject contract, and completed operations coverage for at least 2 years following MBTA acceptance.
- Automobile liability with limits of not less than $1 million.
- Workers' compensation, including employer's liability, as required by Massachusetts General Laws Chapter 152, including a waiver of subrogation as to the MBTA.
- Umbrella liability with limits of not less than $10 million per occurrence and per aggregate, covering "all works and services under the Contract." The exact amount is determined on a project by project basis.
- Pollution liability insurance with limits not less than $1 million per occurrence and $5-million aggregate.
- Railroad protective with limits of not less than $5 million per occurrence and $10-million aggregate.
- Builder's risk on a 100 percent completed value basis.

The MBTA also carries a statutorily required general excess liability policy with limits of $75 million (with a $7.5-million self-insured retention), covering bodily injury and property damage and accidental death.

On one project, the MBTA revised its RFP and contract wording to allow for options for the MBTA to provide builders' risk coverage and OCIPs in the future.

The MBTA has not used an OCIP since 2002, because the MBTA did not find that it clearly generated sufficient cost savings.

7. How Are Insurance Services Procured?

The MBTA conducts an RFP for broker services for its property program and liability program. A broker selection committee (three to five members), approved by the Chief Financial Officer (CFO) and General Manager (GM), makes the final selection decision. The broker services agreement is for 3 years, with a 1-year option for an additional year. Current brokers receive an annual flat fee approved by the MBTA board.

8. How Is the MBTA's Insurance Purchased?

At the direction of the MBTA's risk manager, the insurance broker approaches all viable markets for policy renewal quotes. The treasurer-controller, CFO, or GM makes the final decision on policy procurement based on a recommendation by the risk manager.

9. MBTA Legal Issues

The MBTA did not identify any particular legal issues affecting its insurance program.

E. Central Puget Sound Regional Transit Authority

1. Description of Organization

Central Puget Sound Regional Transit Authority, a public corporation acting under the service name Sound Transit (ST), is a regional transportation authority providing a high-capacity transportation system throughout parts of King, Pierce, and Snohomish counties through commuter rail (Sounder), light rail (Link), and a regional bus system (ST Express). The implementation of the initial phase of the voter-approved regional mass transit system (Sound Move) is scheduled for a 20-year period, ending in 2016. In November 2008, the voters approved a second phase of expansion of the mass transit system, a 15-year program called ST2.

2. Description of ST's Largest Transit Projects

The largest capital projects that ST is currently undertaking include the following:

- The University Link Light Rail Project has a total project budget of $1.614 billion, hard construction cost estimate of $900 million ($973 million with contingency), and a scheduled construction duration of 6 years (2009–2015). Construction will be followed by 6 months of systems testing, with a projected project completion date of 2016.

Eleven primary contract packages are proposed for U-Link construction as follows:

- Three early work contracts—U210 (Utility relocation), U211 (Demolition and site remediation), and U215 (I-5 undercrossing construction pits).
- Two tunnel contracts—U220 (University of Washington Station (UWS) to Capitol Hill Station (CHS)) and U230 (CHS to Pine Street Stub Tunnel (PSST)).
- Two station contracts—U240 (CHS) and U250 (UWS).
- Three system-wide contracts—U260 (Track work), U820 (Yard expansion), and U830 (Systems design, furnish, and install).
- One vehicle contract—U821 (Light rail vehicle procurement).
- The Northgate Link Extension Project consists of a 4.3-mi extension of the light rail from the UWS to Northgate, Seattle, Washington. The project includes twin bored tunnels, transition to an aerial guideway, and an elevated station. The Northgate Link Light Rail Project has a total project budget of $1.354 billion. The duration for construction is approximately 9 years (2012–2020), followed by 6 months of systems testing, which results in a projected project completion date in 2021.

There are eight primary contract packages proposed for the Northgate Link construction project:

- Two early work contracts: N112—Brooklyn Utilities/Site Prep and Roosevelt Utilities/Site Prep, and N114—North Portal Site Prep.
- One tunnel and station excavation contract: N120—Excavation of Roosevelt and Brooklyn stations and tunnels from Roosevelt to UWS.
- One tunnel contract: N130—Tunnels from North Portal to Roosevelt.
- Two underground station contracts: N140—Brooklyn and N150—Roosevelt.
- One aerial guideway and elevated station contract: N160—Northgate.
- One system-wide contract: N180—Track work and systems.

3. Description of Project Delivery System Used

ST generally uses the design–bid–build method of contract delivery. However, more recently it has started to use General Contractor Construction Manager (GCCM, the equivalent of CM/GC or CM at Risk) on its station projects.

4. How Is Risk Assessed and Managed?

ST has an in-house Director of Risk Management who handles all risk management and insurance issues for the ST capital projects. Based on the Director of Risk Management's assessment of the specific risks and exposures of the project under consideration and the project delivery mechanism proposed, the insurance requirements are tailored for the specific project. This can include the use of a traditional insurance program,

with the contractor responsible for its own insurance and adding ST as an additional insured on its general liability and contractor's pollution liability policies, as a risk-transfer mechanism, or the use of a CIP, preferably an OCIP.

The project delivery approach used on certain projects is determined by the type of project. ST has typically used design–bid–build for its tunneling contracts/projects, CM/GC for its station contracts/projects, and DB for other contracts/projects that require an accelerated scheduled completion or are holistic in composition, making the project a good candidate for the DB project delivery approach. ST treats each project as different, with its own unique risks and exposures that need to be evaluated in order to apply the appropriate risk-transfer and risk-financing mechanisms to that specific project under consideration.

The insurance requirements used in the majority of ST contracts are a traditional insurance program, where the contractor is responsible for providing its own insurance with the ST coverage terms, limits, and certain endorsements satisfied, e.g., primary and noncontributory and waiver of subrogation, etc., as well as adding ST as an additional insured on certain insurance policies, e.g., CGL and CPL. Typically, for contractor-provided insurance requirements, the contractor is responsible for the following lines of insurance coverage: general liability (and excess liability to meet required limits), builder's risk, and CPL. If there is an exposure for working within 50 ft of an ST railroad right-of-way, then railroad protective liability insurance coverage is required. If there is an errors and omissions (E&O) exposure for design/engineering and/or agency construction management services, then professional liability insurance coverage is required. ST requires CPL insurance, either through contractor-provided insurance or through an OCIP, when there is an imminent or potential pollution condition by the nature of the specific contractor's scope of work.

ST requires professional liability insurance on all architectural and engineering (A&E) contracts. ST will sometimes require project-specific professional liability insurance coverage to have dedicated limits for the specific project. When the A&E of a CM practice policy is suspect from the standpoint of having too many E&O claims on its loss runs and in development, that has the potential of eroding the aggregate on its practice policy, which would render it useless in the event of an ST claim event. ST has not used OPPL insurance, but has considered its use for several projects. In ST's view, the problem with an OPPL policy is that there are few insurers that have really good coverage forms, and it is difficult to recover any money in the event of an E&O claim by an owner.

Sometimes ST purchases builder's risk insurance for the benefit of the contractor through an OCIP, or it may purchase builder's risk insurance à la carte on a project-specific basis if it is financially viable and provides an economic benefit to ST, versus the contractor purchasing the builder's risk insurance, which is typically marked up with insurance broker's fees and contractor overhead and profit (OH&P) added to the cost. On smaller capital development projects, ST requires the contractor to purchase its own builder's risk insurance coverage and include this cost as a line item in its detailed cost estimate. The builder's risk insurance coverage required is an "all-risk" policy, with total replacement cost for property damage to the project, equipment, and materials in transit, or equipment and materials stored at a defined secured location, e.g., staging or laydown storage areas, during the course of construction in accordance with the terms of the builder's risk insurance policy.

ST uses OCIPs on large capital development projects. Usually projects that have unique risks and exposures, meet the critical mass requirements of projects over $100 million, and have numerous contractors and subcontractors are in highly concentrated populated areas and involve tunneling operations or other heavy civil and complex infrastructure projects. By way of example, the University Link Project OCIP CGL insurance coverage has an effective date of October 20, 2008, to September 30, 2016. This project OCIP was purchased based on a total duration of 8 1/2 years (8 years of construction and 6 months of testing). The CGL also has 6 years of completed operations coverage. The builder's risk insurance and CPL have a policy period of October 20, 2008, to September 24, 2016.

ST has found that a key component of any good OCIP is to start with a thorough and comprehensive OCIP feasibility study. ST's OCIP feasibility study process includes a comprehensive review of risks on a particular project and a rigorous cost/benefit study of whether an OCIP makes sense from a risk management and financial point of view.[121] ST Risk Management does not use

[121] *See* OWNER CONTROLLED INSURANCE PROGRAM (OCIP) FEASIBILITY STUDY UNIVERSITY OF WASHINGTON LINK LIGHT RAIL (U-LINK) CONSTRUCTION PHASE (Mar. 2008) and NORTH LINK LIGHT RAIL PROJECT (NORTHLINK) CONSTRUCTION PHASE OWNER CONTROLLED

CCIPs and does not advocate their use on ST projects. The main reason is that ST chooses to maintain control of the claims administration process for third-party CGL claims for alleged bodily injury or property damage by the general public. As a public agency, ST's political risk is great, and historically contractors are neither diligent nor expedient in the management, administration, and settlement of third-party claims. In contrast, ST is very effective and efficient by handling such claims through an OCIP.

5. Who Writes Contract Provisions?

Contract provisions are written by ST legal counsel. The ST Director of Risk Management provides advice on the insurance provisions in ST capital projects contracts. The ST Director of Risk Management consults with ST legal counsel on indemnification issues.

6. Who Administers the Risk Management Program?

The ST insurance program is administered by the ST Director of Risk Management, who uses insurance brokers for some services, especially in connection with OCIPs.

7. How Are Insurance Services Procured?

ST uses a qualifications-based selection process to procure brokerage services.

8. How Is Insurance Purchased?

The ST Director of Risk Management prepares an insurance specification and underwriting submission, in collaboration with the insurance broker, who then goes to market for proposals/quotes. Based on the response and submittals from the global insurance and reinsurance markets, the Director of Risk Management then evaluates all proposals/quotes for which carrier can provide ST with the best and broadest coverage, at the lowest premium, with the least amount of subjectivities and/or conditions, and at the best value for ST for the risks and exposures under consideration. The ST Director of Risk Management makes a recommendation to the ST Executive Director, who authorizes the placement.

9. Legal Issues

Washington is monopolistic, and the workers' compensation insurance is regulated and administered through a state fund. Unlike other states where the workers' compensation insurance is bundled with the employer's liability insurance coverage, in Washington the workers' compensation insurance is statutory and the employer's liability insurance is typically endorsed to the CGL for through endorsement to the CGL as "stop-gap coverage."

The Washington Code was specifically amended to permit public agency OCIPs[122] and states as follows:

> An Act relating to the acquisition of insurance for regional transit authority projects over one hundred million dollars; and amending RCW 81.112.060.
>
> Be It Enacted by the Legislature of the State of Washington:
>
> Sec. 1. RCW 81.112.060 and 2000 2nd sp.s. c 4 s 32 is each amended to read as follows: An authority shall have the following powers:
>
> (1) To establish offices, departments, boards, and commissions that are necessary to carry out the purposes of the authority, and to prescribe the functions, powers, and duties thereof.
>
> (2) To appoint or provide for the appointment of, and to remove or to provide for the removal of, all officers and employees of the authority.
>
> (3) To fix the salaries, wages, and other compensation of all officers and employees of the authority.
>
> (4) To employ such engineering, legal, financial, or other specialized personnel as may be necessary to accomplish the purposes of the authority.
>
> (5) To determine risks, hazards, and liabilities in order to obtain insurance consistent with these determinations. This insurance may include any types of insurance covering, and for the benefit of, one or more parties with whom the authority contracts for any purpose, and insurance for the benefit of its board members, authority officers, and employees to insure against liability for acts or omissions while performing or in good faith purporting to perform their official duties. All insurance obtained for construction of authority projects with a total project cost exceeding one hundred million dollars may be acquired by bid or by negotiation. In order to allow the authority flexibility to secure appropriate insurance by negotiation, the authority is exempt from RCW 48.30.270.

ST has numerous inter-local agreements with partner agencies that may include insurance requirements for ST capital projects. For example, for the U-Link Project, ST had a Memorandum of Agreement with the University of Washington that contained a broad indemnification agreement and a corresponding requirement that ST purchase and maintain an OCIP that would include project-specific professional liability and pollution

INSURANCE PROGRAM (OCIP) FEASIBILITY STUDY (Sept. 2011), on file with authors.

[122] Amended by H.B. 1747 (A.B. 1859 (Representatives Simpson and Rodne), signed by the Governor and enacted into legislation Apr. 21, 2007).

environmental coverage.[123] In addition, for ST to operate its Sounder commuter rail trains on BNSF Railway's right-of-way, ST has a stringent agreement with BNSF, which includes maintaining a minimum rail liability insurance limit of $200 million.

F. San Francisco Municipal Transportation Agency

1. Description of Organization

The San Francisco Municipal Transportation Agency (SFMTA) is a department of the City and County of San Francisco responsible for the management of all transportation in the City. The SFMTA operates the San Francisco Municipal Railway (Muni), the nation's seventh largest public transit system. The SFMTA has a staff of 4,700 and is governed by a Board of Directors responsible for approval of budgets and contracts. The agency manages five types of public transit in San Francisco, including trolley motor coach, light rail, historic street cars, and cable cars. The agency serves an average of 700,000 weekday travelers, involving 75 transit lines and 217 mi of overhead wire systems.[124]

2. Description of Large Transit Projects

The SFMTA is constructing the Central Subway Project, which is the second phase of the Third Street Light Rail Project. The project has an estimated cost of $1 billion in construction contracts, which includes two utility relocation contracts, one tunnel contract, and one surface level and three underground subway stations, tracks, and related systems.

3. Project Delivery Systems

The SFMTA construction program utilizes the traditional design–bid–build approach and has also adopted DB delivery systems.

4. How Is Risk Administered

Contract risk is administered by obtaining requisite insurance coverage and, for large projects, seeking higher insurance limits using an excess liability policy.

5. Who Writes the Contract Provisions and Administers the Program?

The risk allocation provisions and the insurance contract provisions are drafted by the risk manager and legal counsel.

6. Insurance Requirements and Coverage

The SFMTA requires general liability, workers' compensation, and contractor-provided builder's risk coverage. In addition, its contractors provide environmental pollution, E&O (design liability), completed operations, and automobile/vehicle liability coverage. For certain large projects, SFMTA obtains an Excess Liability (Umbrella) Program, which it calls an OCIP. No workers' compensation coverage is included. The excess policy is purchased by SFMTA to provide the necessary coverage and to reduce the contractor's coverage and bid costs.

SFMTA provides excess liability coverage for a single contract or for the entire construction project. The excess policy sits above the contractor's primary limits, wherein each contractor is required to provide its own primary coverage with a noninsured deductible to ensure that the contractor has "skin in the game." The excess provides higher coverage and reduces the primary insurance requirements and insurance costs and can also cover owner errors and omissions and integrated design team errors and omissions. The excess program applies to multiple primes, joint ventures, and subconsultants. The program does not undermine the competitive advantage of safe, experienced consultants and contractors, and eliminates cross claims above the primary coverage levels. SFMTA has found the excess coverage to be expensive and requires the agency to obtain an insurance broker. SFMTA recognizes that there is a limited amount of underwriters and market for this program.[125]

The owner is an additional insured under the contractor-secured GL policy. The contractor GL policy can be a corporate policy or a project-specific policy (part of a CCIP).

SFMTA has studied varying approaches to insurance, including OCIPs and CCIPs, and found great difficulty in obtaining a cost comparison. Although brokers would provide some cost/overhead information, a full and reasonable cost/price analysis was not possible, since underwriters would not cooperate. In particular, a comparison of products was not possible, since

[123] *See* U-LINK FEASIBILITY STUDY, *supra* note 121, at 37.

[124] SFMTA 2013 Annual Report, at 6, available at http://www.sfmta.com/annualreport (last accessed Apr. 2014).

[125] Interview with Robert Stone, Deputy City Attorney, San Francisco, Cal. (Mar. 5, 2014).

underwriters would not provide bids for alternate insurance coverage on the same projects.

SFMTA is still evaluating the benefits of an OCIP program compared to the cost of the traditional insurance programs. The costs and benefits are not clear, require additional agency resources, and limit the pool of contractors and market competitions, since contractors are not open to non-traditional insurance programs.

In some cases, SFMTA has purchased Owners Protective Professional Indemnity (OPPI) coverage for design errors. The OPPI coverage sits on top of the limits provided by the design consultants through their practice policies.

7. How Are Insurance Services Procured?

Insurance is procured through an insurance broker who is selected though an open competitive RFP or RFQ process.

8. How Is Insurance Purchased?

The selected broker selects the insurance using competitive proposals based upon terms and price.

9. Unique Feature of SFMTA Insurance Approaches

The San Francisco Third Street Rail Project represents an excellent example of how a public agency developed and modified its insurance requirements in response to changing insurance market challenges to provide the necessary coverage limits.

As a result of its risk assessment, SFMTA wanted $500 million in coverage for the Central Subway Project. This billion dollar project consists of one tunnel contract and several contracts for stations, tracks, and related systems. The tunnel involved utilization of a tunnel boring machine in close proximity to the Bay Area Rapid Transit (BART) system and pile-supported buildings. Further, SFMTA desired to demonstrate to the FTA that insurance costs were fair and reasonable and sought a price analysis and price comparison for the Central Subway Project.[126]

Initially SFMTA, through its selected broker, sought to compare firm, bindable costs of a CCIP and OCIP to determine fair and reasonable cost. SFMTA was unable to obtain realistic cost estimates from the insurance underwriters, since they were unwilling to provide cost estimates for different insurance products (CCIP and OCIPs) for the same project and at the same time. The underwriters had two issues with both approaches being marketed simultaneously. The first was market capacity and being able to commit $500 million in limits to an OCIP while committing a like amount to existing and potentially competing CCIP programs for the bidding contractors. Given the limited number of insurers with an appetite for tunneling and below grade heavy construction work, the market had limited capacity and little price elasticity. The second was a widely held reluctance to compete against themselves.

After much discussion with the industry, SFMTA was ultimately provided a price of 18.5 percent of construction costs, which exceeded SFMTA cost estimates. Thereafter, SFMTA decided to develop a hybrid process, which involved suspending the procurement of an OCIP; confirming a CCIP as the primary vehicle for workers' compensation, general liability, and umbrella liability; and placing an Excess Liability policy through its broker to obtain the required $500 million in coverage.

The initial tunnel contract was awarded to Barnard, Impregilo, Healy, Joint Venture Partnership (BIH) and required BIH to provide $350 million in liability insurance limits, made up of two tiers of insurance coverage: $200 million in primary liability and $150 million in excess liability provided through the contractor's CCIP. The SFMTA would also provide $150-million excess liability to secure the desired $500-million total coverage. After award, BIH was unable to obtain the full $350 million in limits due to changing insurance market conditions caused by underwriter concerns and reduced capacity resulting from hurricanes and typhoons.[127]

Thereafter, SFMTA obtained through its broker an excess liability policy of $150 million, while BIH obtained a $250-million project-specific policy and a $100-million corporate policy from Barnard to make up the $500 million in coverage. SFMTA took a credit for the additional premiums cost and subsequently, by agreement with the contractor, SFMTA deducted the $10-million premium for the greater excess policy from the project cost. Utilizing this innovative approach of combining the contractor CCIP of $250 million, the $100-million corporate policy, and the $150-million excess liability policy obtained by the SFMTA, they were able to obtain the $500 million in coverage.

The station contracts also created similar insurance coverage issues, since the first bid

[126] Budget and Legislative Analyst, City and County of San Francisco, Board of Supervisors, Jan. 4, 2013, at 7-1, 7-4.

[127] Interview with Robert Stone, Deputy City Attorney, San Francisco, Cal. (Mar. 5, 2014).

exceeded the estimate due to insurance quotes. The initial station bids were rejected, and the SFMTA combined the station contract work and rebid the project. To resolve the insurance coverage issues, the contractor-provided insurance coverage was reduced from $200 million to $50 million, and the difference was made up with an SFMTA-provided excess liability policy of $150 million. The SFMTA was able to increase the coverage of the $150 million-excess liability policy to $300 million in order to provide the $500 million in coverage.

10. Legal Issues

In California, under the peculiar risk doctrine, a person who hires an independent contractor to perform work that is inherently dangerous can be held liable for tort damages when the contractor's negligent performance causes injuries to others.[128] However, when the injury is subject to workers' compensation coverage, the doctrine of peculiar risk provides no basis for the employee to seek recovery of tort damages from the person who hired the contractor and who did not cause the injuries. This holding, known as the "Privette Doctrine,"[129] insulates the owner from contractor employee liability injuries that are covered under California's workers' compensation. Under California case law, delegation of control of the work site protects the agency from contractor employee liability. In addition, a significant California case held that a hirer would only be liable to the contractor's employee if it retained the ability to control safety and that retention of control affirmatively contributed to the employee's injury.[130] SFMTA expressed concern that an OCIP program, which includes a safety components program, might undermine the agency liability shield.

In addition, the public agency can be held responsible for damages under an inverse condemnation action to landowners that result from excavations and the settling of land due to withdrawal of lateral support.[131] The agency-purchased insurance coverage covers this "negligence gap" and the public owner's strict liability. Further, Section 2782 of the California Civil Code also prohibits construction contract clauses that indemnify the public owner from the sole negligence or willful misconduct of the owner. Such provisions are against public policy and void and unenforceable. The code mandates that owners cannot be indemnified for active negligence.

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[128] Privette v. Superior Court, 5 Cal. 4th 689, 854 P.2d 721, 21 Cal. Rptr. 2d 72 (1993).

[129] *Id.*

[130] Kinney v. CSB Construction, Inc., 87 Cal. App. 4th 28, 103 Cal. Rptr. 2d 594 (2001).

[131] Holtz v. San Francisco Bay Area Rapid Transit Dist., 117 Cal. 3d 648, 552 P.2d 430, 131 Cal. Rptr. 646 (1976).

APPENDIX A—SURVEY

TCRP J-5, STUDY TOPIC 15-01
LEGAL ISSUES WITH OBTAINING INSURANCE ON LARGE TRANSIT PROJECTS

Survey Questions

Agency Name: _____

Name of Employee: _____

Job Title: _____

Contact telephone/cell phone number: _____/ _____

Email address: _____

How many years have you been with the agency? _____

Note
(a) Large Transit Projects are defined as: capital projects over $100M that involve new build, extension or upgrades to infrastructure such as tunnels, viaducts, rails, signal systems, stations, and rolling stock additions or replacements.
(b) Please provide copies via e-mail or on a disk or provide an Internet-link for any contracts or other documents identified in your responses.
(c) In responding to the following questions, please feel free to attach extra pages as needed.

1. Please indicate the types of delivery systems currently in use at your agency
Check box (all that apply)
Design Bid Build
Design build
Design Build Operate Maintain (DBOM)
CM/GC
Public Private Partnerships

2. Are your agency's insurance requirements tailored to its project delivery systems (for example, Design Bid Build; Construction Manager/General Contractor; Design Build; Public Private Partnerships)?
Yes
No

If you answered "yes," please explain how your agency's insurance program has been modified to fit each applicable delivery system
_____
_____
_____
_____

3. Who in your organization is primarily responsible for drafting the contract risk provisions?

Risk Manager
Lawyer
Broker
Procurement Official
Other _____

4. Who in your organization is primarily responsible for drafting the insurance contract provisions?
Risk Manager
Lawyer
Broker
Procurement Official
Other _____

5. How often does your agency use the following construction insurance coverages or approaches on agency projects?
(Indicate use as Always=A, often=O, sometimes=S, and never=N)

	A	O	S	N
Builder's Risk (purchased by Agency or as extension of Agency's property coverage)				
Builder's Risk (contractor provided)				
Owners Controlled Insurance Program (OCIP)				
Contractors Controlled Insurance Program (CCIP)				
Contractors' Pollution liability				
Architects and Engineers Errors and Omissions (Practice Policies)				
Project Errors and Omissions				
Owners Professional Protective Indemnity				
Subcontractor Default Insurance (sometimes known as "Subguard")				

6. With respect to insurance coverage or approaches **where you answered always (A) or Often (O)** in question #5, can you identify why these approaches are so frequently used?
6. a. Generally, why these approaches are so frequently used
_____
_____
_____
_____
6. b. Builder's Risk (purchased by agency)
_____
_____
_____
_____
6. c. Builder's Risk (purchased by contractor)
_____
_____
_____
_____
6. d. Owners Controlled Insurance Program (OCIP)

6. e. Contractor's Controlled Insurance Program (CCIP)

6. f. Contractors Pollution Liability

6. g. Architects and Engineers Errors and Omissions (Practice Policy)

6. h. Project Error or Omissions

6. i. Owners Professional Protective Liability

6. j. Subcontractor's Default Insurance (Sub guard)

7. With respect to insurance programs or approaches where you **answered sometimes (S) or Never (N)** in question #5, can you identify why these approaches are not used more often?

7. a. Generally, why these approaches are not used more often?

7. b. Builder's Risk (purchased by Agency or as an extension of Agency's property coverage)

7. c. Builder's Risk (contractor provided)

7. d. Owners Controlled Insurance Program (OCIP)

7. e. Contractors Controlled Insurance Program (CCIP)

7. f. Contractors' Pollution Liability

_____
_____
_____
_____

7. g. Architects and Engineers Errors and Omissions (Practice Policies)

_____
_____
_____
_____

7. h. Project Errors and Omission

_____
_____
_____
_____

7. i. Owners Professional Protective Indemnity

_____
_____
_____
_____

7. j. Subcontractor Default Insurance (sometimes known as “Subguard”)

_____
_____
_____
_____

8. Please indicate and describe the method most often used in selecting an insurance broker.

Check box

- Open competitive RFP
- Pre-qualified pool through RFQ process then distribute RFP
- Pre-qualified pool through RFP process then make selection
- Personal/professional relationship
- Other (please specify)

_____

9. Please indicate the method most often used in selecting insurer(s).

Check box

- Open competitive RFP
- Pre-qualified pool through RFQ process then distribute RFP
- Pre-qualified pool through RFP process then makes selection
- Personal/professional relationship
- Other (please specify)

_____

10. Please identify any state or federal law, rule, case law or regulation that impacts your agency’s ability to assign risk contractually or affects its insurance program? (Please list)

_____
_____
_____
_____

11. If your agency uses OCIP or CCIP please indicate the type of project

_____
_____
_____
_____

If your agency does not use either OCIP or CCIP, please explain why?

_____
_____
_____
_____

12. Does your agency have a written policy regarding insurance requirements, responsibility for procuring such insurance, and related services on large projects?

Yes
No

If "yes," please provide a reference for where the written policy can be accessed.

_____
_____
_____
_____

13. Please list other insurance issues or case law that affects your agency's insurance program if not otherwise mentioned in response to other questions.

_____
_____
_____
_____

Please send your responses and any other documents, preferably by e-mail, to:

Eric Kerness, Esquire
Kerness Consulting
1357 Stanley Lane
Schenectady, NY 12309
Tel. (518) 347-2778
Cell: (518) 928-9433
Eric@Kerness.com

APPENDIX B—TYPICAL CONSTRUCTION PROJECT INSURABLE EXPOSURES AND TREATMENT OPTIONS

Exposure	*Traditional Treatments*	*Alternate Treatments*	*Comments*
Property in the Course of Construction Physical damage to project and owner's property including some consequential or time element losses. This includes both the project itself as well as existing properties in the case of renovations, repairs, additions or new construction in proximity to other structures. Exposure includes vehicles, materials and equipment used in project.	Builders Risk (Owner) Installation Floater Contractors Equipment Floater Commercial Property Auto Physical Damage	Builders Risk (Contractor) Extension of Owner's Property Insurance Policy Contractor's Builders Risk DIC Contractor's CGL	Can be carried by Owner or Constructor. Include debris removal, expediting costs, delayed completion, soft costs, and business interruption.
Third-Party Liability Injury to third parties, including injuries to workers/employees, and bodily injury or property damage sustained by third parties arising out of the project or its site. This includes damage to property owned by others and injuries sustained by the public.	Workers Compensation Employer's Liability Commercial General Liability Automobile Liability Umbrella or Excess Liability Owners and Contractors Protective (OCP) or Additional Insured Status (AI) on CGL Railroad Protective Liability (RRPL)	Controlled Insurance Programs Owner (OCIP) Contractor (CCIP) Partner (PCIP)	CIPs generally cover WC and General Liability but not Auto. May include marine and pollution liability. Should include completed operations.

Legend
DIC = Differences in Conditions
CGL = Commercial General Liability

Exposure	*Traditional Treatments*	*Alternate Treatments*	*Comments*
Errors and Omissions Increased costs or damages due to breaches of professional duty or professional errors or omissions. This could include errors or omissions on the part of project managers, architects, engineers, other design or engineering consultants and design-build firms.	Errors and Omissions/ Professional Liability (so-called practice policies)	Project Policies (project specific) (PPL) Specific Excess Endorsement (SPX) or Specific Additional Limits Endorsement (SALE) on practice policy. Owner's Professional Protective Indemnity Insurance (OPPI) or similar protective (first party) cover Contractor's Professional Liability (CPrL) Contractor's Protective Indemnity Insurance (CPPI)	
Default Increased costs or damages due to contractor or subcontractor default/inability to perform.	Performance and Payment Bonds (surety)	Contractor/subcontractor Default Insurance (CDI/SDI or Subguard) Combination of Bond and CDI/SDI	Some programs combine Bond (prime) and SDI (major subs) Decision on SDI may rest with Contractor.
Pollution Increased costs or damages due to the discharge or existence of contaminants or pollutants. The source of the contaminants' may be pre-existing site conditions (known or unknown) or accidental discharges during construction.	Environmental Impairment Liability/ Pollution Liability Insurance	Contractors Pollution Liability (CPL)	

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