

SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

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

BILL: SB 718

SPONSOR: Senators Wise, Bennett and Campbell

SUBJECT: Participation in Insurance Plans

DATE: April 3, 2003 REVISED: _____

	ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1.	<u>Johnson</u>	<u>Deffenbaugh</u>	<u>BI</u>	<u>Favorable</u>
2.	_____	_____	<u>CM</u>	_____
3.	_____	_____	<u>JU</u>	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____

I. Summary:

The bill prohibits state agencies, cities, counties, school boards, school districts, political subdivisions, or other public authorities from requiring a contractor or subcontractor to participate in an insurance arrangement in which the governmental entity or contractor of the project provides an owner-controlled-insurance program (OCIP) coverage for all parties operating under the contract by allowing a contractor or subcontractor to opt-out of the insurance arrangement. The bill also prohibits these governmental entities from penalizing a contractor or subcontractor for nonparticipation in an owner’s or contractor’s consolidated insurance program. The bill does not prohibit businesses in the private sector from mandating that a contractor or subcontractor participate in a wrap-up policy.

An OCIP or “wrap-up” insurance is a centralized insurance program where one party, the owner, is responsible for procuring certain insurance coverage that applies to all participants in the project under the contract rather than having each party provide their own insurance. Over the past 10 years, OCIPs have been used increasingly on large construction projects, by the private and public sector, because of the potential for cost savings. Private sector companies that have used or are currently using OCIPs include: Florida Power and Light, Disney World, and Universal Studios. State and local governmental entities that have used or are currently using OCIPs include: Jacksonville Electric Authority, City of Jacksonville - Better Jacksonville Plan, Hillsborough County School District, Florida Board of Regents, Miami Airport, New Jersey Turnpike, and the New York Port Authority.

Currently, various provisions of law address the procurement of goods and services by governmental agencies, including chs. 255 and 287, F.S. The Department of Management Services maintains certain statutory powers, duties, and functions in the procurement process.

This bill substantially amends the following sections of the Florida Statutes: 255.05 and 287.057.

II. Present Situation:

Procurement Process for Governmental Entities

Chapter 255, F.S., relating to public property and publicly owned buildings, specifies the requirements for construction bonds between a governmental entity and any contractors, or subcontractors that are involved in the project. Any person entering into a formal contract with the state or any county, city, or political subdivision, or other public authority, for the construction of a public building, for the prosecution and completion of a public work, or for repairs upon a public building or public work must deliver to the public owner, and record in the public records, a payment and performance bond.¹ Any person providing materials, labor, or services under the improvement contract who does not receive proper payment has a claim against the bond for the amount due.

Chapter 287, F.S., relating to the public procurement of personal property and services, requires the ethical procurement of commodities and contractual services and the adherence to uniform procedures in carrying out such procurement. “The Legislature recognizes that fair and open competition is a basic tenet of public procurement; that such competition reduces the appearance and opportunity for favoritism and inspires public confidence that contracts are awarded equitably and economically.”²

Section 287.057, F.S., delineates the conditions for the public procurement of commodities or contractual services. Unless otherwise authorized by law, all contracts for the purchase of commodities or contractual services for the purchase of commodities by an agency must be awarded by competitive sealed bidding. An agency for purposes of this section is defined to mean state officers and any unit of organization of the executive branch of government.³ Local governmental entities are not subject to these procurement requirements. Examples of commodities and contractual services specifically exempt from the competitive procurement requirements include: legal services and auditing services. Also, the Department of Transportation contracts for construction and maintenance of state roads are subject to different procurement requirements, as provided in s. 337.11, F.S. When an agency determines in writing that the use of competitive sealed bidding (invitation to bid), is not practicable, commodities or contractual services must be procured by competitive sealed *proposals* (request for proposals). Particular situations are exempt from the competitive bid process, including when the agency head determines emergency state action is required, the commodities or contractual services are available only from a single source, or it is in the best interest of the State.

The Department of Management Services (DMS) is responsible for purchasing insurance for state agencies, except that agencies may purchase title insurance or may make emergency purchases for periods no greater than 30 days. The purchase of insurance, whether made by the DMS or an agency, must comply with the competitive bid requirements for commodities, except

¹ Section 255.05, F.S.

² Section 287.001, F.S.

³ Section 287.012(1), F.S.

that the DMS may authorize the purchase of insurance by negotiation when it is deemed to be in the best interest of the state.⁴

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

Insurance Coverage for Construction Projects

As a common practice, project owners, such as state agencies or local governments, as well as contractors and subcontractors, purchase insurance independently to protect against financial losses related to the project under contract. The contractors’ costs of insurance are included in the bids and thus are paid by the project owner. However, contractors can derive profits from this type of insurance program, since contractors with good safety records can receive rebates on the basis of a project’s safety records. In addition, some project owners provide contractors with good safety records with additional bonuses.

Contractors with a better safety record may have a competitive advantage over a contractor with a marginal safety record. The safer contractor has lower insurance premiums, so this lower cost can be reflected in a lower bid. However, many other factors are used in the evaluating bids, and insurance premiums can be less important than other factors, such as labor productivity.

Consolidated insurance programs are commonly referred to as Owner Controlled Insurance Programs (OCIPs), Contractor Controlled Insurance Programs (CCIPs), or wrap-up insurance. This coverage is a centralized insurance program that covers the project owner and all contractors and subcontractors. Rather than having each party provide their own insurance, one party is responsible for procuring certain insurance coverage that will apply to all participants in the project under the contract. Coverage generally includes workers’ compensation, general liability, architects’ and engineers’ professional liability, builders’ risk, excess liability and pollution liability.

Typically two types of wrap-up insurance are available to a project owner. The guaranteed cost plan requires the payment of a flat premium and the premium remains constant during the term of the policy. The second type of plan is known as the loss-sensitive plan that provides that the premium amount is contingent on the policyholder’s paid claims or losses for the project.

⁴ Sections 287.022 and 287.057(4)(d), F.S.

Generally, the loss-sensitive plan provides a refund for low losses and charges additional premiums for high losses, thereby giving the owner an incentive to run a safe operation.

By using wrap-up insurance and eliminating insurance as a factor in bids, the U.S. General Accounting Office noted that more disadvantaged businesses, minorities, and women contractors were able to bid on construction contracts. The report noted that some disadvantaged businesses, minorities, and women contractors have difficulty obtaining insurance to bid on large construction projects.⁵

Opponents of wrap-up insurance, specifically representatives for contractors, contend that the use of wrap-up insurance results in higher costs than traditional insurance coverage. They have indicated that small contractors could be penalized by the use of OCIPs, since they would be required to pay OCIP premiums plus minimum premium payments in order to maintain their individual policies for non-OCIP work. A smaller contractor's buying power could be substantially reduced, if a volume of the work is under the OCIP contract, leaving the contractor little work with which to bargain for the contractor's own coverage.

Use of OCIPs in Florida by Governmental Entities

Proponents of wrap-up insurance policies have indicated that many state and local governmental entities and corporations have used such policies and have experienced significantly lower loss ratios. State and local governmental entities that are using or have used OCIPs include: Department of Transportation (Suncoast Parkway Project), Broward County Arena, Orlando Utilities Commission, Orange County Convention Center, Hillsborough County School District, Jacksonville Electric Authority, City of Jacksonville - Better Jacksonville Plan, and the Florida Board of Regents.

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

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

According to the Department of Transportation (DOT), the critical factor for an OCIP to be successful is loss prevention. A 10-hour OSHA⁶ course was offered to all supervisory personnel and an on-site loss prevention engineer monitored the project for safety violations. The contractor was made aware of any violations and corrective actions were taken. The DOT noted a reduction in accidents and avoided OSHA violations.

The DOT noted that a major benefit of an OCIP was the financial savings. Typically, the number of workers' compensation and general liability losses under an OCIP was less than those projects not included in an OCIP. As a result, the savings that were generated were passed on to the state,

⁵ U.S. GAO Report GAO/RE99-155 Transportation Infrastructure

⁶ Federal Occupational Safety and Health Act

with a portion being shared with the contractors as a “Safety Incentive Bonus.” By including the bonus, the DOT expects the contractors to become partners in the safety program.

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

U.S. General Accounting Office Study of the Advantages and Disadvantages of Wrap-Up Insurance for Large Construction Projects

In recent years, wrap-up insurance policies have been increasingly used because of the potential for cost savings.⁷ In 1999, the United States General Accounting Office (GAO) issued a report entitled, *Transportation Infrastructure—Advantages and Disadvantages of Wrap-Up Insurance for Large Construction Projects*. At that time, the GAO estimated that wrap-up insurance provided coverage for 300 construction projects nationwide. To determine the potential cost savings associated with wrap-up insurance, the GAO evaluated six large transportation projects.⁸ The report identified the following advantages and disadvantages associated with the use of wrap-up insurance:

Advantages

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

⁷ U.S. GAO Report GAO/RE99-155 Transportation Infrastructure

⁸ The total costs ranged from \$400 million to \$10.8 billion.

only oversee safety for their segment of work. Also, some contractors may not emphasize safety and closely monitor safety at the construction site.

Disadvantages

1. Increases administrative costs by the use of wrap-up insurance. Additional resources related to emphasizing job safety, controlling losses, and managing claims were noted. Some project owners out source these administrative functions to insurance brokers or agents, while others performed some or all of these functions with their staff.
2. May require owners to make large premium payments at the start of a construction project and establish a special reserve to ensure that funds are available to pay deductible requirements on claims.

Factors Impacting the Use of Wrap-Up Insurance

The GAO report also noted that state insurance laws, minimum project size, and contractors' concerns might limit the broader use of wrap-up insurance. The report cited a previous General Services Administration study of wrap-up insurance that noted that some states (North Dakota, Ohio, Washington, West Virginia, and Wyoming) require the use of a state fund for workers' compensation for construction projects.⁹ Some states, such as Michigan and Oregon have specific laws that limit wrap-up insurance. Both states require that an owner obtain prior approval for wrap-up insurance from the state insurance regulator. Michigan law establishes a minimum project cost of \$65 million to be eligible for wrap-up insurance. Oregon law sets a \$100 million minimum project cost. The General Services Administration study also noted that insurers usually require at least \$1.25 million in annual premiums before they will assume the risk associated with a wrap-up policy. The GAO also noted that some contractors dislike wrap-up policies because they view insurance rebates as a potential source of profits that would be eliminated by the use of a wrap-up policy, since such rebates would go to the project owner.

III. Effect of Proposed Changes:

Section 1 amends s. 255.05, F.S., relating to performance bonds of contractors constructing public buildings, to prohibit parties to contracts for public building construction from requiring a contractor or subcontractor to participate in an insurance arrangement in which the owner or contractor of the project obtains insurance coverage for the contractor or subcontractors. The bill also prohibiting parties contracting from penalizing a contractor or subcontractor for not participating in an owner or contractor controlled insurance policy. This section would prohibit the state or any county, city, or political subdivision, or any other public authority from requiring OCIP participation by contractors or subcontractors. The provision also prohibits the governmental entity from penalizing such contractors or subcontractors for nonparticipation.

Section 2 amends s. 287.057, F.S., relating to the procurement of commodities or contractual services, to prohibit parties contracting for public procurement of commodities or services from requiring a contractor or subcontractor to participate in an insurance arrangement in which the owner or contractor of the project obtains insurance coverage for the contractor or subcontractors. The bill also prohibits parties to the contract from penalizing a contractor or

⁹ *Wrap-Up Insurance Study*, General Services Administration, December 1997.

subcontractor for not participating in an owner or contractor controlled insurance policy. This provision would prohibit any of the various state officers and any unit of organization of the executive branch of state government from requiring OCIP participation by contractors or subcontractors. This provision would also prohibit the governmental entity from penalizing such contractors or subcontractors for nonparticipation.

Section 3 provides that this act shall take effect upon becoming a law.

IV. Constitutional Issues:

A. Municipality/County Mandates Restrictions:

None.

B. Public Records/Open Meetings Issues:

None.

C. Trust Funds Restrictions:

None.

V. Economic Impact and Fiscal Note:

A. Tax/Fee Issues:

None.

B. Private Sector Impact:

By allowing a contractor to opt-out of the OCIP and obtain traditional insurance, the contractor could incorporate the costs for insurance in the bid for the project. If a contractor obtains insurance coverage and experiences lower than anticipated losses, the contractor may receive rebates on the premiums from insurance carriers, thereby generating profits. However, under an OCIP program, the governmental entity would receive any rebates on the premiums which are based on a project's safety record.

With a traditional project, a contractor with a good safety record (self-insured or insured) may have a competitive advantage over an operator with a less favorable coverage rating. This record could be reflected in a lower bid for the project.

Small and minority contractors participating in OCIPs may no longer benefit from the potential reductions in costs in premiums, because an OCIP would not be generally cost effective for a project owner to provide unless all or the majority of contractors or subcontractors participated. These smaller businesses with little or no loss experience or high-risk classifications may experience difficulty in obtaining affordable coverage.

C. Government Sector Impact:

State and local government entities may no longer realize potential savings from the use of wrap-up insurance policies due to contractors opting out. Ultimately taxpayers would not benefit from reduced insurance costs and overall costs for construction projects.

The use of OCIPs by governmental entities could be adversely impacted or eliminated since the program is not cost-effective unless the majority of contractors participate.

VI. Technical Deficiencies:

None.

VII. Related Issues:

The provisions of this bill would not apply to private sector contracts or contracts of the Department of Transportation for the construction and maintenance of state roads, since these contracts are subject to different procurement requirements, as provided in s. 337.11, F.S.

VIII. Amendments:

None.

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