FINISHING CONTRACTORS ASSOCIATION
CONTRACT INSIGHT

UNDERSTANDING OCIPS

I. WHAT IS AN OCIP?

"Owner Controlled Insurance Program"

Contractors and subcontractors are normally required to provide insurance for work performed on a job site. This typically involves each contractor and subcontractor securing their own insurance for personal injury or loss as a result of construction work. An alternate approach is for a project owner to handle (or "wrap-up") all insurance on the project through an "owner controlled insurance program ("OCIP"). This coverage is designed for large projects and covers all the subcontractors and contractors working on the job. Because the owner of the project is purchasing insurance through an OCIP, contractors and subcontractors do not include in their bids the cost of their individual insurance.

There are two types of "wrap up" insurance programs: Owner Controlled Insurance Programs ("OCIP") and Contractor Controlled Insurance Programs ("CCIP"). [1] While OCIPs have been around for more than 40 years, within the last decade, they have significantly increased in popularity. Their growth is a result of the increased number of large capital improvement projects that occurred during the 1990's economic boom, coupled with a highly competitive construction industry.

[1] This discussion will focus on OCIPs, which comprise approximately 90% of the "wrap-up" programs currently being offered in the U.S., but the principles discussed apply equally to CCIPs.

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OCIPs are generally used in projects whose total construction costs exceed $50 million. An OCIP provides uniform coverage with high liability limits for all contractors and subcontractors. This OCIP coverage can reduce the owner's project costs by approximately one percent to two percent compared to the traditional and fragmented insurance programs purchased by each individual contractor or subcontractor.

Each OCIP is negotiated separately with an insurer and can cover a specific or multiple job sites. Most OCIPs are multi-year programs with fixed durations. For large construction projects the most common duration is two to five years.

The OCIP normally applies to all contractors and subcontractors performing work on the project job site. The job site is defined to include the construction site, storage areas, lay down yards, and on-site fabrication.

OCIPs include general liability insurance, workers compensation insurance (including employer's liability coverage) and builders' risk insurance. This will usually also include an excess or umbrella coverage which matches the primary coverage.

II. ADVANTAGES OF OCIPS.

A. Advantages of OCIPs for Owners.

Fundamentally, the reason OCIPs have been implemented is because they save owners money. The ability of an owner to aggregate the insurance costs of the individual subcontractors and negotiate directly with an insurer has permitted lower costs to owners. Some of the advantages which owners have identified in implementing OCIP programs include:

1. Cost. As discussed above, the proper implementation of an OCIP program can result in a two percent bid reduction (less the amount the owner incurred to purchase the OCIP and risk management services). The net result is an estimated savings of 0.5 percent to one percent of total construction costs.

This cost savings is achieved through premium credits for volume purchasing of insurance by the owner, the elimination of contractors' mark-ups or overhead and profit on their insurance costs, the owner's ability to assume large deductibles, and, particularly, any workers' compensation dividend or retro premium return resulting from favorable loss experience.

2. Scope of Coverage. In the traditional (non-OCIP) environment, an owner sets minimum insurance requirements. It can be difficult, however, to determine whether these requirements are actually met. Insurance certificates only provide summary information. In contrast, OCIPs between the owner and the insurer guarantee broad, known insurance coverage.

3. Policy Limits. In the traditional (non-OCIP) environment, a smaller contractor or subcontractor may carry less than $1,000,000 in CGL coverage. [2] This coverage may be inadequate, if a large judgment or settlement occurs. Under OCIPs, an owner can provide in excess of $800 million in insurance coverage.

4. Improved Risk Management. As a result of centralized risk management through a single insurance program; claims, handling, loss and controls can be greatly improved. Disputes among contractors are all resolved within the confines of the policy.

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[2] CGL is "comprehensive general liability" insurance coverage that most businesses maintain for liability protection.

B. Advantages of OCIPs for Contractors.

1. Safety and Loss Control. The implementation of a broad risk control management program by the owners and their risk consultants can augment existing safety programs of participating contractors. The standardized safety procedures on the whole job site, as well as additional safety staffing implemented as part of a safety incentive program (including periodic safety audits), can result in significant safety advantages to contractors with less injuries to their employees.

2. Claims Management. The large risk management program implemented in conjunction with most OCIPs can permit coordinated claims handling procedures. Programs imposed by owners and their risk consultants can potentially reduce employers workers compensation costs by as much as 30percent including: directing injured employees to preferred provider networks, implementing return-to-work programs and modified-duty-programs, and engaging in medical bill reviews. These sophisticated programs can provide advantages to small contractors which they would otherwise not receive through their individual insurance programs.

3. Dispute Between Contractors. By covering all of the contractors on a project, there is elimination of coverage disputes and subrogation issues between contractors and insurers for accidents occurring on the job site. In the "traditional" situation, the owner, contractor and/or subcontractor are all likely represented by different insurers and attorneys. A single insurer removes this potential source of conflict.

4. Higher Limits. Smaller contractors can participate in projects which demand higher liability limits.

5. Risk History. OCIP claims are not counted as part of the contractor's own aggregate limit history.

6. Small or Minority Contractors. who would otherwise be unable to participate in large projects because they would be unable to secure the necessary insurance for a large project In an OCIP project, the owner provides the necessary insurance. Small and minority subcontractors have little opportunity to negotiate the terms of OCIP programs, as they are broad policies. Similarly, most small contractors have limited ability to negotiate their CGL policies.

While this argument is often touted as an "advantage" by the proponents of OCIPs, as a practical matter, large projects require large contractors who can meet the demanding requirements of a huge project. Moreover, the documentation required on these large projects (OCIPs or otherwise) often exclude small contractors on grounds of simple practicality.

III. DISADVANTAGES OF OCIPS.

A. Disadvantages of OCIPs for Owners.

1. Administrative Burden. There is a significant administrative burden for an owner (or its consultants) to manage an OCIP program. If not competently managed, significant additional costs can accrue to the owner.

2. Market Risk. If the insurance market hardens, a potential financial risk in loss sensitive programs can result in increased premium costs or coverage reductions which harm the owner.

3. Bid Preparation. There are significant additional costs in implementing an OCIP program. These costs include: retaining an OCIP program administrator and/or risk consultant, conducting a feasibility study to evaluate the advantages and disadvantages of an OCIP program, issuing a detailed request for proposals to be submitted to contractors, engaging in a detailed interview and review process with potential contractors, and negotiating rates and scope of coverage with potential insurers.

B. Disadvantages of OCIPs for Contractors.

1. Limited Insurance Coverage. There are gaps in OCIP coverage for contractors. (Discussed in depth below).

2. Complicated Bidding. Contractors usually bid with insurance included. A more complicated bidding process is required in order to delineate credits for insurance as part of bidding. Bids usually require the contractor to demonstrate that insurance has been removed from the bid.

(a) CGL Warning. A contractor is usually required to remove its variable CGL costs. However, it should not remove its umbrella insurance coverage from its cost structure. The amounts the contractor pays for the umbrella CGL policy cannot realistically be backed out of the contractor's insurance costs for an individual project, as this is a fixed and flat cost to the contractor.

3. Safety-Minded Contractors Penalized.

(a) A contractor with a good safety record may lose out in competitive bidding. A "safe" contractor may have a higher bidding structure to reflect more conscientious construction practices. An "unsafe" contractor may therefore underbid the safe contractor.

(b) Moreover, the "unsafe" bidder inherently includes insurance costs when bidding in "traditional" (non-OCIP) situations. The "unsafe" bidder's higher claims history would be passed on as part of the bidding process.

(c) In the OCIP situation, this negative claims history is not included in the cost structure of the "unsafe" bidder. The "unsafe" contractor is not, in turn, penalized for its prior bad business practices.

(d) This problem of rewarding unsafe contractors can be addressed if a workers' compensation "experience modifier" is imposed by the owner's risk consultant, or if specific disclosures as to risk factors are required to be set forth in the bidding process.

4. Documentation Requirements. OCIP projects tend to be much more document and report intensive, imposing additional administrative burdens on contractors and subcontractors.

5. Segregated Payroll. Since OCIP costs must be segregated from other project costs. Additional bookkeeping requirements are required to maintain duplicate payroll records.

6. Loss of Insurance Volume. Because the contractor is no longer purchasing insurance from its insurer, its decrease in payroll volume may result in a lesser volume discount with the contractor's own insurer, because the OCIP transaction is not included in the contractor's insurance history. Put another way, the work done on the OCIP project may decrease the "volume discount" for insurance which the contractor would have realized had the project not been an OCIP.

7. Timely Reporting. Some OCIP administrators have not reported workers' compensation loss data to rating bureaus in a timely manner, thereby adversely affecting the contractor's experience calculation with the state.

8. Loss of Profit. As discussed above, contractors have additional burdens associated with OCIP programs. In a typical situation, insurance costs represent between five percent and 10 percent of contractor's bidding costs. The elimination of these costs not only decreases a contractor's revenue (especially if profit normally involves mark-ups on insurance costs), but also may impose additional burdens which can hurt profitability.

9. Owner's Consultants. Risk and program administrators hired by owners are often highly focused on establishing that contractors deducted the full value of their insurance from their bidding. A review may be conducted before or after the contract has been awarded to the contractor. The program administrators will be attempting to confirm that insurance is no longer a profit center for the contractors. Success by these consultants is often at the expense of a contractor's bottom line.

(a) Post-Award Reviews. Increasingly, OCIP program administrators are reviewing contractors' proposals after the bid has been awarded. This post-award modification is usually addressed as part of the contractual agreement between the owner and the contractor. Contractors should be especially wary of these post-award review provisions. A post-award review correction of an accepted bid will usually come right off a contractor's bottom line by allowing owners' OCIP administrators to reduce a contractor's profit by lowering revenue as a result of a "correction" discovered in the review.

(b) Separate Insurance Breakout. Other bidding alternatives that have been used require bidding contractors to provide bids with and without insurance costs, so that the owner can clearly establish what has been deducted as a result of the elimination of insurance costs. This obviously "doubles" the contractor's bidding efforts and results in additional expense.

(c) Insurance Deductions. In rare cases, project owners require contractors to leave insurance costs in the bid and then deduct these amounts from progress payments. This approach involves obtaining copies of the contractor's insurance policies and other documents, including evidence of the cost of risk with deductibles and self-insured retentions. This is a highly burdensome process administratively, and should only be entered into between a contractor and an owner where there is a high level of cooperation and trust.

(d) Payroll Charge Backs. Payroll is generally estimated as part of the bidding process. Consultants may be used to determine if a charge back is appropriate based on vast increases in payroll costs which, in turn, have a proportional impact on insurance premiums. It is certainly possible where there are large payroll increases that consultants would be used to calculate the proportional impact on insurance costs and seek reimbursement from the contractor.

10. Substance Abuse - Zero Tolerance. Many OCIPs have a "zero tolerance" substance abuse program which bans violating workers from the job site, which could conflict with the contractor's own substance abuse policy.

IV. CONTRACTORS – LIMITING YOUR OCIP RISK.

A. Bidding.

1. Pre-Bid Meetings. In order to properly bid the project, a contractor and subcontractor will be required to attend pre-bid and pre-mobilization meetings to educate the parties on the implementation and administration of the OCIP. The contractor must also work with the owner's insurance representative or OCIP program administrator to validate the insurance credits set forth in the bid proposal.

2. Detail in the Bidding. The contractor must expand the bid package so it can specifically break out for the owner the credit which is being given for reduction in insurance costs. Likewise, the contractor must expand its bid package so that its subcontractors can appropriately provide bid proposals. The process of removing the contractor's insurance costs from the OCIP construction project is sometimes known as the "bid-deduct" process.

3. Time. The contractors are expected to incorporate the OCIP documentation into their bid package. However, it is significant to note that even in the "traditional" situation, a contractor would still be required to obtain insurance certificates for itself and its subcontractors. This tedious, time consuming, and important task is partially eliminated as part of an OCIP program. Finally, the contractor must meet with its insurer to eliminate any gaps in coverage caused by the OCIP program.

B. Gaps in Coverage Issues/Exclusions.

OCIPs are designed to provide coverage for all work performed on the site. However, the coverage is usually subject to significant exclusions which result in narrower coverage to the contractor than it would normally enjoy in a "traditional" situation.

1. DIC. OCIP coverage may not be as broad as the contractor's own insurance. In this situation, the contractor will need to contact its own insurer to obtain excess or Difference-In-Conditions ("DIC") liability coverage. The increased costs associated with DIC coverage is not a cost which should be excluded from a contractor's bid in an OCIP situation. That is, the OCIP process imposes a DIC expense which is usually included in a contractor's OCIP bid.

(a) Tail Coverage. An OCIP usually includes coverage operations for losses in a specified period (e.g. two to five years after project completion). However, a contractor's exposure may continue long after this period. The contractor should again contact its insurer to obtain "tail coverage" for after the OCIP period. This again is an increased cost passed on to the contractor through DIC coverage.

(b) On Site v. Off-Site Exposure. OCIPs are intended to provide coverage for bodily injury or property damage which occur on the project site. Unfortunately, this creates a coverage gap for a contractor who manufactures or fabricates product on or off-site and installs it. Again, DIC coverage is crucial in this situation.

(c) "Montrose" Exclusion. The California Supreme Court in Montrose held that any construction defect loss occurring over a number of policy periods can be allocated equally to each policy year/carrier from the time the work was put into place until such time as it is repaired. If a defect is discovered eight years after construction (but still within the statute of limitations), the OCIP may pay only potentially 50 percent of any settlement leaving the contractor responsible for the other 50 percentto be paid by its primary DIC carrier. Again, it is important that the DIC coverage includes the Montrose exclusions.

(d) Professional Liability. Coverage designed to protect architects, engineers, construction managers and other professionals for their acts, errors and omissions are often excluded from OCIP coverage. A specific rider including such coverage is advisable, if a contractor's work involves "professional" activities.

(e) Pollution Coverage. OCIPs traditionally have an exclusion for pollution-related coverage. To the extent a contractor's work may involve "pollution" issues, DIC coverage is appropriate.

(f) Automobile Liability. Automobile liability and insurance coverage for loss caused by vehicles on and off-site are usually excluded from coverage. Again, this can be addressed through the contractor's normal insurer or through a DIC policy.

(g) Contractor's Equipment. Contractor's equipment is normally excluded through an OCIP, but might be easily included as part of a contractor's CGL/DIC policy.

(h) Watercraft. Not typically provided for in OCIPS, but on rare occasions is an issue (use on work barges and platforms), but again, if applicable, can easily be included under a contractor's CGL/DIC policy.

(i) Aviation. Not typically provided for in OCIPS, but on rare occasions is an issue where helicopter lifts are necessary for large commercial or industrial projects. This sort of coverage is usually addressed through CGL/DIC coverage.

2. Named Insured Exclusions. In the "traditional" situation the contractor's CGL policy excludes "your work" from business risk coverage because an owner, contractor, or subcontractor is required to perform quality work and should not be excused from shoddy performance by insurance. However, in the OCIP situation, there may be no general coverage for the owner or general contractor depending on how the definition of "named insured" is specified. The contractor should ensure that an exception exists for the "your work" exclusion for work performed on the named insured's behalf by a subcontractor. Put another way, a contractor should make sure that subcontractors are still accountable for the quality of their work under the OCIP.

3. Deductibles. Some OCIP policies hold contractors responsible for OCIP deductibles for damage caused by the contractor. A contractor should attempt to insure that only one deductible will be assessed by the owner for a loss which may occur over an extended period. Finally, if multiple policy years are covered by the same carrier for a contractor's primary CGL/DIC coverage, the contractor should obtain an agreement from the carrier that only one year's deductible will be applied to a loss over multiple periods.

4. Builder's Risk. Assuming an OCIP obtained Builder's Risk Insurance, the general contractor should confirm that the OCIP coverage includes:

(a) All-Risk coverage;

(b) That the general contractor and all subcontractors should be included as Named Insured (see above);

(c) That earthquake and flood perils are included in coverage under the OCIP paragraph;

(d) Deductibles of perils to the contractor should not be excessive (that is they should be similar to what the contractor is used to paying) (see above); and

(e) The policy should include a clause which waives the insurer's subrogation rights against all contractors.

5. Substance Abuse Programs. Contractors should see whether there is a requirement for drug and alcohol abuse programs and whether the cost of administering the program a reimbursable expense to the contractor.

6. Return to Work Programs. Contractor's should see if the OCIP requires a light duty return program. If so, whether the cost of lost production for these non-100 percent workers recoverable.

7. Waiver of Subrogation. Contractor's should see whether the OCIP includes a waiver of subrogation that would impede an attempt to subrogate over non-OCIP coverage issues. For example, the OCIP waiver should not preclude the contractor from recovering for auto loss.

8. Workers' Compensation Experience Rating. While contractors must exclude workers' compensation premiums from bids, the contractors need to ensure that their workers' compensation carrier includes the contractor's OCIP experience in any future calculation of the contractor's Experience Modification Rate.

V. TRENDS.

A. Legislation.

States have increasingly passed legislation regulating OCIPS. While no state has "banned" OCIPs, a number of states have passed legislation which precludes the mandatory imposition of OCIPs in public sector projects.

B. CCIPs.

Contractor Controlled Insurance Programs ("CCIPs") are increasingly prevalent. CCIPs involve essentially the same concept as an OCIP. That is, in an OCIP the "owner" procures the insurance and provides it to all of the contractors with the advantages discussed above. In contrast, a CCIP involves a major "contractor" (usually the general contractor) obtaining such global insurance for the project. For very large contractors, CCIPs can offer an additional profit center when owners are unwilling to incur the administrative and financial costs associated with setting up an OCIP. Obviously, as with OCIPs, contractors instituting such an insurance program require large projects and substantial resources.

C. Smaller Projects.

As the insurance market for OCIP bidding becomes more competitive, and consultants become more adept at assisting owners in efficiently running the programs, the size of OCIP projects will continue to decrease. While $50 million has been the current average floor of OCIPs, smaller projects may be possible in the future.

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