CHAPTER 6: INSURANCE COVERAGES

This chapter is devoted to a basic discussion of insurance policy coverages, terms, conditions, and exclusions. Due to the variety of activities and resulting exposures to loss, it is impossible to cover every type or form of insurance a port may purchase. The emphasis of this section, therefore, is on those insurance coverages common to most ports or which may be encountered by port risk managers.

This section often refers to "standard forms." However, it should be noted that while there has been a move by the insurance industry toward standardization, policy language, provisions, terms, and conditions can vary between insurers. Due to this, a port should review so called "standard policy forms" to ensure that the coverage is appropriate for its activities and exposures. To assist ports in their analysis and evaluation, the discussions in this section will highlight some of the more important aspects of the policies.

Insurers are often willing to modify or alter the standard provisions or exclusions of their policy forms. Some modification can be achieved by the use of pre-printed endorsements. Sometimes the development of special language or provisions for an endorsement or even the entire policy is required to meet particular circumstances. The latter method is often referred to as a "manuscript endorsement" or "manuscript policy." The important point to keep in mind is that many of the provisions of insurance policies are subject to modification to meet a port's particular needs and circumstances.

PROPERTY – DIRECT DAMAGE

Any discussions of property loss exposures can be broken down into two categories: (1) the value of the property subject to loss and (2) the loss potential associated with that property. In this section, it is the first category with which we are concerned, i.e., the loss of physical port assets. The second category is discussed in the next section of the *Guidebook*.

Named Perils

The basic Fire Insurance policy covers direct loss by fire, lightning, and removal of property from premises endangered by fire. The Extended Coverage Endorsement broadens the policy by extending coverage for the perils of windstorm, hail, explosion, riot and civil commotion, damage by aircraft or vehicles, and smoke damage. A common method used by many for remembering the perils covered by the Extended Coverage Endorsement is the acronym "WHEREAS" (Windstorm, Hail, Explosion, Riot and Civil Commotion, Aircraft and Automobile, and Smoke).

The basic Fire Insurance policy can also be extended to cover the perils of vandalism, malicious mischief, and sprinkler leakage. A policy insuring specific perils enumerated is generally referred to as a Named Perils policy.

All Risks

An alternative form of coverage which provides broader protection than a Named Perils policy is an "All Risk" form. Unlike Named Perils coverage, which provides coverage for only those specifically scheduled perils, an All Risk policy provides protection against all perils causing direct physical loss unless otherwise excluded. Naturally, there are certain risks such as wear and tear which underwriters do not wish to cover. These are the items excluded. The advantage of All Risk coverage is that the burden of proving that a loss is not covered is shifted to the insurer. In a Named Peril policy, the burden of proving that a loss was caused by a covered peril is the responsibility of the port.

There are two customary approaches to providing All Risk insurance. One is an "All Risk" policy which provides coverage in one master policy form. The second, a Difference-In-Conditions (DIC) policy is used as a supplement to a Named Perils policy. The DIC provides All Risk coverage for those perils not covered by the Named Perils policy.

The best approach for providing All Risk insurance will depend upon the appetite of the insurance carrier and cost. An insurer willing to provide Named Perils coverage may be unwilling to provide "All Risk" coverage at a reasonable cost, if at all, thus the need for DIC.

Flood Insurance

Flood insurance is available as part of an "All Risk" or DIC insurance policy. It can be expensive, particularly for ports having facilities in known flood zones. Often, insurers faced with this situation will impose high deductibles or decline to provide protection.

It was for this reason that in 1968, the federal government created the National Flood Insurance Program. The program falls under the jurisdiction of the Federal Emergency Management Agency (FEMA) which operates the program through the Federal Insurance Administration. The purpose of the program is to make flood insurance available to all at a reasonable cost.

Originally, the program was a joint effort of private insurers and the Federal Government. Today it is strictly a Federal program with the Federal Government underwriting all policies. Flood insurance policies are available through all licensed agents and brokers. The agents and brokers also process claims made against the policies.

Due to the relatively low limits available through the Federal program, many ports with high valued buildings use a layered program. Primary limits are purchased in the Federal program and excess limits are then purchased from a commercial insurer under an All Risk or DIC policy as excess over the Federal policies.

Builders Risk

Builders Risk insurance was designed to protect a building or structure during the course of construction, including materials and supplies that will be used. Some ports prefer to purchase the coverages to maintain control of pricing and coverage. Other ports prefer to require the contractor to do so. If the contractor is purchasing the policy, it is essential that the port write specific insurance requirements in the contract including requiring the port and all participating contractors and sub-contractors to be Named Insureds on the policy. Either way, a port will need to evaluate the scope of coverage of the policy to ensure that it meets the port's particular coverage requirements.

Builders Risk policies can be written on either a "Named Perils" or "All Risks." However, the "All Risk" is perhaps the more common approach. When considering the appropriate limits, a "Completed Value" Builders Risk policy is usually more desirable than a "Reporting Value" policy. Under a Completed Value policy, the dollar limit of coverage is equivalent to the completed cost of the project. The advantage of the completed value forms is that it eliminates potential under-insured values that can arise in a reporting value form. This occurs either when errors are made in calculating interim insurable values or when a monthly or quarterly report is inadvertently not sent to the insurer.

A Builders Risk policy commonly covers property while in transit and while at locations other than the job site. Also, coverage is provided for collapse during the course of construction resulting from defective materials or methods, boiler explosion, and theft of building materials not attached to the building. A port can obtain or require the contractor to obtain an endorsement to the policy that covers the perils of flood and earthquake, as these perils are normally excluded on a builders risk property form.

Another important endorsement to consider is an endorsement providing coverage for "soft costs" or delayed opening loss exposures. These are additional costs associated with construction of a building, for example, loss of rents, additional architects' and engineers' fees, additional interest on funds borrowed, additional advertising expenses, and additional insurance premiums.

Valuation

In order to guaranteed that insurance protection is neither inadequate nor excessive, an appropriate program of establishing insurable values should be implemented by a port. One way to develop values is to do it internally. Original construction costs adjusted for remodeling and repairs, less non-insurable values such as land, excavation costs, site preparation, etc., can be

trended using inflation or deflation factors to trend the base cost to a current value. Trending factors are often available from insurers, brokers, agents, or from independent publishing sources.

Another method is to use the appraisal services of an insurance company or broker. Ports should be aware, however, that these appraisals may not provide the details desired and may be somewhat self-serving for the insurer.

A third method of determining property values is to use an independent professional appraiser capable of rendering impartial and unbiased services. An appraiser's knowledge of court decisions involving obsolescence, fair market value, and depreciation may greatly help in determining the port's equipment values at risk. In addition, formal appraisals are more readily accepted by insurance carriers when granting certain policy provisions such as an Agreed Amount Endorsement and when settling claims after loss. A goal of completing a physical appraisal of all property each ten years, with interim annual valuation adjustment using trend factors, would not be unreasonable. By staggering appraisals for multiple locations over a ten year period, the expense of physical appraisals is often more acceptable to the budgeting process.

Actual Cash Value vs. Replacement Cost

Two methods of valuation are recognized in property insurance. The first method is replacement cost, where the value assigned to the building or contents is the cost to rebuild or replace the property with materials of like kind and quality. The second method is actual cash value, where the value represents replacement cost less an amount which accounts for the technological obsolescence and the physical deterioration of the property. Market value is also a consideration in establishing actual cash value. Actual cash value more nearly represents the value of the property at risk for an organization, although because of inflationary trends, the actual cash value can be in excess of the initial purchase price shown on company accounting records.

Replacement of any structure which is important to operations would require the expenditure of more money than an actual cash value insurance recovery. For this reason, the concept of replacement cost insurance was developed. Replacement cost coverage is one method by which a port can provide funding for this additional loss cost element. Replacement cost coverage should not be used indiscriminately and may not be available for specific properties. Policies written on a replacement cost basis require that the repairs be made or property actually replaced in order to collect full replacement cost. Where property is not repaired or replaced, actual cash value will be paid even though a replacement cost valuation is provided by the policy. For this reason, an actual cash valuation should be used where ports have property which would not be repaired or replaced if damaged.

Coinsurance Clause

To encourage policyholders to insure to full value and simplify property insurance rate making, property policies contain a provision termed a "coinsurance clause." The effect of this clause is to penalize a policyholder who fails to insure to proper value.

Simply stated, the insurance formula operates as follows:

$$\text{Amount of Loss} \times \frac{\text{Limit Purchased}}{\text{Limit Required by Coinsurance Clause}} = \text{Amount of Insurer Loss Payout}$$

The "Limit Required by Coinsurance Clause" in the formula is determined by multiplying the coinsurance percentage stipulated in the policy times the replacement cost or actual cash value depending on which valuation method is used in the policy.

If the ratio of purchased insurance to full value is not equal to the required coinsurance percentage stated in the policy, the port becomes a coinsurer. As an example, assume the following:

Total Insurance Value	$100,000
Amount of Insurance Purchased	$ 67,500
Coinsurance Percentage	90%
Loss Suffered	$ 10,000

Plugging these assumptions into the formula yields the following results:

$$\$10,000 \times \frac{\$67,500}{\$90,000} = \$7,500$$

On this $10,000 loss, the insurer will only pay $7,500 and the port will be a "coinsurer" for the remaining $2,500, in addition to the applicable deductible.

Agreed Amount Endorsement

A special provision can be included in a property policy to offset the possibility of a coinsurance penalty. This provision is known as an Agreed Amount Endorsement and is written affirmation by the insurance company that the values as stated in the policy are sufficient. It suspends the provisions of the coinsurance clause. The Agreed Amount Endorsement is generally granted only when the insurance company is convinced that a good faith effort is being made to establish acceptable values and maintain an adequate level of insurance. Typically, the Agreed Amount Endorsement is granted for a stipulated time period (generally one year) and must then be renewed by the carrier when the insured updates its property values.

Specific and Blanket Limits of Coverage

"Specific" insurance limits is that form of coverage where a stipulated amount of protection applies separately to each building and its contents as scheduled in a policy. In the event of a loss, the amount of recovery is limited to the specific amount scheduled for the property involved.

"Blanket" insurance limits is a form of coverage where all buildings and contents are insured under the policy for one overall amount. The amount or limit is generally arrived at by adding together the individual values of the buildings and contents insured under the policy.

A relatively new approach to limits is sometimes referred to as a "first loss" or layered approach. Under this approach, a maximum limit is established in the policy equivalent to or slightly higher than the highest value for any single location. The single limit applies to each loss regardless of what property is involved. For example, if a port had individual buildings valued at $500,000, $7,000,000, $8,000,000, and $10,000,000, under a first loss policy the limit might be set at $10,000,000 where as under a blanket limit policy the limit would be $25,500,000 ($500,000 + $7,000,000 + $8,000,000 + $10,000,000). Because of the lower limits, first loss policies are sometimes less expensive. They are generally used by firms with buildings of relatively uniform value where there is a geographic distance between locations. This latter point is important since the limit is per loss. If several buildings, because of close geographic proximity are subject to the same loss, sufficient limits for full recovery would not be available under a "first loss" limit approach.

Loss Due to Application of Building Codes

Building codes, electrical codes, or other building ordinances change over time and may be more restrictive then those in effect at the time a particular building was constructed. When a building is damaged by fire or other insured peril, it is possible that extensive portions of the building undamaged by the insured event may have to be demolished, and replaced due to application of the new codes. Insurers are responsible under contract only for the direct damage not the additional expenses caused by the enforcement of the code. Coverage for such additional expenses is available and negotiable. Coverage is available for:

- The value of the undamaged portion of a building which must be demolished because it is not in compliance with the existing building codes.
- The cost to demolish the undamaged portion of a building so affected.

- Coverage for the increased cost of construction of the type required by the stricter code(s).
- The business interruption resulting from the additional time needed to repair or replace the undamaged building portion.

"Demolition Costs" coverage is separately available to cover only the second exposure listed above for property that might not be replaced.

A port would be well advised to stay informed on code changes that can affect older buildings. The costs of demolition or meeting code changes can be substantial and can create unexpected losses to a port.

Valuable Papers and Records

Recoveries under standard fire insurance policies for valuable papers and records are limited to the cost of the media (i.e., paper) in blank form plus the cost of transcribing the records. Fire policies do not insure the cost and expense a port may incur in recreating and reconstructing the information required to enable it to transcribe the data. Insurance protection for this exposure is available through Valuable Papers and Records insurance. Coverage is generally written on an "all risk" basis subject to a deductible. The coverage is relatively expensive and often less cost-effective than a procedure to duplicate valuable papers and records and store them at another location. When off-site storage is not practical, storage in fire proof files in another part of the same building may be an acceptable alternative.

Equipment Floater

Ports generally have a certain amount of equipment not licensed or designed for use on public roads or part of a building or its contents. Items such as forklifts, bulldozers, graders, cranes, street sweepers, tractors, etc., fall into this category of equipment. Coverage against physical loss is provided by an Equipment Floater. While most provide "all risk" coverage, terms can vary between insurers. Smaller values generally are included on a blanket basis. Insurers, however, often require that equipment with significant values, such as mobile cranes, be specifically scheduled. Coverage is often written as a rider to the property insurance policy but can also be written in a separate policy. Because coverage, rates and deductibles vary substantially, a port considering this coverage should seek quotations from several sources.

Property – Time Element

Fire, explosion, or other loss to physical assets of a port can result in two losses. The first would include the cost to repair or replace the damaged property. The second is the "loss of use" of the property. This includes loss of income plus continuing expenses where operations are totally or partially interrupted and costs over and above normal operating expenses where operations must be continued using alternative facilities.

Business Interruption Insurance

Business Interruption insurance policy forms are designed to insure against loss of income and continuing expenses incurred as a result of an interruption of business from direct damage to property. The Business Interruption policy forms most commonly used to insure a port's exposure include a gross earnings form for mercantile and service risks or a combined business interruption and extra expense insurance form.

The geographic spread of facilities and the availability of substitute or alternative operating facilities within a port can affect the need for or amount of business interruption insurance. A port lacking multiple identical facilities which can serve as backup or which is heavily dependent on a continuous stream of revenue for financial stability has a genuine need for business interruption insurance. In addition, bond rating agencies, creditors, or other outside parties, with an interest in a port's ability to meet financial obligations may require the purchase of business interruption insurance. As such, business interruption is a contract of indemnity covering only actual loss of profit and unavoidable continuing expenses otherwise included in normal operating revenues.

Typically, business interruption insurance is provided by endorsement to a Property Insurance policy on either a named peril or an "all risk" ba-

sis. It is important to note that for the business interruption insurance to respond, the loss must be caused by an insured property damage peril. Business interruption losses resulting from uninsured property damage perils are not covered. As an example, business interruption under a policy covering only the fire and extended coverage perils would not respond to a business interruption loss resulting from damage to a warehouse caused by building collapse.

Coverage for the perils of flood, earthquake, subsidence, or employee strikes are generally not covered by standard Business Interruption policy forms. Where these exposures are applicable, coverage must be negotiated.

Standard Business Interruption forms normally contain a coinsurance clause. Generally, the port may choose 50, 60, 70, or 80 percent coinsurance. The appropriate percentage will depend on the estimated period of time that operations would be interrupted.

The exposure identification questionnaire contained in this *Guidebook* (see Appendix C) provides a worksheet which will assist in calculating the business interruption loss potential. It should be noted that the calculations are based on anticipated future loss potential. Working from current budgets, therefore, requires a certain amount of estimation to account for inflation, changes in operation, or other factors which might impact future income.

Ordinary payroll expenses may be insured under Business Interruption. Ordinary payroll can be defined as all payroll except for executives, department managers, employees under non-cancelable contracts, and other employees vital to port operations. Ordinary payroll, under business interruption forms may be excluded, insured in full, or in part. Factors affecting the decision of how much payroll to insure would include:

- The length of time the operations may be interrupted.
- The condition of the labor market. In a tight market it may prove difficult to hire needed employees when operations are resumed.
- The skills and experience needed by employees in order to operate the facilities. It may be a greater expense to train new employees than to keep existing employees on the payroll during the period of interruption. Excluding ordinary payroll can result in disputes with the insurer over the classification of payrolls between those "vital to port operation" and ordinary payrolls.
- The cost of reimbursing the State Unemployment Compensation Fund can exceed the cost of insurance by a significant amount.

Extra Expense

Extra Expense insurance is designed to reimburse the policyholder for the additional expenses incurred to continue operations under alternative methods following physical damage to its assets. Due to the nature of port operations, some services would need to be continued following a physical loss. For example, if the port's administrative offices were damaged by fire, it might rent temporary offices in another building until repairs could be completed. If a critical crane were damaged, the port could lease a mobile crane to avoid an interruption of services which could jeopardize revenues and even result in loss clients.

There is generally little relationship between the normal cost of operations and the extra expenses a port may incur in operating under alternative means following a property loss. This makes it extremely difficult to determine the amount and limit of extra expense insurance to maintain. Perhaps the best method for establishing extra expense limits is to develop contingency plans for possible loss scenarios and then estimate the cost which would be incurred in carrying out those plans. Such plans, when not developed under the stress of an emergency, may even reduce the extra expense should a loss occur. When properly developed, the plan can be implemented quickly and efficiently thereby reducing or eliminating costly mistakes and expenses.

Unlike business interruption insurance, extra expense insurance forms do not contain coinsurance provisions. Extra expense forms, however, may contain sub-limits designed to restrict the amount of recovery to a given period of time. Typically, the sub-limits are stated as a

percentage of the policy limits. For example, a policy may stipulate recovery is limited to:

- 40 percent of the policy limit if the period of restoration is less than one month;
- 80 percent of the limit if the restoration period is not in excess of two months; and
- 100 percent of the limit if the period of restoration is over two months.

Sub-limits can be adjusted to the particular needs of the individual port. Because of the limitations that the sub-limits may place on a port's recovery, they should be evaluated carefully. Oftentimes, the greatest portion of extra expenses is incurred immediately following a loss.

Boiler & Machinery Insurance

Boiler and Machinery insurance is designed to provide coverage for losses resulting from the explosion or accidental breakdown of boilers and other covered machinery. Historically, the standard fire insurance policy excluded coverage for direct and indirect exposures arising from the operations of boilers and other machinery except for loss due to fire. For this reason, specialized Boiler and Machinery policy forms were developed.

Boiler and Machinery insurance tends to be a very stable line and not subject to the wide swings in the premium pricing associated with other lines such as general liability insurance. It responds very well to loss control and engineering measures designed to reduce losses.

Coverage Forms

There are numerous modifications available to the basic Boiler and Machinery policy which permit a port great flexibility in designing the coverage to fit its particular needs. The insuring agreement of the standard policy generally states that the policy will insure against losses from an accident to an insured object during the policy period.

Coverage can be written on a scheduled object basis, blanket group object basis, or comprehensive (all objects) basis. On a specifically scheduled basis, individual boilers or items of machinery are scheduled on the policy. Coverage is provided only on those objects scheduled.

On a blanket group basis, coverage is provided for all objects falling within the description or definition of the group contained in the policy. This method eliminates the need to specifically schedule each individual object and provides flexibility to the port by insuring only those objects where coverage is needed.

Under the comprehensive basis, the definition of object includes all non-production boilers and mechanical and electrical machinery which a port may operate or own. Where desired, coverage can be extended to production machinery as well. This method has a decided advantage over the scheduled and blanket object basis in that it eliminates the need to specifically identify or schedule boilers and machinery to the policy. Premiums for this coverage are generally higher because of the diversity of objects insured. However, premiums can be controlled by the use of deductibles. Deductibles, in essence, eliminate claims on smaller objects or loss exposures while still providing the catastrophic coverage required by many ports.

Coverage

There are six coverages offered under standard Boiler and Machinery policies. The following are the coverage options available in a standard policy:

- *Loss to Property of the Insured* – Physical damage coverage for the objects and other real and personal property of the port damaged by the accident to the object.
- *Expediting Expenses* – Covers the cost of making temporary repairs and the cost which a port may incur in speeding up or expediting permanent repairs. Typically, this coverage is limited to $25,000. In the basic policy, however, these limits can be increased. Additional limits may be warranted where a port has vital or unique equipment that must be put back into service by the quickest possible means to avoid delay and financial hardship.

- *Liability for Property of Others* – Provides coverage for property of others in a port's care, custody, and control which may be damaged as a result of an accident.
- *Defense Settlement Supplementary Payments* – Covers the cost of legal defense, court and other associated expenses, interest on judgments, and other costs resulting from claims. This coverage is similar to that found in the liability insurance policy.
- *Automatic Coverage* – Provides automatic coverage for objects which a port may install at any location scheduled in the policy or at newly acquired locations, provided they fall within the class of objects which are already insured. Typically, the port must notify the insurer within ninety days for coverage to continue.
- *Bodily Injury Liability* – Covers bodily injury resulting from an insured accident. It is an optional form of coverage under a Boiler and Machinery policy. Because this duplicates the coverage of a port's general liability insurance policy, it is normally not required.

Method of Valuation

Standard Boiler and Machinery provisions limit recovery to actual cash value (see ACV discussion under Property – Direct Damage, page 6--3). It is possible to amend the actual cash value provision to replacement cost basis. Recovery under repair or replacement is limited to the smaller of:

- The cost to repair the damaged property at the time of the accident.
- The cost to replace the damaged property with property of like kind and quality.

If the property is replaced by property of different kind or better quality, larger size or capacity, the insurer is not liable for the amount in excess of what would have been paid if replacement had been made with like kind. If the object is not replaced or repaired, the insurer is liable only for actual cash value. Unless an object will not be replaced, it is advantageous for a port to insure its boiler and machinery on a replacement cost basis.

Indirect or Time Element Insurance

Boiler and Machinery policies can be extended by endorsement to provide insurance protection for indirect or time element losses (see Property – Time Element, page 6--5) arising from a boiler and machinery loss. Both business interruption and extra expense insurance coverage can be obtained under Boiler and Machinery policies. Because physical damage from boiler and machinery accidents, except caused by fire or lightning are excluded from fire insurance policy forms, time element coverage provided under a fire policy will not respond for boiler and machinery related time element losses. Where significant boiler and machinery time element exposures exist, a port will also need to purchase this coverage under the boiler policy.

Fidelity Insurance

The potential for loss caused by employee dishonesty is most difficult to recognize or adequately evaluate. Often employees who are the most valued and trusted, commit embezzlements or misappropriations, which can occur over a period of time. When the loss is finally discovered, it may often exceed the amount of insurance maintained by the organization.

Although considered insurance, Fidelity coverage is actually a bond. There is an important difference between insurance and bonds. An insurance policy is a two-party contract between the insured and insurer where the insurer promises to reimburse the insured in case of loss. A bond is a three party contract, which guarantees that one party (the surety) will meet an obligation due to a second party called an obligee (the port), as a result of the failure of the principal (port employee) to fulfill his or her obligations. In every surety bond, there is an obligation that the principal will make restitution to the surety for any payments the surety must pay to the obligee.

The coverage for loss caused by employee theft is a fidelity bond in which the surety obligates itself to the port to make good on losses caused by the dishonesty of port employees.

There are a number of different fidelity bond forms. The forms most appropriate to ports, however, are the public employees blanket bond and the public employees blanket position bond.

Public Employees Blanket Bond

This form covers all employees of the port. New employees are automatically covered without notice to the insurance company. The limit of the bond is the insurer's aggregate liability per loss regardless of the number of employees involved. It does not apply separately to each employee causing the loss.

This bond is on a discovery basis so that the entire loss, without regard to period of time over which thefts occurred, is covered unless specifically limited by the insurer.

Public Employees Blanket Position Bond

This policy form provides coverage similar to the blanket bond. The principal difference in forms, however, is that under the blanket position bond, the limit of liability applies per employee rather than per loss. Because the bond limit could be paid for each of a number of employees involved in a loss, the premium rate is generally higher for this bond than for the blanket bond form.

Many knowledgeable bond experts believe that the public employees blanket bond is the preferred form. They argue that most employee dishonesty losses are caused by a single employee and that, for an equivalent premium, a higher limit can be purchased under the public employees blanket bond as compared to the public employees blanket position bond. The most appropriate form for ports, however, will depend on its specific circumstances and perhaps statutory requirements.

Faithful Performance Provisions

Public employees bonds may be written on a "faithful performance" basis. The primary difference between this and the "honesty" form discussed earlier is coverage for loss resulting from the failure of employees to faithfully perform their duties or to account properly for all funds or property received by virtue of their position or employment. The term "faithful performance" is generally based on statute and regulations that define the degree of care imposed on employees. Faithful performance provisions provide broader coverage than normal fidelity bonds since statutes and regulations defining the degree of care imply that employees may be held responsible for losses even though they may have been entirely honest in their own conduct.

Employees Covered / Employees Excluded

Employees are defined in the honesty insurance form as all members of the staff of a port, excluding anyone who is required by statute to be individually bonded for faithful performance. Also excluded from coverage is any treasurer or tax collector, regardless of whether or not the employee has such a title.

Faithful performance forms define employees as all members of the staff while in the employment of a port and not required by law to furnish an individual bond to qualify for office.

Ports should review governing statutes or regulations to determine which of the honesty or faithful performance bond form is required.

Due to the definition of covered employees, coverage under both bond forms end when an employee is terminated. Sometimes, however, a terminated employee is able to appear as still being employed which could permit access to port assets. This exposure to loss would be uninsured under standard bond provisions making it practical to have coverage extended beyond the standard bond provisions. Many insurers will extend coverage to 30, 60, or 90 days following termination of an employee.

From time to time, ports find it necessary to contract with intervening employers, such as Kelly Services, etc., to obtain part-time or additional employees for peak work periods. These employees are often given access to vital records and are in a position to embezzle port funds. Coverage is not provided under the standard provisions of a port fidelity bond for these individuals.

The most appropriate risk management practice is to require proof of insurance from the intervening employer. However, this is not always practical. Often, these employees are hired as needed, on short notice, without the risk manager's knowledge. For this reason, it is practical for the port to extend the definition of employee under its own fidelity coverage to provide protection for employees hired through intervening employers.

Money and Securities Insurance

This insurance provides coverage for theft of money and securities both inside and outside of port premises. Money and securities is defined as currency, coins, bank notes, bullion, travelers and registered checks, money orders and negotiable or non-negotiable instruments, or contracts representing either money or property.

Inside coverage provides protection against losses within the port premises or any banking premises caused by actual destruction, disappearance, or wrongful abstraction of money or securities.

Outside coverage provides protection for the destruction, disappearance, or wrongful abstraction of money and securities outside the premises or while being conveyed by a messenger or armored car company or while within the home of any messenger.

Property, other than money and securities, is covered against robbery while being conveyed and theft, while in the home of a messenger. For other property, recovery is limited to the cost to repair or replace the property with like kind and quality. The policy limit is on a per occurrence basis.

Forgery Insurance

Depositors forgery insurance provides protection against loss from forgery or alteration of outgoing checks or other instruments of the port. Forgery on incoming instruments can also be insured. It is often assumed that the bank is liable for losses caused by forgery or alteration. However, where a port's negligence contributed to the loss, a bank may be able to escape liability. If a port fails to notify its bank of the theft of blank checks, a check writer, or signature stamp, the bank can look to the port for reimbursement. Because of this, defense coverage is included to protect the port against allegations of negligence.

General Liability

General liability insurance protects the port against claims seeking to hold the port responsible for personal injury, bodily injury, or property damage losses to third parties. There are a number of general liability policy forms available, but perhaps the most appropriate for ports is the Commercial General Liability Form. This form provides the broadest coverage of all the various forms.

Commercial General Liability Form

The commercial general liability policy form provides the following basic coverages:

- *Premises and Operations* – Covers liability arising from the ownership, maintenance, and use of premises owned or occupied by the port and operations on or away from the premises unless excluded by the other provisions of the policy.
- *Contractual Liability* – The basic form provides limited coverage for contractually assumed liability. Cover is limited to agreements for the lease of premises, easements, sidetrack agreements with railroads, elevator maintenance, agreements required by municipalities except those involving performance of municipal work, and the part of any contract pertaining to business under which the port assumes the tort liability of another to pay for bodily injury or property damage to a third person or organization.
- *Independent Contractors* – Covers the liability of the port arising from operations performed on its behalf by independent contractors.
- *Products and Completed Operations* – Covers bodily injury or property damage arising from products sold, handled, or distributed

by the port or from its performance of faulty work once the work has been completed.

- *Personal and Advertising Injury* – Personal injury typically includes the perils of libel, slander, malicious prosecution, loss of reputation, humiliation and false arrest, imprisonment or restraint. Advertising injury means injury arising out of oral or written publication of material which slanders or libels a person or organization or disparages their goods, products, or services which infringes upon copyright, title, or slogan.

The standard commercial general liability form, while providing broad scope of coverage, is not "all encompassing." The standard form is designed to provide coverage for those exposures common to all commercial concerns. For this reason, it must be tailored to meet the particular needs of the ports where non-standard exposures exist.

Extensions and Modifications to Coverage

Incidental Medical Malpractice

Courts have given professional status to individuals and employees for medical malpractice losses arising out of rendering first aid treatment. Although not specifically excluded, court precedence has been set where incidental medical malpractice is not covered by standard liability policies. Coverage under the commercial general liability policy can be obtained, however, by the addition of an Incidental Malpractice Endorsement.

Defense of Persons or Property

The definition of "occurrence" in the standard policy requires that property damage must be neither expected nor intended from the standpoint of the insured. This definition eliminates coverage for those instances where the port may perform any intentional act which results in property damage. An example might be where port employees damage property of others in order to prevent the spread of a fire.

Many insurers will amend their definition of occurrence to include coverage for the use of reasonable force which results in property damage if caused for the purpose of protecting persons or property. This is a valuable extension of coverage for ports and generally worth obtaining.

Employee vs. Employee Claim Exclusion

Employees are "insureds" under the standard commercial general liability policy but only "for acts within the scope of their employment by you or while performing duties related to the conduct of your business. However none of these 'employees' is insured for bodily injury or personal injury to a co-employee while that co-employee is either in the course of his or her employment or performing duties related to the conduct of your business...." This is sometimes referred to as the "fellow employee" or "employee vs. employee" exclusion which can be removed by endorsement.

Non-owned Watercraft

Ports may periodically charter or hire boats or other craft in the pursuit of port business. An example of this can occur when the injured party could institute a claim against the port alleging that at the time of the accident, the boat was being used in connection with port business. The watercraft owner's insurance provides primary coverage but may not extend protection to the port or be inadequate to fully cover a judgment.

Automatic coverage for non-owned watercraft is restricted to watercraft under 26 feet. If a port is a frequent user of non-owned watercraft or charters larger watercraft, it should insure this exposure with a separate specialized policy.

Owner Controlled Insurance Program (OCIP)

An Owner Controlled Insurance Program (OCIP or Wrap Up) is an arrangement where the owner of a construction project buys insurance coverage for general liability, workers' compensation, and course of construction risks for all project participants.

There are two considerations before selecting an (OCIP) as the project insurance. Does your State permit (OCIP) programs and is the project

large enough to generate the economies of scale desired.

Reasons for an OCIP

All major construction projects ($100,000,000 and up) should avail themselves of these programs whenever possible. The benefits to all and especially the Owner are many, in addition to the considerable savings in insurance costs. Briefly the owner benefits as follows:

- The project owner has control. In the absence of an OCIP, the owner has no chance to review the insurance coverages of each contractor coming on the job let alone continuing to monitor them after receiving initial certificates, etc.
- The owner enjoys enormous economies of scale and invariably has broader coverage. Individual insurance programs for many contractors are invariably inadequate.
- An OCIP affords higher limits of liability. Limits of insurance carried by most contractors are inadequate and requirements are usually higher than individual contractors can obtain or afford on a "one job" basis. Aggregate limits shown on certificates of insurance may be eroded by other claims already submitted.
- Subrogation waivers and hold harmless agreements are more easily obtained where there is a single insurer.
- Situations frequently arise wherein two or more contractors are involved in a single loss occurrence. With one insurer, there are no problems - with several insurers, usually everyone suffers.
- In an OCIP, contractors individually have the privilege of insuring deductibles or other coverage limitations that might exist in the general program, particularly where it is obvious they cannot absorb the risk.
- An OCIP eliminates conflict of interest.
- An OCIP achieves fully controlled centralized claim handling by a single carrier.
- Centralized coordinated Safety Program produces both direct and indirect savings.
- With an OCIP, the owner is protected from "safe place to work" and "fellow employee" suits because there is but one carrier for both the Liability and Workers' Compensation coverages.
- Where dividends are earned, the owner receives them, thus further reducing costs.
- Overall, the OCIP affords vastly eased administration. This, in turn, provides energy conservation, reduces problems, and enables project managers to concentrate on building.
- An OCIP broadens the number of contractors eligible to compete, especially minority contractors and subcontractors who otherwise may be unable to obtain required limits and the broader coverages demanded.

Figure 12 shows the differences in a program of individually insured contractors vs. an OCIP.

Figure 12
Comparison Between OCIP and Individual Program

Individual Program	OCIP Program
Each Contractor Procures his own insurance	The Owner/GC purchases insurance for all
Additional Insureds Endorsement required for Owner/Builder on each contractor's policy	No Endorsement required - protection exists for all
Duplicate Coverage	Overlap is eliminated by homogeneity by Broad Coverage purchased
All Risk Builders Risk unless otherwise self-insured	All Risk Builders Risk: which can include transit exposures is purchased by owner for all parties assuring uniformity of coverage and proper limits
Auto Liability	Not included
Equipment Floater	Not included
Professional Liability is secured by each contractor with an exposure at varying limits and aggregate impairments	Owner/GC purchases for all. Limits per claim and aggregate apply to the project only. Bids reduced by contractor's cost of insurance

How an OCIP Works

1. Programs on major construction projects normally include the following coverages:

   a) Workers' Compensation, including Employer's Liability

   b) Commercial General Liability (excluding Automobile) covering operations originated at or from the job site.

   c) All Risk Builder's Risk

   The Commercial General Liability policy and Workers' Compensation policies are usually negotiated with underwriters on a "cost plus" basis whereas the All Risk Builder's Risk would be negotiated on a rate per $100 of final construction costs.

   Unless state laws permit otherwise, Workers' Compensation rates and modifications of each contractor or sub would apply and separate policies are issued for each.

   Under the OCIP's Commercial General Liability policy the Owner, All Contractors and all Subs (excluding suppliers and those subs whose payrolls do not exceed $10,000) are covered under one very broad program and individual policies are written for all parties. However, only one insuring company is involved. Some states that do not permit Wrap-ups will permit Owner Controlled Programs. The insurance regulations of the State of the project prevail.

2. The following coverages are normally *excluded* in each of these programs:

   a) Automobile Liability and Physical Damage – this is due to the fact there is no way that a contractor can assign specific vehicles to any one job.

   b) Contractor's Equipment Coverage – this is due to the same condition as autos. Contractors will assign their equipment as needed to various jobs. Normally included in this category is the exclusion of any tools, equipment, scaffolding staging, personal property of subcontractor or lower-tier subs, structures erected to house workmen, field offices, and/or materials; the capital value of which is not included in the work.

   c) Professional Liability for any architects, engineers, doctors, nurses, or other persons who would need such coverage. These parties are normally included for their job site general liability exposure only. OCIP coverage for the professional liability of architects and engineers is available as a separate program.

   d) Transit Coverage could, if desired, be included within the All Risk Builder's Risk.

3. The Owner pays the premiums and will be the recipient of any dividends.

4. The Commercial General Liability policy can be written to include or exclude Products and Completed Operations Liability. Normally they are included. When excluded, each contractor or sub would have to negotiate with their carriers for this coverage which could be quite costly since the underwriter is not benefiting from the other wrap-up premium generated. It is strongly recommended that these coverages be included in the OCIP CGL along with an extension of at least two years on the Completed Operations.

5. Carriers – Insurance Companies

   Several American insurance companies currently participate in OCIP programs and those that are writing them vary greatly in their approach.

   The plans generally used are as follows:

   a) *Guaranteed Cost* – Generally all companies that use this approach adjust their liability rates annually. However, any such adjustment would reflect a much lower rate than individual contractors could achieve by themselves using different carriers.

   b) *Retrospective (Retro) Plans* – Usually, under these plans the maximum would be 125 percent; the minimum, 40–50 percent; a basic of approximately 20 percent, and a Loss Limit varying be-

tween $250,000 and $1,000,000. Some carriers prefer no Comprehensive Loss Limit. The loss limits used will determine the excess premiums charged.

c) *Retention Plan* – This is similar to an "all down" retrospective plan (see (b) above) except that premium discounts are permitted while they are not permitted under Retro programs. The standard is the maximum, and the minimum is approximately 50 percent. Again, the loss limit will determine the excess premium charged.

Carriers also vary in their choice(s) of payment plans. The objective is to set up the best cash flow arrangements possible for the owner.

Of paramount importance in these programs is the effort expended by the carriers in the areas of loss control and claims. Generally, one claim person, at a minimum, is assigned to the project, usually on a full time basis. The Insurance Company Loss Control specialists work closely with the Owners, Project Manager, and the Broker's Loss Control personnel to establish and monitor a program that is thoroughly communicated to all and consistently enforced.

Automobile Liability and Physical Damage Insurance

Ports typically own a number of private passenger automobiles, vans, and trucks licensed for highway use. In addition, ports may lease, hire, or permit employees to use personal vehicles in the pursuit of port related business. The use of automobiles creates an exposure to loss in the areas of bodily injury and property damage to third parties, injuries to third party passengers in port vehicles, and physical damage losses to the port's vehicles.

Due to statutory requirements, the potential catastrophic nature of liability losses and the need for experienced personnel to adjust third party claims, insurance is the most commonly used risk financing method for port vehicle liability exposures. For larger ports or those with a significant fleet, the most cost-effective means for financing physical damage to a port's vehicles is often self-insurance.

Coverage

The Business Auto (BAP) is the mostly commonly used policy for insuring automobile exposures. The BAP offers a simplified approach to designing insurance coverage. On the declaration page, (see Exhibit G, page B--7) the various coverages available under the form are scheduled. For each scheduled coverage, space is provided to insert a number. The number to be inserted can be selected from a table in the policy which defines the automobiles to be insured (Exhibit G). For example, a number "1" inserted in the space next to liability coverage would mean all automobiles are covered for bodily injury and property damage liability to another party.

Physical damage coverage may provide either comprehensive or specified perils coverages and collision. Comprehensive is an all-risk type coverage. However, specified perils cover only specific occurrences such as fire and theft. Collision covers hitting another object or overturning. Physical damage coverage is typically subject to a deductible. Ports interested in insuring physical damage exposures should obtain quotations at several deductible levels in order to determine the most cost-effective deductible.

Physical damage losses to individual vehicles are generally within the self-insurance capacity of most ports. Over the long run, substantial savings can be realized by assuming these losses. Of course, feasibility and cost-effectiveness of self-insuring depends on many factors including the size of the port, the individual value of the vehicles, the size of the port's fleet, and the effectiveness of its loss control programs.

Ports which choose to self-insure physical damage exposure to vehicles should recognize one exposure which may be beyond the ability of the port to comfortably retain. The exposure is created when many of the port's vehicles are parked together. A fire, explosion, or similar peril could destroy a large number of vehicles in a single accident. One method for a port to obtain protection for this loss potential is to insure

its automobiles for physical damage under the property insurance policy covering the port's buildings. Some insurers will extend coverage to vehicles parked within a specified distance of an insured building.

A second cost-effective method for obtaining this coverage might be to insure the vehicles for comprehensive coverage under conventional automobile policy, establishing a "per loss" limit adequate to cover the combined values of all vehicles at risk with a "per loss" deductible at a level in excess of the value of a single automobile.

Medical Payments Coverage

Medical payments coverage pays for any necessary, medical, surgical, and dental expenses incurred by a passenger in a vehicle operated by or with permission of the named insured port. Benefits are paid without regard to legal liability.

Since the port's liability protection will respond for claims where the port is legally liable, medical payments coverage can be viewed principally as a public relations form of insurance. Where a port feels an obligation for these claims, it is generally more cost-effective to treat them as a cost of doing business by paying them out of current operating funds rather than by purchasing insurance. It should be remembered that injuries to employee passengers while working are covered by workers' compensation. Therefore, medical payments coverage is not needed for this exposure.

Contractual Liability

Liability that a port may assume under a contract is covered under the standard automobile insurance policy. Such a liability exposure can arise for a port in the hire or rental of vehicles belonging to others.

Fellow Employee Exclusion

Anyone using a vehicle with the port's permission is protected against liability claims of third parties. Coverage, however, is excluded for any employee where the claim is made by a fellow employee and results from an accident involving a vehicle being operated in the course of the employee's work. This exclusion eliminates potential employee collusion in making claims. However, it also bars coverage for deserving claims. As a result, some employers have eliminated this policy exclusion. Others have kept the exclusion but developed contract language to the effect that the insurer will waive this condition when requested by the insured. This has the effect of allowing the exclusion to be waived for deserving claims yet used as a bar of coverage where employee collusion is suspected. The appropriate treatment of this exclusion depends upon the philosophy of the individual port.

Employee Use of Vehicles

The business automobile policy can provide coverage for the port when employees use their own personal automobiles for business of the port. The port's policy, however, will not provide protection for the employee when a personal automobile is used. This should not be confused with the coverage that is extended to employees while driving port-owned vehicles.

Many employees believe that the non-ownership liability insurance purchased by a port also insures them while using their personal vehicles in pursuit of port business. When an accident occurs, often the employee will turn to the port for insurance protection only to find that there is no coverage. To eliminate potential employee relations problems, it is often advantageous to inform all employees who may use their personal vehicles on port business of this fact, and that it is their responsibility to arrange their own personal insurance protection. Generally, this does not place an undue hardship on employees since most ports provide mileage allowances, a portion of which is designed to cover the cost of insurance. (Note: Coverage can be extended under the port's policy for an employee using his/her personal auto on port business. However, coverage is always excess of the employee's personal insurance and is never primary.)

It should also be noted that this is not coverage for the personal automobile of an employee who is provided a port vehicle for his regular use. He has coverage while operating the port vehicle, but not for another vehicle he may use or borrow. Any employees who are provided a vehicle

for the regular use should be aware of this situation.

Public Officials Liability

A port and its appointed or elected officials and officers face legal liability exposures arising out of executive and management decisions. This is distinct from other forms of liability which generally involve accidental bodily injury or property damage. The port and its officials are exposed to threat of legal action for every decision they make, much the same as corporations and their boards of directors. Directors and officers liability protection is the insurance remedy for private corporations whereas public officials liability is generally used by public entities. Both insurance coverages provide protection for wrongful acts arising out of executive and management decisions. Coverage for all employees is normally included.

Claims can arise from a number of acts, errors, or omissions. Citizens file claims for poor quality of services; for failure to provide services; zoning and rezoning; annexation/detachment and property condemnation. Employees have filed claims for dismissal/nonhire, failure to promote, disciplinary action, and unfair labor negotiations.

Ports may have professional engineers, attorneys, and other professionals on staff whose professional acts may be added to the coverage under the Public Officials Liability policy, or coverage can be arranged under a separate Professional Liability policy to avoid shared limits situations. The policy annual aggregate limit applies to all coverages on a shared basis.

Policy Forms

A port's risk management program should include public officials liability coverage to protect its public officials. Presently, no standard liability forms have been developed for this loss exposure. The risk manager should carefully review the insuring requirements and exclusions of the various public officials policies in selecting a policy most appropriate for the port. All wrongful acts committed by public officials, whether actual or alleged, should be covered including errors, acts, omissions, breach of duties including misfeasance, nonfeasance, or violation of federal or state civil rights laws. The insurance policy should include, in addition to the port, all individuals who were, now, or shall be elected or appointed to commissions, councils, or other units under the jurisdiction of the port. Both paid and non-paid individuals should be included, in addition to all employees.

Insurance policies are written on a claims-made basis. Insurance protection is determined by the date of the claim for claims-made policies subject to a retroactive date which limits claims to events happening after that date.

Employment Practices Liability

In addition to Public Officials liability, a risk management program should include coverage for Employment Practices liability. It is a line of insurance for one of the fastest growing litigation threats to employers. Employment Practices liability (EPL) extends coverage for the perils of sexual harassment, wrongful termination, discrimination, failure to promote, breach of employment contract, and similar actions. EPL insurance is a product that was created in the late 1980s as a result of expanded civil rights laws, including federal employment acts such as American with Disabilities Act (ADA), Civil Rights Act (CRA), Age Discrimination in Employment Act (ADEA), Equal Pay Act (EPA), Family, Medical Leave Act (FMLA), etc.

EPL cases typically involve charges of economic damages as well as emotional distress, humiliation, damage to reputation, mental anguish, etc. A Commercial General Liability (CGL) policy is not intended nor designed to pay claims for these EPL type exposures. CGL policies typically have a broad exclusionary endorsement for employment practices claims. Risk managers should review their CGL and Public Officials Liability policies and are encouraged to obtain their insurer's position regarding these types of claims. Many Public Officials Liability policies are silent as respects to EPL perils or will have specific exclusions that can be deleted. A port's Human Resource Department should be kept up to date concerning labor laws, and employee handbooks should contain port policies regarding employment related issues, i.e., anti-discriminations policy, sexual harassment policy, substance abuse policy, etc. Good employment practices will help reduce potential losses.

Given various limitations and exclusions in other liability policies, a stand-alone EPL policy should be considered. EPL is a relatively new line of insurance, and coverages offered by insurers vary with some providing broader coverages than others. Some advantages of having a stand-alone EPL policy include an independent limit of liability (does not need to be shared) and a broad definition of covered wrongful acts. Most insurers will cover administrative, civil, criminal, arbitration, and Equal Employment Opportunity Commission (EEOC) proceedings. Careful consideration should be given to definitions, terms, conditions and exclusions, who is an insured, is the entity covered, what are the claim triggers, what are the specified perils, defense costs, deductibles and exclusions. Punitive damages are normally excluded but can be included usually at an additional premium. It is highly recommended that punitive damages be included.

Loss prevention practices, including well-written policies and procedures, are the best means of both controlling and defending these claims.

Police Professional Liability

Those ports that operate their own police department or harbor patrols to enforce applicable laws and regulations on port facilities are exposed to a loss exposure that may not be adequately covered or maybe excluded in general liability policies. The loss exposure is greatest for ports that operate detention facilities and that have employees with full arrest authority. Of course, a police professional liability exposure does not exist for those ports which do not operate a police department.

Policy Forms

A police professional liability policy should optimally cover all liability arising out of law enforcement activities including bodily injury, property damage, false arrest-detention, malicious prosecution, libel-slander, wrongful entry/eviction, assault-battery, Section 1983 violation of civil rights under color of law, other discrimination, inmates property loss, inmate vs. inmate fights, and intra-employee claims. Coverage for police professional liability is written on either a claims-made or occurrence basis.

Umbrella Liability

One of the most important policies carried by any port is its umbrella liability policy. This policy provides protection for catastrophic liability loss exposures. An umbrella liability policy serves as a blanket over many primary liability policies. It may provide excess insurance protection for general liability, terminal operators liability, auto liability, public officials liability, police professional liability, and employer's liability coverages. An umbrella liability policy may also go a step further and provide broader insurance protection than is provided by the primary policies. This is accomplished through broad insuring language.

There are no standard industry forms. This necessitates an evaluation of every umbrella contract. The policies may exclude employee injuries, failure to perform a contract, nuclear damages, long-term pollution, asbestos, employee benefit plan fiduciary liability, war, and responsibility for property of others in your custody.

Umbrella liability policies may be confused with pure excess liability policies which provide protection over a specific liability policy. As mentioned previously, an umbrella liability policy may provide broader protection than the primary coverages. Where an umbrella liability policy provides broader protection than the primary coverages, an insurer will require that a port assume the first portion of any loss. Usually the lowest minimum retention is $10,000.

Extension and Modifications to Coverage

Conversely, umbrella liability policies may not be as broad as the port's primary liability policies because of differences of policy language between the umbrella and underlying liability policies. To assure that the umbrella provides coverage at least as broad as that of the underlying policies, following form (policy language) or as-broad-as primary endorsements (add-ons) have been developed for umbrella policies. Representative language may be similar to:

> "As respects the underlying insurance identified herein, this insurance shall apply to any loss for which the underlying insurance

has been maintained. Where no underlying insurance exists or where terms, conditions, and limitations of the umbrella are broader than the underlying insurance, the umbrella will apply based on its terms, conditions, and limitations."

An umbrella liability policy will include a schedule of all underlying insurance policies. A port's risk manager should make sure that the information included in the schedule is correct and that all applicable liability policies are listed. It is also important that the primary insurance policies have the same anniversary date as the umbrella liability policy. When different anniversary dates exist between the underlying policies and the umbrella policy, a gap in protection can arise. This can occur when the aggregate liability limit of a primary policy is exhausted and some of the losses making up the aggregate do not fall within the policy of the umbrella because the primary and umbrella policies have different anniversary dates. The umbrella insurer could refuse protection since the primary policy has not exhausted the aggregate liability limits within the policy term of the umbrella. To avoid this potential conflict, anniversary dates of all policies should be made concurrent. If it is not possible to have the anniversary dates of all the policies the same, the umbrella policies should include a non-concurrent endorsement.

The cost of attorney's fees and other costs associated with a liability claim can be substantial. Consequently, a port should make sure that adequate defense coverage is provided within its umbrella policy. First dollar defense coverage should be provided where there is no underlying insurance and excess defense coverage should be provided on claims involving both primary and umbrella coverages.

The umbrella policy should include the provision that, in the event of exhaustion of the primary aggregate limits, the umbrella will drop down to apply as primary insurance.

MARINE INSURANCE

While the principals of marine insurance are the same as those of the more familiar property and casualty insurance coverages, customary practices, terminology, and policy forms differ substantially. The objective of this discussion, therefore, is to introduce the reader to some of the terminology and more important coverage points.

It is customary that insurance for a port is provided under Marine forms tailored to merge land exposures and marine exposures.

Coverage Forms

Over the years, insurers have developed a number of policy forms and amendatory provisions to cover the particular needs of an insured or group of insureds. These policies are based on original Lloyds General Forms. The provisions of these forms could be made to apply to either ship or cargo by the addition of specific terms or provisions. Coverages for port operations were added to create a package of coverages for the exposures of a port commonly referred to as Ports Liability or Terminal Operators Liability.

The coverages, most common to a Port Package, which can be purchased singly or in combination, include:

Commercial General Liability

Covers "on-land" operations and exposures not including watercraft.

Protection and Indemnity

Covers the operation of watercraft by a port. Coverage includes: 1) bodily injury liability including passengers, visitors, stevedores, or others on vessels in addition to third parties; 2) property damage liability including the cost of raising, destroying, or removing a wreck if deemed to be a hazard of navigation; 3) negligent damage to cargo; and 4) fines or penalties for violation of the law. Additionally, coverage can be extended to cover liability for transportation, wages, and maintenance and cure for injured masters and members of a ship's crew.

Wharfingers Liability

Covers a port's obligation to provide safe berthage for a vessel moored at port-provided docks, wharves, or piers. This obligation includes safe approach and departure. Certain liabilities can be contractually transferred to others such as a tug boat operator, tie-down contractor, pilot contractor, stevedoring com-

pany, and even a vessel owner. However, the ultimate responsibility is the port's necessitating insurance protection.

Stevedores Liability

Covers a port's liability arising out of loading or unloading a vessel and moving goods.

A landlord port will have, at worst, a vicarious liability as the owner of the port facilities. Defense coverage is the most important aspect of coverage in this situation.

An operating port may or may not provide stevedore services directly. Stevedores may be employees of a port or hired under contract with a stevedoring company.

In either case, liability for losses caused by "unseaworthiness" of a vessel should be contractually imposed on the vessel owner and not accepted by a port. For stevedore subcontractors liability should be contractually transferred to the subcontractor via hold harmless wording.

Warehouseman's Legal Liability

Covers the legal liability of a warehouseman (bailee) for lost or damage to property in its care, custody, or control. A port that stores goods for customers has the legal status of a bailee for hire. A port can be held liable for the disappearance or destruction of goods in its custody if it can be proven that the port was negligent.

The warehouseman's legal liability policy provides protection if the port is held legally liable for lost or damaged goods. This policy provides broad protection for goods stored in specified port locations. Coverage applies to the property of port customers only for the account of the bailor (port). Thus, port property is *not* covered and liability must be proved before an insurer will make a claim payment. Defense is included in the policy coverage.

When evaluating a port's loss exposures in terms of the warehouseman's legal liability, an insurance underwriter will look for favorable loss experience, qualified personnel, good facilities and equipment, and reputable clientele. Insurance coverage is usually written subject to a deductible to eliminate high frequency/low severity claims.

Pilots Liability

Covers loss exposures to a port that provides pilots to vessels entering and leaving the port. Coverage includes Bodily Injury and Property Damage liability including damage to the vessel.

The basic policy form excludes "Loss of Use" of the vessel while undergoing repairs. Coverage can be extended to do so and it is strongly recommended that the coverage extension be added.

Towers Liability or "Tugboat" Insurance

Covers loss caused by negligence from the operation of a tugboat that causes damage to a vessel under "tow." Coverage is normally added to the insurance on the vessel rather than to the Terminal Operators policy. However, this should be included as a part of the "package" of coverages for a port.

Hull Insurance

Covers loss from physical damage to a vessel owned by a port.

Over the years, as vessels became more sophisticated and specialized, the definition of "hull" expanded to include propulsion systems, boilers, machinery, refrigeration systems, and other mechanical equipment on board. Coverage can be extended to include provisions and stores used in the operation of the vessel. Coverage for cargo and personal effects of crew or passengers is not included.

Coverage is "All Risk" including collision with another vessel and can cover either hull or machinery or both combined. Blanket combined coverage is recommended.

The limit of insurance is normally on a valued basis with a stated amount in the event of a total loss. Replacement Cost is available for newer vessels.

Hull policies are always written on a deductible basis subject to either a flat dollar amount or "franchise" percentage. Under a franchise deductible the vessel owner is responsible for 100% of losses less than the franchise amount. Losses exceeding the franchise amount are paid by the insurer as if no deductible applies.

Three (3) policy forms are available:

1) "Construction Risks," which is similar to Builders Risk insurance but which includes loss during launch and sea trial.

2) "Port Risks," which includes operations only while within the navigation limits of the port.

3) "Navigation Risks," for operations within the agreed navigation limit, e.g., "within the Port and Gulf of Mexico and Ports therein."

Railroad Liability

Covers the operations of port owned railroad facilities. Exposure in this area of operations will vary substantially from port to port. Some ports have no railroad operations, others may have a switching, loading/unloading operation, and still others may operate a short line railroad.

In any event, railroad operations present an added exposure to loss anywhere from crossing safety requirements to damage to railroad cars and cargo. Also, if considered operating "in furtherance of interstate commerce" employees may be subject to the Federal Employers' Liability Act (FELA).

Coverage for FELA is not included in a standard workers' compensation policy and must be specifically added.

Benefits available under FELA are potentially very generous. They can include lost wages, medical expenses, estimated future earnings, and pain and suffering. Awards are determined in the tort system and based on comparative negligence. Because these tort-based recoveries are usually larger than the no-fault workers' compensation benefits, the FELA premium rates are substantially higher than workers' compensation rates.

The effect of a port tariff, statutes exempting port employees, or court rulings should be considered in determining the need for FELA coverage for railroad employees.

Environmental Liability

Background – For the last 30 years, the insurance industry has been attempting to find a solution to covering or not covering liability for losses caused by pollution and contamination events.

Adverse court decisions under general liability and umbrella liability policies resulted in the first steps to limit coverage for events deemed uninsurable under standard rate structures, if at all. The so-called "D," "E," "Z" exclusions were introduced to eliminate liability for the oil industry perils of explosion, blowout, and cratering of wells.

Continued court decisions held that, in the absence of an exclusion, each policy in force during a period of gradual pollution covered the ultimate loss on a pro-rata basis. This led to the introduction of a Gradual Pollution Exclusion in 1973.

The interpretation of this exclusion varied widely from federal to state courts and even between state jurisdictions. In some, the exclusion was upheld, in others discovery was held to be the occurrence and thus covered.

An inevitable result of the chaos within the courts was the development of an Absolute Pollution Exclusion in the mid-1980s. At the same time, exclusionary wording for asbestos and lead paint exposures was added because neither was defined as a pollutant or contaminant by the Environmental Protection Agency (EPA).

Current Status – Increased scientific knowledge of exposures, risk, and insurance needs has led to the emergence of specialized underwriters and insurance coverages to meet virtually every need in the area of pollution risks.

Also, the EPA's 1995 Brownfields Action Agenda created a partnership relationship between the responsible government agencies and property owners, operators, sellers, buyers, and communities replacing the old adversarial means of doing business.

Stated simply "Brownfields" is an attempt to apply uniform standards to contaminated sites for the purpose of encouraging clean-up and redevelopment. Instead of remediation to original conditions, "Brownfields" allows a standard of intended use that can dramatically reduce clean-up costs and liability exposures.

A menu of the products and services available through one or more insurers would include:

- Contractors Pollution Liability
- Consulting, Engineering and Design Professional Liability
- Fixed site clean up costs and third party liability (can include Business Interruption, Loss of Rents, or Rental Value for owner)
- Storage Tank Liability
- Restoration Cost Stop Loss (Per Project)
  a) Excess of Retention
  b) First dollars utilizing funded captive reinsurance

  Note: Investment income and unused funds belong to the insured party under b) above
- Analytical Laboratories Errors & Omissions
- Transporter Pollution Legal Liability
- Waste Treatment Pollution Legal Liability
- Property Transfer Liability, Clean Up, Business Interruption, and Extra Expense
- Brownfields Restoration/Development Liability, Clean-Up Costs including Stop Loss, Business Interruption
- Creditor Reimbursement including Collateral Value Loss Reimbursement
- Pollution Event Crisis Management
- Crisis Management Procedures Audit
- Crisis Management Response Simulation and Assessment

Additional coverages and services are available on a tailored basis to meet specific needs or unique situations. The above list is only a sampler. Increased competition, exposure knowledge and experience have made the current environmental risk marketplace quite responsive to buyers' needs.

WORKERS' COMPENSATION

The objective of workers' compensation statutes is to assure the payment of medical expenses and prescribed wage replacement for employees injured in work related accidents. The laws of governing jurisdictions vary considerably in content and scope, however, all center around the concept of statutory medical and wage replacement (compensation) to injured employees regardless of fault.

Workers' compensation statutes, in addition to establishing the benefit levels for injured employees, are designed to ensure that employers are financially able to meet workers' compensation obligations. Generally, this is accomplished through requirements that employers either purchase insurance from a commercial carrier or qualify with the governing jurisdiction as a self-insurer. In Nevada, North Dakota, Ohio, Washington, West Virginia, Wyoming, Puerto Rico, and the Virgin Islands, monopolistic or state administered funds have been established. In these jurisdictions, if an employer is not permitted or cannot qualify as a self-insurer, it must purchase insurance from the monopolistic fund since commercial insurance is not permitted.

Policy Form and Coverage

The basic workers' compensation policy consists of two parts:

Coverage A – Workers' Compensation: Under this part, the insurer agrees to pay all benefits or obligations falling within the workers' compensation statutes of specified state jurisdictions. This coverage is probably the only insurance contract which does not contain a maximum limit of liability.

Coverage B – Employers' Liability: Under this coverage part, insurance is provided for the claim of employees that do not fall under the workers' compensation statute. Coverage is limited to those states which are designated in the policy. This section contains specific limits of liability. The standard limits are:

Bodily Injury by Accident – Limit/Accident – $100,000
Bodily Injury by Disease – Policy Limit – $500,000
Bodily Injury by Disease – Limit/Employee - $100,000

However, higher limits are available. Umbrella policies will provide coverage in excess of primary employers' liability limits.

Coverage C – Other States Insurance – The policy is issued listing one or more states, under item 3A of the Declarations Page, in which employees of the port are working. The part of the

policy, item 3C, enables the port to have automatic insurance coverage for new operations in the states listed in this section. Suggested wording for item 3C to assure most comprehensive coverage: "States of the United States except those listed in Item 3A above and in ND, NV, OH, WA, WV, WY." Note your responsibility to advise the insurer at once if you begin work in any state listed in item 3C.

In addition, the basic policy provides for the insurer to undertake the legal defense of any suits, even if fraudulent or groundless, and to pay all expenses in connection with defense of a claim.

Extensions of Coverage

Voluntary Compensation Endorsement

In certain jurisdictions, not all classes of employees fall within the Workers' Compensation Act. Also, certain states do not require employers to carry coverage where only a few employees exist. Constantly changing compensation statutes make it difficult to stay completely up-to-date on potential loss exposures not covered under the law. It is possible to provide coverage for this exposure by attaching a Voluntary Compensation Endorsement to the policy. Coverage can be extended to either a particular class of employees by designating the class or to all employees of the port.

Since an injured employee not covered by the compensation act may have no recourse other than to sue his employer, the voluntary compensation endorsement can be advantageous by avoiding litigation.

The policy excludes coverage for the monopolistic states of ND, NV, OH, WA, WV, and WY. In those states, if the employment is such as to be subject to the compensation act, coverage must be purchased from the state fund. Coverage from the state fund, however, normally do not provide employers' liability coverage. Since the employers' liability coverage of the standard policy only extends to states designated in the contract, a potential uninsured exposure exists. This is not a serious area of concern for most ports since the exposure may be eliminated by extending the employers' liability coverage of the policy to cover all states including monopolistic states; or, if the insurer is unwilling to grant this extension, "stop-gap" coverage can be secured under the general liability policy.

In Rem Endorsement

In non-marine losses, any action taken by an injured employee or third party would be filed against the person or organization causing the injury. In marine liability, however, a master or member of the crew can bring a claim against the vessel from which the loss occurred as if it was an entity unto itself.

If an action is filed against the vessel, it can be seized regardless of registry or ownership until the claim is resolved. Due to court backlogs, resolution of a claim may take considerable time during which the vessel could sit idle. To prevent the vessel from being seized and possibly idled for a considerable period of time, a port can endorse its workers' compensation policy with an "In Rem" Endorsement. This endorsement provides that such an action would be covered as if against the port and not against the vessel.

Workers' Compensation Acts

In addition to workers' compensation obligations imposed by state statutes, ports may be subject to workers' compensation obligations created by Federal statute. Specifically, ports may be subject to workers' compensation claims under the U.S. Longshore and Harbor Workers' Compensation Act (USL&H), the Jones Act, or the Federal Employers Liability Act.

U.S. Longshore and Harbor Workers' Compensation Act

This federal act provides statutory benefits for employees engaged in maritime employment including longshoremen, harbor workers, ship repairers, and boat builders from injuries occurring on the navigable waters of the United States including adjoining piers, wharfs, dry docks, terminals, marine railways or other adjoining areas customarily used by an employer in unloading, repairing or building a vessel. On average, benefits payable under this Act are substantially higher than those under state compensation acts. While political subdivisions are specifically exempt under USL&H, some ports have voluntarily become subject to or pay the same benefit levels as specified in the Act due to negotiated

labor contracts. In addition, ports may be subject to the contingent-liability of contractors and others who fail to maintain appropriate insurance coverage for their employees. Standard workers' compensation policies do not extend to obligations created by federal acts. Coverage can be obtained under the standard policy, however, by the addition of a U.S. Longshore and Harbor Workers' Compensation Act Endorsement.

Jones Act

This federal act specifies the rights of American sailors, masters, and members of crews for injuries sustained in the course of their employment. Unlike state workers' compensation statutes, this Act does not provide statutory limitations for injuries or medical benefits. It is a negligence type of act without restrictions to recovery from the employer. Ports may be subject to the provisions of this Act when police, fire, maintenance, or other vessels are operated by the port. Coverage for this exposure can be provided by one of several methods. The normal and most common method is to insure the exposure under a protection and indemnity policy (P&I). For a further discussion on this policy, see the discussion under Marine Insurance. Insurance for this exposure can also be provided under the Employers' Liability Coverage B of the standard workers' compensation policy attaching "Amendment to Coverage B Endorsement-Maritime." This endorsement broadens the territorial limits of the policy and permits separate limits for maritime exposures. Coverages can also be provided in a voluntary compensation endorsement which is amended by the addition of an "Amendment of Voluntary Endorsement – Maritime Coverage".

Federal Employers' Liability Act

This federal act specifies the rights of interstate railroad employees. Like the Jones Act, it does not provide statutory limitations for indemnity or medical benefits. It is a negligence type of act that does not restrict the recovery from an employer.

Ports subject to this exposure can obtain coverage under the standard workers' compensation policy by specific endorsement and reporting of appropriately classified payrolls. Because this is a negligent act, without statutory benefit level provisions, the $100,000 limit for employers' liability coverage found in the standard workers' compensation policy should be increased either to $500,000 or $1,000,000 and applying the port's umbrella policy as excess insurance protection. Voluntary Compensation coverage is a valuable supplement which may avoid litigation by making statutory workers' compensation benefits available on a "no-fault" basis.

MISCELLANEOUS INSURANCE COVERAGES

Management Information Systems (MIS)

MIS equipment plays an integral role in managing and coordinating the operations of ports across the country. While limited coverage is available under standard property and boiler and machinery policies, the unique, specialized and critical nature of MIS functions makes the purchase of specific insurance coverage advisable.

Special MIS insurance is available to protect a port from:

- Physical damage to or destruction of hardware, media, and data.
- Extra expense involved in utilizing alternative facilities, emergency repairs to damaged facilities, additional personnel, overtime wages to resume or sustain MIS operations.
- The cost of recapturing or reproducing lost data.
- Loss of business income resulting from interruption of MIS operations.

Coverage is available on an "all risk" basis including electrical breakdown. The risk manger will have to consider a number of factors.

- In selecting the limit for physical damage, the purchase price of owned equipment should not be used because it may be insufficient to cover the cost of prudent upgrading in view of technological advancements or the unavailability of identical equipment. The contract obligations for leased equipment will determine the appropriate limit,

which may exceed the purchase price or current market value of the equipment involved.

- Estimates of all costs of operating at alternative facilities for the period of time required to rebuild present facilities would be the measure of Extra Expense limits.
- If adequate periodic duplication of data is practiced and the duplicate copies are stored off premises, the reproduction costs should be minimal. However, if some data must be reconstructed from source documents, material expense could be involved.
- The determination of an adequate limit for loss of business income will require the combined efforts of operations, MIS, and financial personnel.

Risk management action before a loss can play a major part in minimizing the loss arising from interruption of MIS operations. Pre-loss planning for the use of an off premises "hot site" or reciprocal agreements with local organizations having compatible equipment to allow use of facilities during non-working hours are practical loss mitigation actions. Daily or weekly duplication of computer data for safe storage at an appropriate off premises site will minimize recapture and reconstruction functions. Periodic reevaluation of potential business interruption from loss of MIS operations will assure adequate limits for this exposure.

Non-Owned Aircraft

Most ports do not own aircraft. However, a contingent liability exposure does exist if a port charters aircraft for port sanctioned trips. While coverage carried by the aircraft owner is primary, a port could be joined in a suit with the owner as a result of the operation or use of the aircraft. Non-owned aircraft liability coverage is excluded from primary general liability policies. Many umbrella liability policies exclude coverage for aircraft owned or chartered by or on behalf of the insured. Coverage is further excluded for employees who operate an aircraft in the course of their employment.

A port can purchase a primary non-owned aircraft liability policy to protect itself from this loss exposure. The umbrella carrier may then be willing to amend its policy to include this exposure so as to provided added limits of insurance protection. A final alternative is to attempt to amend the port's umbrella liability policy to respond to all non-owned aircraft claims, regardless whether or not there is primary coverage. This alternative, of course, would make the port responsible for the umbrella's retention. Because of the catastrophic nature of this loss exposure, it is important that ports subject to non-owned aircraft exposures secure insurance protection through one of the alternatives discussed.

Special Events Liability

From time to time, a port will sponsor activities or make port facilities available to individuals or organizations for events not usual to a port's operations. The events can include parties, outings, special tours, or off-site activities, such as golf outings, employee outings, boat charters, sporting events, etc. Underwriters accept certain activities as normal to a port's operations, but will treat others as unacceptable or beyond the scope of accepted risk for which premium has been charged.

There are two options available to a port to handle these situations. First, to have the port's policies endorsed to specifically grant coverage or, second, to purchase a special events policy to insure an event outside of existing coverage. The latter insulates existing insurance from losses which could adversely affect future coverage and pricing. Also, coverage not otherwise available under existing policies can be obtained, i.e., hole-in-one insurance, athletic participants accident insurance.

Under special events policies, coverage can be specific, limited in time, place and amount with premium charged for the event only. Blanket insurance for a facility or types of events occurring with some regularity is also available at pre-agreed rates, limits, deductibles, etc.

It is recommended that the purchase of special events insurance be weighed against the future effect on existing insurance if the risks arising from special events were to be included as "usual operations."

In any case, both the port and the sponsoring organization(s) should be named as insureds under insurance policies covering special events.