

Workshop H

CONSTRUCTION RISK AND INSURANCE ISSUES

Panelists

David B. Dolnick
Risk Manager
The Brady Companies

Marge Layne
OCIP Manager
CCSF Public Utilities Commission,
San Francisco

Louis P. Iglesias
Executive Vice President and COO
AIG Risk Management, Inc.

R.L. "Bunny" Oakes III
President—Construction Division
TIS Insurance Services, Inc.

James Shay
Corporate Risk Manager
Swinerton Incorporated

Moderated by

William S. McIntyre
Chairman
American Contractors Insurance Group

Risk managers for construction project owners, contractors, and subcontractors face myriad risk and insurance challenges. Sometimes, the objectives of these parties coincide, such as completing a project with no injuries. Other times, real or perceived differences in objectives create opposition between parties that can frustrate the process, generate animosity among participants, and be counterproductive for everyone involved. In this session, a panel representing a cross-section of the industry will discuss a variety of current issues, some of which are controversial, with the goal of increasing awareness, opening dialogues, and improving cooperation among project participants. The agenda will include risk allocation issues, wrap-up insurance programs, terrorism risk and insurance, market conditions, and a variety of other topics.



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Our construction team manages insurance and risk management programs for a wide range of contractors, from specialty trade shops to multi-national contractors, and their needs range from basic brokerage services to the development of highly integrated risk control, transfer and retention programs.

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David B. Dolnick
Risk Manager
The Brady Companies

Mr. Dolnick is a panelist for Workshop H, "Construction Risk and Insurance Issues," on Wednesday. He serves as risk manager for The Brady Companies, a La Mesa, CA, specialty contractor with diverse operations throughout California and the western United States. He has primary responsibility for developing and implementing risk management programs involving loss and accident prevention, claim and litigation management, risk transfer, and risk financing under both traditional as well as alternative programs, and for performing exposure and coverage evaluations and determinations. Mr. Dolnick developed and implemented workers compensation claims control procedures under an alternative financing arrangement that reduced the open inventory of claims by more than 70 percent and costs by more than 60 percent. He assists the five local and regional offices in developing and implementing safety and accident prevention procedures and quality control programs.

Mr. Dolnick has served in similar capacities for R.E. Hazard Contracting Company and for JWP West (formerly known as University Industries) in San Diego, and has experience in several capacities, including loss control, underwriting, and marketing with Citation Insurance Company, Fremont Indemnity Company, and with California's State Compensation Insurance Fund. Mr. Dolnick began his insurance career in the life and disability field in 1972.

Mr. Dolnick earned a bachelor of arts degree from Ripon College in Ripon, Wisconsin, in 1972. He served on the Board of Directors for the San Diego County Safety Council from 1986 through 1992, and is currently a professional member of the American Society of Safety Engineers, serving as San Diego Chapter President in 1985. He is a deputy member of the Risk and Insurance Management Society, where he serves as a chapter mentor, and is also a member of the Board of Directors of the San Diego Chapter, serving as chapter president for both 2001 and 2002. On a Society level, he is a member of the RIMS Member and Chapter Services Committee. Mr. Dolnick also serves on the Risk Management Committee for the Associated General Contractors of America, and has been active on that group's Steering Committee and on its Mold Litigation Task Force.

He was selected Risk Manager of the Year by the San Diego Chapter for 1997, and received the National "Heart of RIMS" award for service to his Society and the community during 1998. He has been a speaker at national, regional, and local conferences on risk management, legal claim management, loss control, and safety-related topics, and has authored articles appearing in *Risk Management Magazine* and in *Constructor Magazine*, as well as in several regional publications.

Louis P. Iglesias
Executive Vice President and COO
AIG Risk Management, Inc.

Mr. Iglesias is a panelist for Workshop H, "Construction Risk and Insurance Issues," on Wednesday. He is executive vice president and COO of AIG Risk Management, Inc. He is responsible for overseeing the Domestic Profit Centers, as well as the Operations, Financial, and Human Resources functions of the company.

Previously, Mr. Iglesias held the position of Senior Vice President of AIG's Domestic Brokerage Group. In that capacity he was responsible for AIG's National Accounts segment of business for the United States and Canada. This portfolio is inclusive of all Property Casualty Accounts with revenue in excess of \$700M and includes all insurance lines of business. He was also President of AIG Construction Risk Management Group and was responsible for the effective design and delivery of complex insurance, loss control, and claims management programs to large construction projects and contractors countrywide.

Mr. Iglesias has over 18 years' insurance industry experience, the past 9 years at AIG. He holds the Chartered Property and Casualty Underwriter and the Associate in Risk Management designations. He is a graduate of the State University of New York with a bachelors degree in business finance.

Marge Layne
OCIP Manager
CCSF Public Utilities Commission, San Francisco

Ms. Layne is a panelist for Workshop H, "Construction Risk and Insurance Issues," on Wednesday. She has been a professional in the insurance field for more than 30 years. She began her career with the broker joint venture, Transit Insurance Administration, in the administration of one of the first owner controlled insurance programs in California during the construction of the San Francisco Bay Area Rapid Transit District (BART), which was the first fully automated transit system in the United States. Upon completion of construction, Ms. Layne became the risk manager for BART, handling its operational insurance coverages, including employee benefits.

Leaving BART, she then worked for California & Hawaiian Sugar Company as its insurance manager and managed the property, casualty, and marine insurance program for several years.

Eager to get back into the construction insurance field, when the San Francisco International Airport was commencing its major \$2.4 billion expansion program that included construction of a new international terminal and light rail system, Ms. Layne accepted the position of OCIP manager for the City and County of San Francisco to manage its OCIP for the airport.

Upon substantial completion of that major project, she was asked to bring her expertise to the San Francisco Public Utilities Commission, another department of the City and County of San Francisco, to manage an OCIP for its major \$3.6 billion capital improvement program, which began February 1, 2002, and is scheduled for completion in approximately 10 years.

R.L. "Bunny" Oakes III
President—Construction Division
TIS Insurance Services, Inc.

Mr. Oakes is a panelist for Workshop H, "Construction Risk and Insurance Issues," on Wednesday. One of four principals/owners of TIS Insurance Services Inc., Knoxville, he is immediate past president and is on the executive committee of the Insurors. He entered the insurance business with Flenniken/Corroon and Black (now Willis of Knoxville) in 1979. Leaving there in 1983, he spent 8 years with Broadus/Anderson/Sedgwick (now Marsh USA). He has been with TIS Insurance Services Inc. since 1991 and is currently president of the Construction Division. He earned a bachelor of science degree in business from the University of Tennessee at Knoxville in 1976.

James Shay
Corporate Risk Manager
Swinerton Incorporated

Mr. Shay is a panelist for Workshop H, "Construction Risk and Insurance Issues," on Wednesday. In his position as corporate risk manager, he coordinates the continued development of Swinerton's risk management programs including its specialized wrap-up program which has \$800 million of committed construction volume, as well as deploying the Subguard (subcontractor default protection) program throughout the organization. He is also involved in current risk management technology projects and in developing and presenting foundational risk management programs. He entered the insurance industry with Norcal Mutual Insurance, followed by Employers Insurance of Wausau working claims. He joined Swinerton Incorporated as the insurance claims manager in 1995.

Swinerton Incorporated is the parent company for a number of firms providing diverse construction services to various industries. Currently an OSHA VPP Contractor in California, Swinerton is widely recognized as one of the industry's leaders in safety. Swinerton is currently ranked 12th in the ENR Top 50 Domestic General Builders.

Mr. Shay is a San Francisco Bay Area native and in 1988 graduated from San Francisco State University.

William S. McIntyre
Chairman
American Contractors Insurance Group

Mr. McIntyre is cochairman of this Conference and is also moderating the panel for Workshop H, "Construction Risk and Insurance Issues," on Wednesday. For more than 30 years, he has been involved in the insurance industry. He is chairman and a shareholder of American Contractors Insurance Group, Ltd. (ACIG), in Dallas. ACIG is construction-industry-owned. Mr. McIntyre has been very active over the years with the Associated General Contractors of America, writing articles and reviewing contract documents, and he is currently serving on AGC's Risk Management Committee. He has written many articles on insurance and risk management for construction and insurance industry trade journals. He coauthored *101 Ways To Cut Business Insurance Costs*, published by International Risk Management Institute, Inc. (IRMI). Mr. McIntyre also is a technical adviser for IRMI's reference manual for contractors, *Construction Risk Management*.

Notes

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CONSTRUCTION RISK AND INSURANCE ISSUES

Risk managers for construction project owners, contractors, and subcontractors face numerous risk and insurance challenges. Sometimes, the objectives of these parties are identical, such as completing a project with minimal or no injuries. Other times, real or perceived differences in objectives create opposition between parties that can slow down the project, generate animosity among participants, and be counterproductive for everyone involved.

In this session, a distinguished panel representing a cross section of the industry will discuss a variety of current issues, some of which are controversial, with the goal of increasing awareness, opening dialogues, and improving cooperation among project participants, such as the owner, contractor, subcontractor, broker, and insurer.

In Their Words ...

In preparation for this discussion, we asked each of our panelists to summarize, from their unique perspective as an owner, contractor, subcontractor, broker, or insurer, two or three key construction risk management challenges. Their responses are presented below.

OWNER'S PERSPECTIVE Marge Layne OCIP Manager City and County of San Francisco

State of the Insurance Market

- Post September 11th, the insurance marketplace has been in a total state of turmoil. The costs of every form of insurance have escalated, making it difficult for small-to-midsize contractors to obtain the necessary insurance required by the owner under its contract provisions.
- There is limited capacity/reinsurance.
- There are a limited number of insurers willing to provide coverage. As an example, the California State Compensation Insurance Fund, which has normally provided workers compensation coverage for small-to-midsize contractors with not-so-pristine loss experience, has changed its underwriting criteria. The State Fund will only provide insurance on a last-resort basis. Contractors will now need to be rejected by three insurance companies before the State Fund will consider providing coverage.
- Using California as an example, the California Department of Insurance has approved increases in the workers compensation disability benefits. Maximum Weekly Temporary Total Disability will increase from \$490 in 2002, to \$602 in 2003 and 2004 and \$840 in 2005. California workers compensation premium rate increases were approved at 11.1 percent on January 1, 2003, 7.2 percent on July 1, 2003, and 22.5 percent on January 1, 2004.
- California Insurance Guaranty Association had declared that it will run out of money by November 2004 and has requested for \$1.5 billion in funding.

Contractors' Meeting Owners' Insurance Requirements

- There is a cost impact on contractors' bids due to the state of the marketplace.
- There is a limited number of qualified bidders because of the cost and availability of insurance at limits required under the contracts.
- There are limited coverage terms and conditions, including the following:
 - (a) Acceptable financial rating of insurers
 - (b) Additional insured status—more difficult to receive the preferred additional insured endorsement
 - (c) Reduced limits of coverage
 - (d) Less availability of key coverage components
 - (e) Higher deductibles/SIRs—ability for contractors to meet them financially
 - (f) Surety capacity and solvency

Determining the "Right" Insurance Program

- What should be the minimum insurance requirements and acceptable level of financial ratings for insurers?
- How to reduce coverage gaps?
- Identifying cost savings measures through alternative programs such as wrap-ups

Additional General Comments

- Very often, certificates of insurance are incomplete and do not provide evidence of all of the contractual requirements.
- In order to be named as an additional insured under the contractor's policy, the policy must be endorsed or must contain blanket wording that provides the coverage automatically if the named insured has contractually agreed to do so. The broker or agent may not have the authority to issue the additional insured endorsement and it could take several months before it is received from the contractor's insurance company.
- Having a certificate of insurance that requires notice of cancellation does not guarantee that the owner will be notified.
- In the current insurance market, contractors may not have coverage bound as of the renewal date and the new insurer may not agree to backdate coverage, which could lead to a lapse period with no coverage.
- General contractors may not require up-to-date and complete certificates of insurance from their subcontractors.
- General contractors may not pass through contractual requirements to their subcontractors.

- Completed operations coverage can be evidenced for the current policy period but must be purchased at each renewal in order for there to be coverage for the full 10 years of statutory liability for construction defects. Once the project is completed and the owner has paid the contractor, it is very difficult to maintain evidence of the insurers providing completed operations for the contractor.

GENERAL CONTRACTOR'S PERSPECTIVE

**James Shay
Corporate Risk Manager
Swinerton Incorporated**

Subcontractor Insurance

The insurance provided by the subcontractors is becoming less and less reliable, with limits, insurer solvency issues, and additional insured endorsement restrictions making an effective and equitable financing/transfer of risk very difficult. An inordinate amount of resources are devoted to reviewing, verifying, and tracking subcontractor insurance certificates and endorsements. But, as insurer financial difficulties have risen, the ability to get claims paid timely has become a near impossible task.

Owner Risk Transfer/Owner Risk Management

Owners are clearly more educated on insurance and risk management issues. Further, with the relatively common use of OCIPs and other owner sponsored insurance initiatives, owners have taken it on themselves to provide the risk financing behind the contractual risk transfer obligations taken on by the general contractor and subcontractors. Problems arise when the risk financing arrangements made by the owner, which are supposed to be designed to benefit all parties in the construction process, are inadequate to protect the interests of the builders relative to the contractual risk transfer obligations imposed by that same owner. Shortcomings such as high deductibles, completed operations tail less than the applicable statute of limitations, low limits, lack of an insurer advocate, and restricted coverages all serve to leave the construction entities financially vulnerable to various liabilities. The only prudent response is to arrange difference-in-conditions (DIC) programs, where possible, having the effect of lessening the cost savings benefit the owner sought to begin with.

Mold

While the worst of this scare may be behind us, some insurers (pollution liability) seem to have let the pendulum swing back to the point where they claim mold is not a pollutant, except if is tested and is of a certain variety commonly known to be particularly toxic. Fortunately, the policy form does not speak to such definitions, but it does make claim resolution difficult and speaks to the fact that, aside from exclusions, there remains little consistency between insurance lines or insurers as to how to address this risk.

Residential Construction/Insurance

Where has all the coverage gone? Urban infill housing needs and low interest rates have sparked a flurry of multifamily residential construction projects. However, there is scant insurance available to adequately protect the interests of the builders. Further, owner/developers commonly approach such projects using a limited liability company (LLC) as the corporate entity. When the project is finished, the

LLC can close down leaving only the builders as potential targets. Without adequate insurance in place (and with subcontractors' insurers placing residential exclusions on the policies), how will liabilities ultimately be addressed? Are there emerging markets for such coverage?

SUBCONTRACTOR'S PERSPECTIVE
David B. Dolnick
Risk Manager
The Brady Companies

Three Risk Management Challenges Facing Construction

Mold

The plaintiff's bar has done a superb job of whipping up a feverish frenzy over mold contamination. The response to that furor on the part of the insurance industry has been, at best, late, adversarial and incomplete. Sadly, the response by the majority of our peers in the construction trades has been worse.

In the early days of the assault, a few policyholders with first-party claims were stonewalled by their insurers. That magnificent accomplishment in public relations led to very few enormous verdicts; judgments related far more to the jury's ire at the insurer's bad behavior than to the real impact of mold on the policyholder. Those decisions, however, erected before a gullible and impressionable public, the image of gold mines of immense wealth and easy extraction. Apocryphal tales of homeowners torching their dwellings and collecting millions spread faster than any real wildfire, and transformed the dull science of mycology into a glittering casino filled with slot machine spewing bars of shiny gold and heralding riches to come.

The resulting onslaught of claims and litigation has overrun the capacity of at least one state to handle the frightened public response, and others are perilously close. The construction industry's response? We continue as before, engaging in our defense in the time-honored tactic of blame shifting, or, to use a more ennobling and erudite word, indemnification.

Subcontractors, as the actual constructors of the building, are told that they are responsible for the prevention of mold growth, and reams of contractual clauses are drafted to that end. The poor quality and incomplete nature of the architectural drawings are ignored; the impossibly tight schedules with unrealistic deadlines are swept aside; and week by week we continue to expose interior products to exterior conditions. In one recent example (the names have been omitted to protect the budding litigants from embarrassment), the roof covering was left off of the plumbing chases in an apartment complex. Several thundershowers later, the inevitable occurred, and a hapless drywall subcontractor was selected as the victim du jour. The rationale was simplicity at its finest, "Well, it is growing on your product, isn't it?" This myopic viewpoint, and its kith and kin, must be universally abandoned if we are to survive the rising tide of public distrust our actions foster.

Construction Defect Litigation

The litigation of construction defects, perfected in California in the 1970s, is spreading rapidly across the country. Lucrative for plaintiff firms and their experts, construction defect suits are very difficult and expensive to defend against, a factor that allows plaintiffs to extract high-value "cost of defense" settlements in cases of marginal worth. This trend also frequently pits the staff of the satellite office of experienced plaintiff firms against inexperienced and generally unsophisticated general contractors, often

represented by their general counsel, who may, but more often does not, have any idea how to defend against a highly coordinated attack in a complex litigation arena.

Adding to this trend, as interest rates fall to record lows, a greater number of marginal projects are able to enter the construction stream. These are frequently underdesigned and are often rushed to completion, placing inordinate scheduling, financial, and manpower demands on the construction industry. Every contractor working today knows of numerous attempts to construct a \$40 million building for \$36 million. If this trend continues, the construction industry will continue to make itself a target for construction defect litigation, as far too many of these projects are subsequently brought back into financial health by the filing of a suit.

Silica

NIOSH, OSHA, and other agencies have, for years now, attempted to grapple with industry's use of silica and silica-containing compounds. While the most harmful of the silica dusts are regulated, the ubiquitous nature of silica makes tighter controls extremely difficult. The sheer number of products in common use that contain silica is daunting, and removing silica from the stream of commerce would be virtually impossible. Among the many silica-containing products in common use, one of the most ubiquitous is common sand. Its uses are so numerous that they are virtually impossible to catalog. Attributing an individual's silica exposure to the sand used in construction, however, is difficult. The ubiquitous nature of sand is not, however, limited to the construction site. Playgrounds, beaches, yards, and gardens can all contain greater or lesser amounts of sand and, therefore, silica in varying quantities. The same can be said for a great many other products.

Contrasting against these facts, the number of deaths attributed to silicosis and its related diseases continues to rise. When the current furor over asbestos fades and the hyperbole over mold is reduced to manageable and factual statements, the cottage industries spawned by both will turn their eyes elsewhere for survival. Will their gaze alight on silica? Perhaps it will, but if our industry responds no better than it did to asbestos or mold, the potential and the future of construction, are not good.

BROKER'S PERSPECTIVE
R.L. "Bunny" Oakes III
President—Construction Division
TIS Insurance Services, Inc.

Environmental

The area that concerns me the most as an agent/broker working with contractors is environmental issues. Over the last 25 years, the insurance industry has made it difficult, expensive, and confusing to adequately insure a contractor's environmental risk. The laws and exposures are changing every day. What materials are used in construction, construction means and methods, and handling of construction waste that were OK in the past are now found to be hazardous. Whether it is asbestos, lead paint, mold, etc., what is OK today might not be OK tomorrow.

When you have an environmental issue, the coverages are so confusing and technical that the expenses and issues that arise between insurance companies, defendants, and plaintiffs sometimes are double and triple the cost of actually correcting and fixing the problems. Even if you think you have coverage, usually you find out that there are always coverage issues and costs that are not covered. These types

of claims can literally put contractors out of business, because of the insufficiencies, expenses, and penalties that are tied to environmental cleanup and potential third-party litigation. When an environmental issue arises, nobody is the winner except possibly the people who are employed and making a living from our legal system. These are the most frustrating, inefficient, and costly disputes you can possibly get into.

Contractual Risk Transfer

The whole "*contractual risk transfer*" philosophy seems to be challenged more than ever before. To me, there are three basic fundamentals of "*contractual risk transfer*," including the following.

- Transfer the risk to whoever controls it the most.
- Require insurance coverage for this risk.
- Make it stop there; prevent the insurance company from pursuing members of the construction team.

Proper Coverage for Subcontractors

It is harder and harder for contractors to make sure their subcontractors are properly insured. For instance, workers compensation has become very state-specific with the growing number of state self-funded programs, participants in the assigned risk plan, captives, PEOs, etc., it has become harder and harder for contractors to confirm their subcontractor has proper workers compensation coverage. Over the last several years, we have had more claims against general contractors involving improperly insured subcontractors on their workers compensation than uninsured subcontractors. The hard insurance market not only brought higher premiums, it brought many exclusions; whether it is exclusions for subsidence, mold, EIFS, residential construction, etc., it is extremely hard for upstream contractors to know their subcontractors are properly insured. Even for automobile coverage that used to be pretty basic, it is harder and harder to confirm that trucking operations—specifically hauling/dump truck operations—are properly insured on their automobile coverage. Many hauling contractors now are restricted in regard to how their automobile insurance is provided. A lot of them cannot get *Symbol 1* and a lot will have very specific driver warranties.

These are just some of the many issues I hear from contract administrative personnel with contractors in making sure their subcontractors are properly insured. It is almost like the insurance industry is fighting itself on two different ends. Most insurers for general contractors will require very strict insurance language and requirements for that general contractor's subcontractors. For them to even insure this general contractor, they require very broad and specific language for the subcontractor to comply with. On the other hand, from the subcontractor's perspective, insurers are looking much harder at providing additional insured status, waiver of subrogation, and other language being required by the general contractor.

Workers Compensation: Injuries and Disease

From a workers compensation perspective, repetitive motion-type injuries and occupational disease issues seem to be growing in the construction industry, and, from a loss control standpoint, these type risks are much harder to address. We have had contractors that have had significant claims coming from carpal tunnel, hearing loss, and the age-old back claims. Workers compensation laws pretty much say the employer of the injured employee when these problems manifest themselves is liable for the whole claim.

Other Comments

A few other areas have to do with the stability of the insurance marketplace, professional liability for design build and construction management services, construction defects, and our totally ridiculous system for dispute resolution. We all have many challenges in front of us as we move on in the future. Hopefully, we all can work together as a team to successfully address these risks as we work together in the future.

INSURANCE COMPANY PERSPECTIVE
Louis P. Iglesias
Executive Vice President & COO
AIG Risk Management, Inc.

Carrier Stability

Carrier stability is a key issue for construction firms in light of the weakening capital base of the insurance and reinsurance industry. Estimates of industry underreserving range from \$50B to \$120B. Several insurers that actively underwrite contractors and wrap-up projects have been downgraded or put in receivership. Specific issues are as follows.

- Multiyear wrap-ups with completed operation extensions. A number of wrap-up projects have been forced to change insurers midterm at higher prices with more restrictive terms than that of the original program by the downgraded insurer.
- Ability to contractually transfer risk to a subcontractor insurer in financial difficulty. There needs to be greater scrutiny of subcontractor insurers due to the difficulty or inability to transfer risk to impaired insurers.

There has been movement in loss reserving due to noncollectible contractual transfer. This issue ultimately comes back to the contractor accepting certificates that include inferior insurers.

Need for Improved Understanding of the “Total Risk Management” Approach

With the hardening market, increased legal fees, and the current workers compensation crisis, it is more important than ever to understand risk management concepts. In a typical loss sensitive program, 70 percent to 80 percent of insurance costs are for losses incurred. As more insurers exit construction or offer less guaranteed cost products, contractors need to improve loss control programs and recognize strong claims handling practices. The contractor needs to concentrate on preventing and cur-tailing losses as well as selecting an insurer that will complement their efforts. These actions will result in insurance program efficiencies and assist in mitigating losses and expenses.