



CITY OF SACRAMENTO

DEPARTMENT OF GENERAL SERVICES

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OFFICE OF THE DIRECTOR

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RISK MANAGEMENT & INS. DIVISION
SUPPORT SERVICES DIVISION

April 16, 1985
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City Council
Sacramento, California

Honorable Members in Session:

CITY MANAGER'S OFFICE
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SUBJECT: RISK MANAGEMENT PROGRAM AUDIT

SUMMARY

This is an informational report transmitting the audit and evaluation of the City's Risk Management and Insurance Program, conducted by Warren, McVeigh and Griffin, the City's Risk Management Consultant.

BACKGROUND

The objective of the audit is to provide the City's Risk Management and Insurance Committee reasonable assurance that the program provides adequate financial protection against any potential catastrophic loss.

AUDIT FINDINGS

Overall, the City's insurance program remains well structured. However, the audit provides several recommendations that would further enhance the overall program (see Section II Recommendations, Pgs 3 and 4, of Exhibit I).

CONCLUSIONS

Based on the Risk Management Committee's review of the recommendations with operational managers and its knowledge of City operations, the Committee's responses to each of the audit recommendations are provided in Exhibit II.

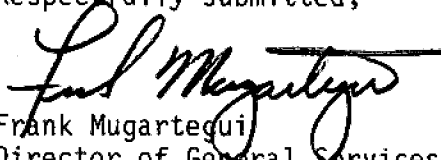
FINANCIAL OVERVIEW

Over the past few years there was sufficient capacity available in the market place for insurance coverage at reasonable premiums. Today the market place has changed dramatically - underwriting capacity is shrinking and, where coverage is available, premium increases from 100% to 500% are common.

RECOMMENDATION

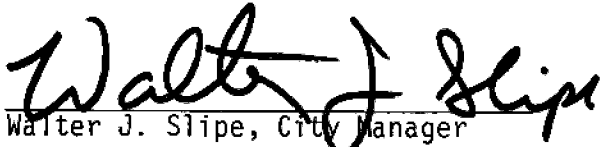
This report is for Council information only and requires no action.

Respectfully submitted,


Frank Mugartegui
Director of General Services

April 23, 1985
All Districts

For City Council Information Only:


Walter J. Slipes, City Manager

Attachments (2)

cc: Risk Management Committee
Corroon & Black/James Burpo/Insurance Services
Warren, McVeigh & Griffin

CITY OF SACRAMENTO
RISK MANAGEMENT AUDIT UPDATE

February 22, 1985

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San Francisco, California 94111

Warren, McVeigh & Griffin, Inc.

Risk Management Consultants

February 22, 1985

City of Sacramento
Risk Management & Insurance Division
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Attn: Mr. William Redmond
Risk Manager

RISK MANAGEMENT AUDIT UPDATE

This report presents the results of our update of the 1981 audit of the City of Sacramento's risk management and insurance program.

Activities undertaken in this study include:

1. Interviews with City personnel to determine changes in the types and extent of the City's loss exposures since our 1981 audit.
2. Physical inspections of certain facilities, including the American River Water Treatment Plant, the Community Center buildings, and the sanitary fill site.
3. Detailed analysis of current property, liability and excess workers' compensation insurance policies.

The first chapter of this report summarizes the major findings of our study. The second chapter is an index of all recommendations. The recommendations concerning property, liability and workers' compensation insurance policies are amplified and explained in chapters III and IV.

We again appreciate the opportunity to work with the City on this assignment. We will be glad to answer any questions which may arise concerning this report.

By Robert L. Wilkinson
Robert L. Wilkinson, CPCU, ARM
Vice President

By C.C. Griffin
C.C. Griffin, CPCU
President

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I. SUMMARY

I. SUMMARY

Overall, the City's insurance program remains well structured. Despite recent price increases, the program also remains reasonably priced in today's insurance marketplace.

PROPERTY RISKS

Many of the recommendations made in our 1981 audit report have been implemented, with the result that the City has broad, well structured insurance coverage for most of its property loss exposures.

A major exception is coverage for property loss due to employee dishonesty and other crime-related areas. Coverage for these areas remains basically unchanged from the coverage we reviewed in 1981. Although, to our knowledge, the City has not experienced a major loss in those areas, we recommend strongly that the City increase coverage for employee dishonesty and forgery of City checks. Selection of an adequate limit is difficult as we are aware of no current guidelines. Our recommendation, based solely on experience, is that the City consider a limit of at least \$5 million.

The text also includes several new recommendations which, if implemented, should further enhance the City's property insurance program.

LIABILITY RISKS

The City's insurance coverage for its liability loss exposures is neither as broad, nor as well structured, as its coverage for property loss exposures. We have commented on many of the liability problem areas in previous correspondence with the City's Risk Manager. Recommendations made in that correspondence are not repeated in this report.

Major items addressed in this report include environmental impairment liability and recommendations for amending the terms and conditions of the City's various excess liability policies to avoid unnecessary coverage disputes between the City and its insurers.

THE INSURANCE MARKETPLACE

During the past several months, the insurance marketplace has undergone a dramatic change. The change has been marked by severe price increases (increases ranging from 100% to 500% are common) and a shrinkage of market capacity for many kinds of insurance coverage. Areas which have been especially impacted include earthquake insurance coverage and liability coverage for public entities.

The City experienced the first wave of this market change when its policies were renewed last year. The second wave will occur when the City's policies renew this year. The City may anticipate difficulty in placing its earthquake insurance coverage, i.e. pricing will be very high and total capacity will be restricted. Also, the City may anticipate further price increases for its liability coverage and greater difficulty in finding a market for that coverage. The City's current liability insurer has already withdrawn from writing business for public entities.

II. RECOMMENDATIONS

II. RECOMMENDATIONS

The following is a complete list of recommendations contained in this report.

	<u>Discussion on Page(s)</u>
1. Delete the requirement on the City's blanket property policies that property be "repaired, rebuilt or replaced on the same premises" in order to recover its replacement cost.	6
2. Amend the insuring agreements, terms and conditions of the National Fire Insurance Company of Hartford policy to match those of the Fireman's Fund Insurance Company policy.	6
3. Amend the blanket property policies to add coverage for the increased time to rebuild damaged or destroyed property due to the operation of building laws.	7
4. Add a "joint loss agreement" to the City's property insurance policies and to the boiler and machinery policy.	7
5. Amend each property policy to designate the loss adjustment firm which the insurers must use in the event of a loss.	8
6. Amend the appraisal provision of each property policy to require that appraisers separately determine questions of fact and questions of law.	8
7. Amend coverage on the City's mobile equipment policy to apply on an "all risks" basis in lieu of the current "named perils" basis.	11
8. Amend the definition of "accident" on the boiler and machinery policy to read "any sudden and accidental damage to an object, or part thereof, that necessitates repair or replacement of the object, or part thereof . . ." in lieu of the current definition which states that an "accident" means "a sudden and accidental breakdown of the object, or part thereof, which manifests itself at the time of its occurrence by physical damage to the object that necessitates repair or replacement of the object, or part thereof . . ."	14
9. Consider amending the boiler and machinery policy to a "comprehensive" form in lieu of the current form which provides coverage only for specifically described object groups.	15
10. Add a "joint loss clause" to the boiler and machinery policy.	15

	<u>Discussion on Page(s)</u>
11. Purchase the minimum limit of "faithful performance" coverage required by law. Purchase excess employee dishonesty coverage with limits of at least \$5 million.	16
12. Purchase depositors' forgery coverage in the same amount as employee dishonesty coverage.	17
13. Amend the Named Insured on each liability policy to include "any and all Boards, Commissions, Authorities and Districts under the jurisdiction of the City of Sacramento and/or the City Council." Submit proposed wording to the City Attorney for review before use.	20
14. Amend each excess liability policy to state that it will follow the insuring agreements, terms and conditions of the City's first layer excess policy.	20
15. Amend policy Condition B, Insured's Duties in the Event of Occurrence Claim or Suit, on the Industrial Underwriter's policy to require notice of loss as soon as practicable following knowledge of a loss by the City's Risk Manager, in lieu of the current requirement for immediate notification.	21
16. Amend policy Condition 8, Notice of Loss, on the American Centennial Insurance Company policy, to require that the City notify the insurance company of potential loss as soon as practicable upon knowledge by the City's risk manager that the loss may involve the Company, in lieu of the current requirement for immediate notice.	22
17. Delete the provision from the Midland Insurance Company policy which states that coverage under the policy terminates automatically upon termination of coverage under the immediate underlying policy.	22
18. Delete policy Condition 1, Prior Excess Insurance and Non-cumulation of Liability, from the Chicago Insurance Company policy.	23
19. Amend policy Condition 2, Maintenance of Underlying Umbrella Insurance, on the Chicago Insurance Company policy to state that failure of the City to maintain underlying insurance shall not invalidate the coverage afforded by the Chicago Insurance Company policy, but that coverage shall apply as if underlying insurance were so maintained.	24
20. Delete the provision from the Midland Insurance Company policy which states that coverage under the policy terminates automatically upon termination of coverage under the immediate underlying policy.	25

III. PROPERTY RISKS

III. PROPERTY RISKS

A. BUILDINGS, CONTENTS AND OTHER FIXED PROPERTY

1. Exposures

In addition to increases in the replacement cost values for buildings and contents, major exposure changes since our 1981 audit report are the addition of a Central Communications Building and a Museum & History Building.

2. Current Insurance Program

The City's buildings, contents and other fixed property are insured under blanket property insurance policies written by Firemen's Fund Insurance Company and National Fire Insurance Company of Hartford. The blanket limit is \$189,238,697. The Firemen's Fund policy affords coverage for 88.85% of each loss and the National Fire Insurance Company policy affords coverage for 11.15%. Coverage applies excess of a \$100,000 retention for all losses except losses caused by earthquake or flood perils. Coverage for loss caused by those perils applies excess of a \$100,000 retention or 5% of the value of the property at the location of the loss, whichever is greater. Also, losses due to earthquake or flood perils are limited to \$50 million. This limit approximates the value of City buildings which are required by various agreements to be insured against loss by flood or earthquake.

In addition to the blanket property policy, the City purchases separate property insurance for the fine arts collection at the Crocker Art Gallery and the historical collection at the new Museum of History. Those policies are written on special forms designed for museum collections.

3. Recommended Coverage Improvements

Generally, the City's insurance policies are well written and afford a broad coverage scope. We offer the following recommendations for additional improvement:

Recommendation

- o Delete the requirement on the City's blanket property policies that property be "repaired, rebuilt or replaced on the same premises" in order to recover its replacement cost.

Discussion

The Replacement Cost Endorsement attached to the City's blanket property policies currently includes a requirement that property be "repaired, rebuilt or replaced on the same premises" if the City is to recover its replacement cost.

In most situations, the requirement would not present a problem as damaged or destroyed property would normally be repaired, rebuilt or replaced on the same premises. However, a situation may arise in which the City wishes to rebuild destroyed property at a site other than the location where the loss occurred. As long as the cost to rebuild at the new site is no greater than the cost to rebuild at the former site, the location should not be a factor in determining insurance recovery.

Based on our experience, most insurers will delete the same premises requirement upon request and at no additional cost. The City should request such an amendment.

Recommendation

- o Amend the insuring agreements, terms and conditions of the National Fire Insurance Company of Hartford policy to match those of the Fireman's Fund Insurance Company policy.

Discussion

The all-risk form attached to the National Fire Insurance Company of Hartford policy contains insuring agreements, terms and conditions which are different from those of the Firemen's Fund Insurance Company policy.

Since the purpose of the National Fire Insurance Company policy is to participate in all losses, on a percentage basis, which are insured by the Firemen's Fund policy, the insuring agreements, terms and conditions of each policy must be identical.

The City's insurance broker, Mr. Harold Weiner, is aware of this situation and has requested National Fire Insurance Company to issue a corrected policy form.

Recommendation

- o Add coverage for the increased time to rebuild damaged or destroyed property due to the operation of building laws.

Discussion

The City's blanket property policies have been amended to include coverage for additional costs which are necessary to comply with changes in building code requirements. Because such changes may also extend the time period which would normally be required to repair or replace damaged property, coverage should be added for any increase in extra expense or business interruption loss during this time period.

The addition of the coverage may result in a nominal additional premium charge.

Recommendation

- o Add a "joint loss agreement" to the City's property insurance policies and to the boiler and machinery policy.

Discussion

Sometimes it is difficult to determine if a particular loss is insured by a property insurance policy or by a boiler and machinery insurance policy. When such a loss occurs, it is not uncommon for the property insurer and the boiler and machinery insurer to each deny liability. The result is that the insured must pay for the damage and sue each insurer.

To reduce the possibility that such an event will occur, a "joint loss agreement" (see Exhibit I) should be added to the property policies and to the boiler and machinery policy.

Recommendation

- o Amend each policy to designate the loss adjustment firm which the insurers must use in the event of a loss.

Discussion

Since each loss adjustment will involve two insurance companies, an attempt should be made to have each insurance company agree upon a single loss adjustment firm prior to any loss occurrence.

Also, selection of a competent loss adjustor can have a significant impact upon the outcome of a loss settlement.

Based on our experience with other clients, we recommend an adjusting firm of the caliber of Graham Miller, Inc. or Toplis & Harding.

Recommendation

- o Amend the appraisal provision of each policy to require that appraisers separately determine questions of fact and questions of law.

JOINT LOSS AGREEMENT

In consideration of the mutual covenants and conditions herein contained, _____, hereinafter referred to as the Insured, and _____, and _____ agree:

- 1. That if the Insured suffers a loss which both the undersigned companies agree is insured in whole or in part under their respective policies of insurance, and
- 2. Further agree with the Insured in writing as to the total amount of loss payable under both parties, and
- 3. The insurance companies do not agree on the amount of such insured loss each insurance company shall pay,

such loss shall be settled by payment of the full amount thereof to the Insured, each Company to contribute the sum for which it admits liability, plus an amount equal to one-half (½) of the amount of loss that is in disagreement.

The Insured will cooperate in furnishing information and technical data as may be required by the insurance companies in order that they may determine, by such steps as they may select, the final apportionment of the loss between such companies.

This Agreement shall become effective on _____ and shall continue until cancelled by either insurance company on 30 days' written notice to the other company, and the Insured, or until the insurance in either company under present or replacement policies is terminated.

PROPERTY INSURANCE
Policy No. _____

By: _____
(Official) (Title)

BOILER & MACHINERY INSURANCE
Policy No. _____

By: _____
(Official) (Title)

Discussion

In an appraisal procedure, the appraisers are supposed to determine only the amount of the loss, not make a legal interpretation of any provision of the insurance policy.

In practice, appraisers frequently make such a legal interpretation.

Once made, the decision of the appraisers is difficult to overturn in a court of law.

To correct this situation, the "appraisal" provision of each policy should be amended to specifically require appraisers to separately determine questions of fact from questions of law. Also, each policy should state specifically that interpretations concerning questions of law can be appealed through the judicial process. A suggested wording is:

"The appraiser shall determine the matter in dispute, but in the event there is a disputed question of law involved, such as the proper legal interpretation of any provision of this policy, the appraisers shall make a separate and distinct determination of all of the facts material to the determination of the issue to be decided, and, on the basis of the facts so determined, shall also determine the question of law.

"The determination of questions of fact by the appraisers hereunder shall be conclusive and binding upon the parties hereto, but any legal conclusion reached by the appraisers from facts so determined may be submitted by either party to a court of competent jurisdiction for final determination in the manner provided by law, provided an appropriate legal action is commenced within 90 days after receipt of the appraiser's written decision by such party. If no further legal action is commenced within such period, the legal conclusion reached by the appraisers shall be conclusive and binding on the parties. In the event any such court determination is sought, it will be submitted, heard and determined solely on the basis of the facts determined by the appraisers, and neither party shall be entitled to submit any additional or different facts for consideration by the court."

B. MOBILE EQUIPMENT AND OTHER VEHICLES

1. Exposures

Except for an increase in total values from \$14 million to approximately \$20 million, the City's loss exposure from damage to or destruction of mobile equipment and other vehicles is basically unchanged since our 1981 report.

2. Current Insurance Program

Insurance coverage for damage to or destruction of mobile equipment and other vehicles owned, rented or borrowed by the City, is provided under an insurance policy written by Insurance Company of North America. The policy affords a \$20 million limit for owned, rented or borrowed machinery and equipment which has been reported to the insurance company and a \$5 million limit for newly purchased, rented or borrowed machinery and equipment. A deductible of \$25,000 applies to each claim for loss or damage. If the aggregate deductible amount reaches \$100,000 during the policy year, no further deductible applies.

Coverage applies for loss caused by the following named perils.: fire and lightning, windstorm or hail, collapse of bridges or culverts, explosion, collision, upset or overturn of equipment, strikes, riots and civil commotion, earthquake, landslide or flood, aircraft and objects falling therefrom, vandalism and malicious mischief, and theft.

3. Recommended Coverage Improvements

Recommendation

- o Amend policy coverage to apply on an "all risks" basis in lieu of the current "named perils" basis.

Discussion

The policy affords coverage only for specific perils, which are named on the policy.

While the list of perils includes most common loss sources, the burden of proving that a loss was caused by one of the perils named rests with the City. If, instead, coverage were written on an "all risks" basis, the burden of proving that a loss was not covered by the policy shifts to the insurance company.

Though all risk coverage may be slightly more expensive than named perils coverage, the cost differential is justified, based on our experience, by the difference in placement of the burden of proof.

C. CROCKER ART MUSEUM

1. Exposures

Except for changes in value, the museum's exposure to loss is basically unchanged since our report in 1981.

2. Current Insurance Program

The Crocker Art Museum purchases museum insurance coverage from the Los Angeles office of Fred S. James & Company. The coverage is placed with several insurers, and is tailored to museum risks. It insures against all risks of loss with very few exclusions and includes both domestic and international transit exposure.

3. Recommended Coverage Improvements

The current insurance program affords a broad coverage scope. We have no recommendations for further improvements.

D. HISTORY MUSEUM**1. Exposures**

The History Museum, located in old Sacramento, represents a new exposure.

2. Current Insurance Program

Insurance coverage for the Museum's historical collections is provided under a policy purchased from the Los Angeles office of Fred S. James & Company. The coverage, underwritten by underwriters at Lloyd's London and The Institute of London Underwriters Companies, is tailored to museum risks. It insures against all risks of loss with very few exclusions and includes both domestic and international transit exposures.

3. Recommended Coverage Improvements

The current insurance program affords a broad coverage scope. We have no recommendations for further improvements.

E. BOILER AND MACHINERY**1. Exposures**

The City's exposure to loss from boiler and machinery objects has not changed significantly since our 1981 audit report.

2. Current Insurance Program

The City's insurance coverage for boiler and machinery accidents has been increased from \$1 million per accident to \$2 million per accident, subject to a \$500 per accident deductible. Coverage for additional expenses to expedite repairs has been increased from \$1,000 to \$25,000. The classes of objects insured has been amended to include "portable air tanks in the State of California."

3. Recommended Coverage Improvements

Recommendation

- o Amend the definition of "accident" to read "any sudden and accidental damage to an object, or part thereof, that necessitates repair or replacement of the object, or part thereof . . ." in lieu of the current definition which states that an "accident" means "a sudden and accidental breakdown of the object, or part thereof, which manifests itself at the time of its occurrence by physical damage to the object that necessitates repair or replacement of the object, or part thereof . . ."

Discussion

The City's boiler and machinery policy affords coverage for losses caused by "accidents." "Accident" is defined as follows:

"Accidents shall mean a sudden and accidental breakdown of the Object, or a part thereof, which manifests itself at the time of its occurrence by physical damage to the Object that necessitates repair or replacement of the Object, or part thereof . . ." (Emphasis added)

The words underlined in the above definition can result in coverage problems. For example, the key word "breakdown" is not defined in the policy, but the dictionary defines it as "a failure to function." Suppose the boiler or other machinery is damaged enough to require extensive repairs, but does not "fail to function." Or, suppose the damage to the object does not manifest itself at the time of its occurrence, but is discovered later by ultrasonic testing. The current definition would not afford coverage for either situation.

To avoid these problems, the insurer should substitute the following definition of "accident":

"Accident shall mean any sudden and accidental damage to an Object, or part thereof, that necessitates repair or replacement of the Object, or part thereof . . ." (Emphasis added)

Most boiler and machinery insurers will substitute the alternate definition at no additional cost.

Recommendation

- o Consider amending the policy to a "comprehensive" form in lieu of the current form which provides coverage only for specifically described object groups.

Discussion

The City's boiler and machinery coverage currently applies only to three classes of objects:

- o Boilers, fired coil water heaters and electric steam generators;
- o Metal unfired pressure vessels which are permanently located on the premises of the insured; and
- o Portable air tanks in the State of California.

Coverage does not apply to many types of objects to which the City may be exposed to loss. For example, no coverage is afforded for miscellaneous electrical apparatus, such as electric control panels, or for the pumps at the City's water treatment plant.

One solution to this situation would be to expand the list of covered objects. A better solution may be to amend the policy to a "comprehensive" form. That form would cover all types of boiler and machinery objects without identifying each specific type. While the cost for such a form is higher than the cost for forms which are limited to specific types of objects, the cost can be contained through acceptance of a higher deductible, such as \$5,000 or \$10,000.

The City should request a premium quotation for a "comprehensive" form and compare it to the cost of its current coverage. If the cost differential is minimal, the City should purchase the broader form.

Recommendation

- o Add a "joint loss clause" to the boiler and machinery policy.

Discussion

See Discussion under section A above.

F. CRIME

1. Exposures

The City's exposures to crime loss remain basically unchanged since our 1981 audit.

2. Current Insurance Program

The City's crime insurance coverage also remains basically unchanged from 1981. All City employees, except the Treasurer and the Assistant Treasurer, are insured under faithful performance bonds in the amount of \$100,000. The limit for the Treasurer and the Assistant Treasurer is \$200,000.

Recommendation

- o Purchase the minimum limit of faithful performance coverage required by law. Purchase excess employee dishonesty coverage with limits of at least \$5 million.

Discussion

Faithful performance coverage is generally more expensive than employee dishonesty coverage. Also, many insurers are reluctant to afford high limits of liability for such coverage.

Therefore, to obtain the high liability limits necessary to afford adequate coverage for losses caused by dishonest acts of employees and officials, the City should purchase faithful performance coverage only for the amount required by law for certain City officials. Coverage for all other employees, and excess coverage for the City officials who are required to provide faithful performance bonds, should

be written on a dishonesty form. Selection of an adequate limit for that form is difficult because losses usually occur over an extended time period. We are aware of no current guideline for establishing an adequate limit. However, based on our experience, we recommend a limit of at least \$5 million.

Recommendation

- o Purchase depositors' forgery coverage in the same amount as employee dishonesty coverage.

Discussion

Depositors' forgery coverage provides protection against forgery of City checks by non-employees. However, many such losses involve collusion by employees. Unless the involvement of an employee can be proven to the insurer, the bonding company normally will only reimburse the insured for the amount of the depositor's forgery limit. If that limit is the same as the limit for employee dishonesty coverage, the difficulty of proving involvement of an employee disappears.

IV. LIABILITY RISKS

IV. LIABILITY RISKS

A. AUTOMOBILE LIABILITY, GENERAL LIABILITY AND ERRORS AND OMISSIONS LIABILITY

1. Exposures

The City is exposed to legal liability losses arising out of the use of automobiles by City employees, hazards emanating from City owned or leased premises, the existence and maintenance of streets and sidewalks, errors and omissions by City employees and various other exposures.

The City's maximum exposure from such losses is not possible to estimate since it depends upon the nature of the accident, the number of persons injured and the outcome of a trial. Awards in such trials, as well as in out of court settlements, have shown significant increases during the past few years. Often, multi-million dollar amounts are awarded to a single claimant. Awards to multiple claimants due to a single occurrence can be catastrophic.

2. Current Insurance Program

The City currently self-insures the first \$1 million of each loss occurrence arising out of automobile liability, general liability or errors and omissions liability. Excess policies, written by various insurers, provide total limits of \$50 million excess of the City's retained limit. (See Exhibit 2)

3. Recommended Coverage Improvements

We have previously reviewed and commented on the City's first excess layer liability policy, written by Industrial Underwriters Insurance Company. The following recommendations, if implemented, will further broaden the City's liability coverage. Many of the recommendations may not be possible to implement during the current policy period, due to current conditions in the insurance marketplace. However, long-term, the City may be able to implement them.

Exhibit 2EXCESS LIABILITY INSURANCE SCHEDULE

<u>INSURER</u>	<u>LIMITS OF LIABILITY</u>
<u>Layer 1</u>	
Industrial Underwriters Insurance Company	\$10 million xs \$1 million SIR
<u>Layer 2</u>	
American Centennial Insurance Company	\$5 million p/o \$10 million
Midland Insurance Company	\$5 million p/o \$10 million xs \$11 million
<u>Layer 3</u>	
Chicago Insurance Company	\$10 million p/o \$30 million xs \$21 million
Midland Insurance Company	\$15 million p/o \$30 million xs \$21 million
Western Employers Insurance Company Insurance Company	\$5 million p/o \$30 million xs \$21 million

a. All Excess Layers

Recommendation

- o Amend the Named Insured on each policy to include "any and all Boards, Commissions, Authorities and Districts under the jurisdiction of the City of Sacramento and/or the City Council." Submit proposed wording to the City Attorney for review before use.

Discussion

The "Named Insured" is limited now to the "City of Sacramento." "Commissions," and "Boards" are included within the first excess policy's definition of "Insured," but are not shown as "Named Insureds."

The difference between "Named Insured" and "Insured" is that the policies afford somewhat less coverage to "Insureds" than to "Named Insureds." For example, coverage for owned and hired automobiles applies only if the automobile is owned by or hired by the "Named Insured."

To afford the same protection to City Commissions, Boards, or Authorities as is afforded to the City itself, the "Named Insured" should be amended to include such entities. A suggested wording is:

"The City of Sacramento, and any and all Commissions, Boards, Districts and Authorities operated by or under the jurisdiction of the City of Sacramento and/or the City Council, or for which the members of the City Council function as the governing body."

This suggested wording should be reviewed by the City Attorney before use.

b. All Excess Layers, Except First Layer

Recommendation

- o Amend each excess policy to state that it will follow the insuring agreements, terms and conditions of the City's first layer excess policy.

Discussion

Maintaining coverage uniformity through the excess layer policies is necessary to avoid disputes among insurers and resultant costly litigation.

Though most excess liability forms contain wording to the effect that the policy is subject to the same insuring agreements, terms and conditions as the underlying insurance policy, they usually include the additional statement "except as otherwise provided herein."

The additional statement is unacceptable because the terms and conditions of the excess policy frequently conflict with the terms and conditions of the underlying policy. The resulting coverage conflict often must be resolved in court.

To avoid this situation, each excess policy should be endorsed to state clearly that it follows the insuring agreements, terms and conditions of the first excess policy.

A suggested wording is:

"It is agreed that, except in regard to the premium and the limits of liability, this policy shall follow the insuring agreements, terms and conditions of Industrial Underwriters Insurance Company, Policy Number JL884-3506, including all renewals and rewrites thereof."

The recommended endorsement should result in no additional cost.

c. Layer 1 - Industrial Underwriters Insurance Company

Recommendation

- o Amend policy Condition B, Insured's Duties in the Event of Occurrence Claim or Suit, to require notice of loss as soon as practicable following knowledge of a loss by the City's Risk Manager, in lieu of the current requirement for immediate notification.

Discussion

Policy Condition B, Insured's Duties in the Event of Occurrence, Claim or Suit, currently requires the City to "immediately advise the Company of any occurrence which appears likely to exceed \$250,000 . . ."

Such a requirement often leads to disputes with the insurance company over what constitutes "knowledge of a loss" or what constitutes an "immediate report." Though the courts usually adopt a liberal attitude in such matters, the need for litigation can be greatly reduced by amending the policy wording to require that knowledge of a reportable claim must first be had by the City's Risk Manager and that his obligation is to provide the insurance company with notice as soon as practicable. A suggested wording is as follows:

"The Insured's Risk Manager shall, as soon as practicable, advise the Company of any occurrence which appears likely to exceed \$250,000 . . ."

The suggested wording should be reviewed by the City attorney prior to submission to the insurance company.

d. Layer 2 - Midland Insurance Company & American Centennial Insurance Company

Recommendation

- o Amend policy Condition 8, Notice of Loss, on the American Centennial Insurance Company policy, to require that the City notify the insurance company of potential loss as soon as practicable upon knowledge by the City's risk manager that the loss may involve the Company, in lieu of the current requirement for immediate notice.

Discussion

As discussed above, the requirement that the City provide immediate notice of loss to the insurance company often leads to unnecessary disputes. Instead, the policy should be amended to require notice of loss as soon as practicable upon knowledge by the City's risk manager that the loss is likely to involve the American Centennial policy.

Recommendation

- o Delete the provision from the Midland Insurance Company policy which states that coverage under the policy terminates automatically upon termination of coverage under the immediate underlying policy.

Discussion

Section III, Maintenance of Underlying Insurance, of the Midland Insurance Company policy includes the following statement:

"In the event of cancellation or nonrenewal of the underlying insurance immediately preceding this policy, either by the Insured or by the issuer thereof, this policy shall terminate as of the same date without notice to the Insured, and the Insured waives any right of notice of such termination."

The provision is onerous, as loss of one coverage layer automatically jeopardizes another coverage layer. The policy should state only that in the event of cancellation of the underlying coverage, the coverage afforded by it shall apply in the same manner as if underlying insurance were maintained.

e. Layer 3 - Chicago Insurance Company, Midland Insurance Company and Western Employers Insurance Company

We have not received a copy of the Western Employers policy. Therefore, the analysis which follows is limited to the Chicago Insurance Company policy and the Midland Insurance Company policy.

Recommendation

- o Delete policy Condition 1, Prior Excess Insurance and Non-cumulation of Liability, from the Chicago Insurance Company policy.

Discussion

Policy Condition 1, Prior Excess Insurance and Non-cumulation of Liability, on the Chicago Insurance Company policy, states that "if any loss . . . is also covered in whole or in part under any other excess policy issued to (the City) prior to the inception date hereof, the limit of liability hereon . . . shall be reduced by any amounts due to (the City) on account of such loss under such prior excess insurance."

The effect of the endorsement is to reduce the limit of liability by the amount available to the City under any applicable insurance in effect prior to the Chicago policy's inception date. Since the City has paid a premium for the full coverage limits, the restriction is unfair. Many umbrella policies are available which do not have such a restriction. Therefore, an attempt should be made to delete the restriction from the policy. If agreed to by the insurer, the amendment should result in no additional cost.

Recommendation

- o Amend policy Condition 2, Maintenance of Underlying Umbrella Insurance, on the Chicago Insurance Company policy to state that failure of the City to maintain underlying insurance shall not invalidate the coverage afforded by the Chicago Insurance Company policy, but that coverage shall apply as if underlying insurance were so maintained.

Discussion

Policy Condition 2, Maintenance of Underlying Umbrella Insurance, on the Chicago Insurance Company policy states, "it is a condition of this policy that the Underlying Umbrella Policies shall be maintained in full effect during the currency hereof . . ."

Such an absolute requirement is unusually harsh. Instead, the excess policy should be amended to state that it shall apply in the same manner as if the underlying policies were in effect.

Many excess umbrella policies, including other policies purchased by the City, include wording similar to the following:

"Failure of the Insured to maintain underlying insurance policies shall not invalidate this policy, but in the event of such failure, the Company shall be liable only to the extent that it would have been liable had the Insured complied therewith."

The recommended change should result in no additional cost.

Recommendation

- o Delete the provision from the Midland Insurance Company policy which states that coverage under the policy terminates automatically upon termination of coverage under the immediate underlying policy.

Discussion

As discussed above with regard to Layer 2, the provision is onerous. The policy should state only that in the event of cancellation of the underlying coverage, the coverage afforded by it shall apply in the same manner as if underlying insurance were maintained.

B. ENVIRONMENTAL IMPAIRMENT LIABILITY

1. Exposures

The City has many exposures to environmental impairment liability, such as the operation of landfill sites, the storage and disposal of wastewater, the storage and disposal of solvents, and the storage and use of pesticides. The City employees we interviewed demonstrated an acute awareness of these exposures and, based on our discussions, appear to be taking appropriate action to eliminate or minimize the exposures. The City does not own or operate any hazardous waste disposal facilities; nor does the City issue permits for any such facilities within City limits.

2. Current Insurance Program

The City's liability insurance program affords coverage for liability arising out of pollution, providing the discharge is sudden and accidental. The program does not cover loss or damage arising out of gradual pollution, such as leachates from the City's sanitary fill sites.

3. Recommended Coverage Improvements

Until recently, the commercial insurance marketplace has provided some coverage forms for gradual pollution. However, few policies were sold due to:

1. The coverages' relatively high cost.
2. The presence of certain troublesome exclusions.
3. Insurer's requirements for detailed application and engineering inspections, which had to be funded by the insured.

Recent changes in the liability insurance marketplace have resulted in such coverage being almost nonexistent. We are aware of only two insurers currently writing this coverage, and only with relatively low limits. We do not foresee that this situation will change in the near future. Therefore, the City should do everything possible to minimize its pollution exposures through loss control measures.

CITY OF SACRAMENTO

RISK MANAGEMENT COMMITTEE'S RESPONSE
TO THE RISK MANAGEMENT AUDIT RECOMMENDATIONS

NOTE: SEE SECTION II, PAGES 3 AND 4

Recommendation 1: Delete the requirement on the City's blanket property policies that property be "repaired, rebuilt or replaced on the same premises" in order to recover its replacement cost.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

Recommendation 2: Amend the insuring agreements, terms and conditions of the National Fire Insurance Company of Hartford Policy to match those of the Fireman's Fund Insurance Company policy.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

Recommendation 3: Amend the blanket property policies to add coverage for the increased time to rebuild damaged or destroyed property due to the operation of building laws.

Committee Response: The committee has directed the broker to price these changes as an option at the time of policy renewal to determine what the increased premium of this option would cost.

Recommendation 4: Add a "joint loss agreement" to the City's Property insurance policies and to the boiler and machinery policy.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

Recommendation 5: Amend each property policy to designate the loss adjustment firm which the insurers must use in the event of a loss.

Committee Response: The committee concurs and has directed the broker, Corroon & Black/James Burpo, to request the amendment.

Recommendation 6: Amend the appraisal provision of each property policy to require that appraisers separately determine questions of fact and questions of law.

Committee Response: The committee has directed the broker to price these changes as an option at the time of policy renewal to determine what the increased premium of this option would cost.

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Recommendation 7: Amend coverage on the City's mobile equipment policy to apply on an "all risks" basis in lieu of the current "named perils" basis.

Committee Response: The committee has directed the broker to secure quotes on an "all risks" basis in addition to the current "named perils" basis for the mobile equipment policy at the time of policy renewal. The committee will decide then which configuration will be the most effective coverage considering overall price differentials.

Recommendation 8: Amend the definition of "accident" on the boiler and machinery policy to read "any sudden and accidental damage to an object, or part thereof, that necessitates repair or replacement of the object, or part thereof..." in lieu of the current definition which states that an "accident" means "a sudden and accidental breakdown of the object, or part thereof, which manifests itself at the time of its occurrence by physical damage to the object that necessitates repair or replacement of the object, or part thereof..."

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

Recommendation 9: Consider amending the boiler and machinery policy to a "comprehensive" form in lieu of the current form which provides coverage only for specifically described object groups.

Committee Response: The committee has directed the broker to price these changes as an option at the time of policy renewal to determine what the increased premium of this option would cost.

Recommendation 10: Add a "joint loss clause" to the boiler and machinery policy.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

Recommendation 11: Purchase the minimum limit of "faithful performance" coverage required by law. Purchase excess employee dishonesty coverage with limits of at least \$5 million.

Committee Response: Committee concurs and has directed the broker Corroon & Black/James Burpo to get quotes for minimum limit of "faithful performance" coverage as required by law. To also get quotes for excess employee dishonesty coverage with limits of \$1 million and \$5 million.

Recommendation 12: Purchase depositors' forgery coverage in the same amount as employee dishonesty coverage.

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Recommendation 12-Continued

Committee Response: Committee concurs and has directed the broker Corroon & Black/James Burpo to get quotes for depositors forgery coverage in the same amounts as employee dishonesty coverage. (i.e. \$1 million and \$5 million)

Recommendation 13: Amend the Named Insured on each liability policy to include "any and all Boards, Commissions, Authorities and Districts under the jurisdiction of the City of Sacramento and/or the City Council." Submit proposed wording to the City Attorney for review before use.

Committee Response: The committee concurs and has directed the broker to check with the City Attorney at time of renewal for proposed wording change.

Recommendation 14: Amend each excess liability policy to state that it will follow the insuring agreements, terms and conditions of the City's first layer excess policy.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

Recommendation 15: Amend policy Condition B, Insured's Duties in the Event of Occurrence Claim or Suit, on the Industrial Underwriter's policy to require notice of loss as soon as practicable following knowledge of a loss by the City's Risk Manager, in lieu of the current requirement for immediate notification.

Committee Response: The committee has directed the broker to include this change at the time of policy renewal.

Recommendation 16: Amend policy Condition 8, Notice of Loss, on the American Centennial Insurance Company policy, to require that the City notify the insurance company of potential loss as soon as practicable upon knowledge by the City's risk manager that the loss may involve the Company, in lieu of the current requirement for immediate notice.

Committee Response: The committee has directed the broker to include this change at the time of policy renewal.

Recommendation 17: Delete the provision from the Midland Insurance Company policy which states that coverage under the policy terminates automatically upon termination of coverage under the immediate underlying policy.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

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Recommendation 18: Delete policy Condition 1, Prior Excess Insurance and Non-cumulation of Liability, from the Chicago Insurance Company policy.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

Recommendation 19: Amend policy Condition 2, Maintenance of Underlying Umbrella Insurance, on the Chicago Insurance Company policy to state that failure of the City to maintain underlying insurance shall not invalidate the coverage afforded by the Chicago Insurance Company policy, but that coverage shall apply as if underlying insurance were so maintained.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.

Recommendation 20: Delete the provision from the Midland Insurance Company policy which states that coverage under the policy terminates automatically upon termination of coverage under the immediate underlying policy.

Committee Response: The committee concurs and has directed the broker Corroon & Black/James Burpo to request the amendment.