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ALASKA POWER AUTHORITY

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February 16, 1983

Honorable Richard I. Eliason
Senator
State Capitol
Pouch V
Juneau, Alaska 99811

Dear Senator Eliason:

Per your request, I am enclosing a draft copy of a preliminary report on Tyee Project Wrap Up Insurance Program by our Risk Management Consultant, Mr. Dan McCarthy. We had a meeting with the State Risk Manager, Mr. John Haywood and the State's Broker, Mr. Dave Carlson to request additional information. Since this meeting, we have not as yet, received any additional information and, therefore cannot complete our report.

Also, enclosed is a short report on the pros and cons of insurance in general. I specifically requested our risk manager consultant to be as brief as possible.

Sincerely,

Raymond J. Benish

Raymond J. Benish
Director of Finance

Enclosures: as stated

RJB/[illegible]

cc: Commissioner Dick Lyon

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ALASKA POWER AUTHORITY

DRAFT

Report the Wrap-up Insurance Program for the Tyee Lake Project.

(Item 3 of Assignment II)

This report will analyze the various components of this Wrap-up Insurance Program and attempt to comment on its value in terms of its components and in financial terms.

A separate comment regarding cancellation of the Program will be made, as well as a suggested audit system.

The components include:

DRAFT

1.- Analysis of the various Pac Mar insurance policies.

2.- Analysis of the "rating" plans for Workers' Compensation and General Liability.

3.- Comment on the various contracts with the broker, the carrier and related fees.

4.- Comment on the system of separate service contracts for safety, loss reporting and claims handling and claims supervision.

5.- Comment on the selection of carrier and its reinsurance for this project; comment on the choice of Pac Mar as the carrier, dealing primarily with the class of business in which it is engaged, its domicile and the services rendered the Project.

DRAFT

General Comment:

The contract with Scott Wetzel Services for safety engineering and loss reporting and the contract with Shepard & Associates for claims supervision of loss adjusting by Pac Mar have now been made available. Let me hasten to add that I had not specifically requested these, believing they would be made available along with the other materials specifically requested to aid in this effort.

Also, not available at this time is the specific request of Pac Mar for the contractor payroll reporting system and the periodic calculations of contractor and over-all lost ratios. Copies of several invoices were provided. (These are forthcoming per Dave Carlson's letter of December 10, 1982, but not yet received).

DRAFT

As I understand matters, the genesis of this wrap-up program is the agreement between State Risk Management and the Alaska Power Authority.

Risk Management in turn arranged for broker services employing the joint venture of Marsh & McLennand and Corroon & Black / Dawson, in a contract between the joint venture and the Alaska Power Authority, contract number CC08-2307.

These brokers were engaged in the premise that State Risk Management had recently undergone a "broker selection process" resulting in the selection of these brokers, not only for other State insurance matters, but also for the Tyee Project Wrap-up Program.

M+Mc/C+B

The joint venture adopted the acronym (APCOP) meaning Alaska Power Construction Program.

Item 1 - Analysis of Worker's Compensation Insurance Policies (W/C). Issued by Pacific Marine Insurance Company of Alaska

Separate Standard W/C Policies have been issued to each contractor and subcontractor performing work at the site and contracted all necessary extensions of coverage including "offshore" exposures and a three year Retrospective Rating Plan "D". (This will be discussed under item-2, following.)

Four W/C Policies have been provided for review as representive of all such policies issued. These are:

Harrison Western Corporation/Southeast Drilling Co.
Mitsui and Co. (U.S.A.), Inc. and D.W. Close Company, Inc.
Power City Construction, Inc. & Power Constructors, Inc., Power Two.
Alaska Power Authority. This policy was subsequently cancelled "flat", ie without a premium charge.

At this time there were 21 W/C Policies issued, with 17 remaining in force. Each policy is numbered sequentially.

In addition to the policy written for APA, one other was cancelled "flat" for an unknown reason. Two policies were written for a "short term", ie to completion of the contractor's work.

All policies appropriately provide for each insured's own appropriate work classifications and experience rating modification to be used in premium calculations. Final, total premium for insured is based upon audited payroll for this project.

The three policies received for review provide statutory W/C limits and a $100,000 limit for Employer's Liability. The Maritime limit provided is $500,000.

Item 1 - (Continued)

Depending upon each insured's operations/exposures, these limits may be inadequate. It is possible that the Excess General Liability Insurance provides protection excess these limits. A review of the evidence of insurance for "Subscription Policy" number SOAMC-1982-APA-1 does not confirm this possibility. This evidence indicates that a $35,000,000 limit is provided including Worker's Compensation Insurance; however, there is no evidence in this form that Employer's Liability and Maritime Insurance is included.

This task could have been made easier if a complete schedule and description of insurance was provided showing primary and excess layers. Copies of various materials were voluntarily provided by Mr. Haywood, others were specifically requested; most were received.

It was my belief that upon receipt of these policies, systems, agreements, etc., that I could properly analyze them for this report. But I find that certain assumptions must be made at this time in order to complete this assignment on any kind of timely basis.

I shall make additional inquiries of Dave Carlson regarding these assumptions and supplement this report at a later date.

Worker's Compensation is a straight forward kind of insurance. The review of the sample policies found no inadequacies except for the possible rather low limit of liability for Employer's Liability and Maritime Coverages which will be investigated further.

Does this put State in vulnerable position?

Item 1 (a) - Analysis of General Liability Insurance, Issued by Pacific Marine Insurance Company of Alaska.

The named insureds for this protection is State of Alaska/Alaska Power Authority and Prime Contractors and their Subcontractors of all tiers.

This approach is proper and can and should be done for liability insurance for wrap-up projects.

The limit of liability is $500,000 Combined Single Limit for Bodily Injury and Property Damage. The limit is per "occurrence" and in the "aggregate". There is a $5,000 deductible applied to Property Damage classes.

Premium is based upon audited payroll for the project for insured contractors and subcontractors. Advance premium of $35,000 is required.

Policy provisions include:

Broad Form General Liability Extension, which provides improved Contractual Liability protection; Personal Injury and Advertising, Incidental Medical Malpractice Insurance among other broadening features such as Premises Medical Payments Coverage. As with the W/C Policies, final premium is subject to the Retrospective Rating Plan 'D' provision.

Although this policy can be considered adequate, there is nothing special concerning it. It could have been broadened in several additional ways, but probably thought to be unnecessary following exposure analysis.

There is a Subscription Policy in affect providing $35,000,000 per occurrence of protection for both Bodily Injury and Property Damage Liability. The subscribing companies are not known. The Evidence of Insurance made available does not indicate if the coverage afforded is "Following Form" or otherwise. It does indicate that it provides W/C Coverages, but it does not indicate that it provides Employer's Liability or Maritime protection.

Item 1 (a) - (Continued)

I am unable to provide Bests Key Ratings because the subscribing companies are not listed in the "Evidence" provided. However, there is a Broker's Warranty indicating that there are insurances in affect in insurance companies totally the indicated limit.

Item 1 (b) - Other Insurance:

Inland and Marine Cargo

Subscription Policy (companies unknown) providing Inland and Ocean Marine Cargo Insurance

Limit is $5,000,000 any one vessel (and presumably any one land conveyance), subject to a $5,000 deductible.

The insureds include State of Alaska/Alaska Power Authority, Prime Contractors and their Subcontractors of all tiers.

Coverage analysis is impossible in view of receipt of the "Evidence" only.

Premium determination is impossible due to lack of information.

As with the W/C, Subscription General Liability inquiry will be made of Dave Carlson of this Subscription Policy for detail to permit adequate analysis.

Broker's Warranty is provided.

Builder's Risk/Course of Construction Insurance.

Subscription Policy (companies unknown) providing property insurance for the construction at Tyee Lake Hydroelectric Project.

Limit is $45,000,000. Phase I - Power Tunnel and Powerhouse. There is no deductible indicated in the "Evidence" provided, although it would be most unusual if there were not one.

The insureds include State of Alaska/Alaska Power Authority, Prime Contractors and their Subcontractors of all tiers.

Item 1 (b) - (Continued)

Coverage analysis is impossible in view of receipt of the "Evidence" only.

Premium is based on value of material on site and constructed value prior to completion. The rate is $.06/$100 of referenced value on an annual basis.

As with the W/C, Subscription General Liability and Subscription Inland & Marine Cargo Policies, inquiry will be made of Dave Carlson for details to provide an analysis of this Subscription Policy.

Broker's Warranty is provided.

Item 2 - Analysis of Retrospective Rating Plan D for Worker's Compensation & General Liability Insurance.

The standard three year "Rating Plan" has been revised to meet the needs of the Project in terms of the length of time the Project is expected to be completed.

Plan Expense Factors

The Plan has been further modified in terms of the applicable Rating Plan factors. These are improvements in factors as follows:

- Loss conversion factor (LCF) is 1.0, ie no loss adjustment charge is made in the plan. This is arranged so as to accomodate a separate loss adjustment agreement between APCOP and Pac Mar, wherein charges for loss adjustment are provided. This contract will be discussed later in this report.

  Normally a LCF in Plan 'D' agreements are a function of the minimum and maximum premium and basic premium factors among other considerations; they can range from a low of about 1.08 to a high of about 1.40 times incurred losses.

State premium taxes are charged under the plan as follows: W/C 1.037 and G/L 1.03 times the developed ratio premium of Basic Premium + (Losses x LCF) x taxes of 1.037 & 1.03.

Losses

The Plan provides for a maximum chargeable loss of $300,000, any one occurrence, combined W/C and G/L. A single W/C loss of $300,000 is chargeable if they are separate and distinct occurrences.

Item 2 - (Continued)

Basic, Standard, Minimum & Maximum Premiums

The Standard Premium is the premium generated for each insured contractor/subcontractor, ie their payrolls times their applicable W/C and G/L rates.

The Basic Premium is established at $150,000.

The Minimum Premium is established at the Basic Premium of $150,000 x the state tax multiplier of 1.037 or 1.03.

How does payment work?

The maximum premium is $150,000 plus incurred losses.

This plan, as most Retrospective Rating Plans, provides for severe penalties in the event the Plan is cancelled prior to the completion of the Tyee Project.

The Plan also provides for agreement for final computation of premium following the completion of the Project.

General Comment:

All the major wrap-up programs with which I have any familiarity utilize a retrospective rating of some kind. The size of the project and therefore the amount of premium along with the broker's ability to negotiate determines the favorable or unfavorable plan factors.

The Tyee Plan factors are generally acceptable. But one must realize that Pac Mar is essentially issuing insurance policies and are compensated per terms of its agreement with APCOP as well as for certain plan costs and receive a premium.

Item 2 - (Continued)

The Tyee Plan contains severe cancellation penalties as well as what amounts to an open maximum premium in that the maximum premium is established at $150,000 plus incurred losses.

While the plan provides for final premium following completion of the Project, it also is conceivable that large amounts of money could be due and payable if severe incurred losses are outstanding at completion of the Project.

The normal maximum premium protection is prevented obviated by this Plan's maximum and final premium provisions.

Item 3 - Comments regarding various contracts/agreements for Services for Tyee Project Wrap-up Program.

The first agreement to be analized is Standard Agreement Forms For Professional Services Contract between Alaska Power Authority and the Joint Venture of Marsh & McLennan, Inc./Carroon and Black/ Dawson & Co., Inc. (APCOP) - number CC08-2307. All other service agreements for the Tyee Project flow from this Agreement.

These are:

- The purchase of various insurances referenced above.
- Agreement with Pacific Marine Insurance Company of Alaska (Pac Mar)
- Agreement with Scott Wetzel Services.
- Professional Services Contract with Pac Mar for claims adjusting.
- Claims Consulting Contract with Shepard and Associates.
- Agreement with Lewison & Associates for technical services.
- Agreement for Data Processing Services No. 210273C with Manus Services Corporation.

APCOP agreement No. CC08-2307

The effective date of this contract is October 1, 1981. There have been three amendments to the contract, since its inception.

The basic contract requires the APCOP Contractor to provide 18 separate services. Some worthy of note in this analysis are items 8, 9, 10 and 15.

Item 8 states that Contractor will provide Project contractors with complete premium and loss summaries on a quarterly basis.

BUT

If this is being done for contractors, it most certainly should be done for APA as part of an accounting and audit program. For the APA, the APCOP should summarize the separate reporting for Project contractors.

Item 3 - (Continued)

what is this??

Item 9 requires the Contractor to provide a safety incentive formula for Project contractors which will include a safety dividend for them. This dividend is due six months following contract expiration.

This formula necessarily ties-in with the retro agreement with Pac Mar and would be affected should the Wrap-up Program be cancelled. It should include the contractors own loss experience but should also be related to over-all Project experience.

Care must be taken in developing such a formula and a preliminary draft should be undertaken as soon as possible for APA's review and approval. This draft should be as precise as possible in terms of the definitions contained in it.

Item 10 relates, implicitly to the entire wrap-up program and particularly to items 8 and 9. Also implicit in this item is the proper selection of insurance companies providing protection to the Project.

Financial integrity also implies that APA be prepared to pay various premiums per Pac Mar contract and the retrospective plan in effect for the Project.

Item 15 of this contract delineates the services which may be subcontracted and include those referenced above; ie, safety, claims adjustment, insurance company selection, etc.

Appendix E of this contract is the appointment of the Brokers as Brokers of Record, allowing them to effecticate the insurances provided in the Tyee Wrap-up.

There is no specific reference to the fees or other compensation to be paid the joint venture under this contract, The APCOP budget prepared for the Tyee Project does not contain a provision for fees or other compensation to the joint venture. The budget for the project provides for total insurance expenditures of $3,784,602, plus certain project related expenses, such as travel expense incurred by Risk Management.

Amendment No. 3 does provide for a payment of $50,000 to Carroon & Black/Dawson for services rendered to August 31, 1982 plus a flat fee of $151,000 to Marsh & McLennan for its services for the term of the Project.

Item 3 - (Continued)

Following execution of its contract, APCOP entered into the various contracts/agreements referenced above.

APCOP also entered into an agreement with Pac Mar setting forth the fees to be paid Pac Mar, certain of its expenses and the establishment of a Trust Account. This will be discussed in the analysis of the Pac Mar agreement following. At this point, I would like merely to raise the question of fees and/or commissions to be earned by APCOP.

It is my understanding from Amendment No. 3 that APCOP receives $151,000 as its fee for services rendered its contract for the term of the Project.

Further I am told APCOP received a brokerage commission (amount unknown) for placement of Pac Mar's (reinsurance) for this Project.

The various W/C Policies are stamped 0% commission. No such stamp appears on the G/L Policy. Nor does the subscription form policies for Inland & Marine Cargo and Builders Risk contain this note.

The budget for the Project provides for reimbursement for certain expenses incurred by the providers of services to the Project.

These questions of fees, commissions and expenses should be fully disclosed in an on-going format. Further the budget should be sufficiently detailed to identify all Project costs and provide for comparison of budget to actual expense incurred. This reporting should be provided at least quarterly and should contain premium and losses by contractor with all applicable expenses relating to insurance cost clearly identified.

Agreement with Pac Mar

This is a most important agreement. I shall attempt to accurately relate the agreement to the retro agreement in detail, particularly in financial terms. This agreement and the retro agreement require payments to Pac Mar for services to be performed by it on behalf of insured contractor and A.P.A.

It provides for certain fees to be paid Pac Mar in addition to certain expenses listed below. It must be considered in conjunction with the retro rating plan discussed earlier. One must have had a complete understanding of the role of Pac Mar in the Project, including what was intended by insurance of this agreement and the retro agreement.

The agreement is dated and effective September 17, 1982 by and between APCOP and Pac Mar.

Before listing payments Pac Mar required under this agreement, one should recall that the retro agreement requires payments to Pac Mar of a Basic Premium of $150,000; also requires payment of premium taxes. It also provides for a minimum and maximum premium.

Payments required under this agreement are:

$100,000 - purpose not identified - but is assumed to be a service fee for engaging in the Tyee Wrap-up Program - PLUS Boards, Bureaus and Commissions Taxes; involvency/Guaranty Funds; assigned risk plan funds.

Normally these fees are charged in the insurance premiums or within the Basic Premium Charge in a Retrospective Plan as an excess loss charges. I find it difficult to understand why Pac Mar chooses to pay these charges under this agreement. It is possible that duplicate charges are invoked, once in the insurance policy and retro agreement and again under this agreement.

These are questions that should be addressed in the proposed audit procedure to be developed.

Agreement with Pac Mar (continued)

It should be noted that Pac Mar is compensated separately for its loss adjustment services.

It should be noted, that per terms of this agreement that Pac Mar receives the investment income on $150,000 required by this agreement to form a Trust Account. The purpose of this account is to pay claims liabilities. Contributions to this account, however, are based on "incurred" claims.

The agreement provides for a "run-off" claims on a 6, 18 and 30 month basis following completion of the Project or July, 1984. Thereafter Pac Mar requires a letter of credit equal to the difference between $150,000 and estimated determined amount of claims to be paid. This done again at 12 months following the first determination and the second and third determinations. Any excess funds in the Trust account, following the third determination are returned to APCOP.

At this important time, Pac Mar assumes all claims liabilities for its own account following agreement amount it, APCOP and insured representative as to the estimated amount needed to pay these possible future liabilities.

The following two aspects of this agreement puzzles me. First, the agreement provides for payment of investment income by Pac Mar to APCOP on amounts in excess $150,000 in the Trust Account. These payments are $20,000 due July 1, 1983 and $20,000 due January 4, 1984. These payments are made in lieu of broker commissions, according to the agreement.

APCOP told me it was to receive $151,000 in fees from the Project, plus broker commission for placement of Pac Mar's Project insurance. Nothing else.

BUT

At best, this arrangement encourages a build-up of funds in the Trust account.

Secondly, according to paragraph 6(a) Pac Mar turns funds over to APCOP which are in excess of $150,000. What happens to the funds, if any, is an unanswered question.

I recommend a meeting with APCOP and APA to pursue a better understanding of this agreement, following which understandings should be reduced to writing.

Agreement with Scott Wetzel Services (SWS)

The agreement is dated June 14, 1982 by and between SWS and APCOP; it became effective, as to work, December 1, 1981.

This is a straightforward agreement providing safety and fire protection engineering services to the Project.

Phase I fees are	$ 46,000
Phase II fees are	12,500
Phase III fees are	19,500
Total fees	$ 78,000

These fees are set forth in amendment to the original contract. The amendment also establishes an expiration date to agreement - November 30, 1984. The copy of the amendment provided was not signed by APCOP.

The safety engineering portion of this contract is often provided by the W/C insurance company. Apparently APCOP believed these services would best be provided by an outside qualified technical organization. Also, apparently Pac Mar may feel its interests are best served by a firm such as S.W.S., although a reference to this effect is absent in the various policies, retro agreements, other documents I have reviewed. This absence of reference may be detrimental to Pac Mar in view of the requirement that W/C carriers are to provide safety engineering services to their insureds. Other arrangements, such as the S.W.S. agreement are acceptable when documented.

But this does make one wonder about the order of magnitude of the fees charged by Pac Mar in its retro and separate agreement with APCOP. Essentially these fees are for the issuance of policies and the providing of a Trust Account and issuance of claims drafts.

Although the agreement references a calendar of visits to the Site, it was not attached to the copy provided me. Assuming a reasonable frequency of site visits and acknowledging S.W.S. technical and practical expertise, the fees appear to be reasonable. A rough estimate of charges for these services, if provided by the W/C insurance company could range from 1/2 of 1% to 1% of total standard premium. This range would approximate S.W.S. fees and I believe S.W.S. services would be superior.

Agreement with Scott Wetzel Services (SWS)
(Continued)

There exists a separate agreement providing data processing services. However, I believe SWS provided at least one loss run. Such a run was given to me during my visit to Marsh & McLennan offices in November.

Professional Services Contract Between Pac Mar and APCOP.

1982(2d) (1983)?

The agreement is dated July 6, 1982, and expires June 30, 1982. It is by and between APCOP and Pac Mar for loss adjusting services. I understand that there was a separate agreement with another loss adjusting firm prior to this contract.

This is a straight forward claims adjusting contract providing needed services in the adjustment of Workers' Compensation and General Liability claims.

The fees are:

Bodily Injury Liability per claim	$310.00
Property Damage Liability per claim	$150.00
W/C Lost Time, including maritime	$310.00
W/C Medical only, including maritime	$ 60.00

The contract also provides for reimbursement of airfare and receipted expenses for lodging, etc.

Settlement authority is $10,000 to be paid from yet another Trust Fund to be established in the amount of $25,000. by the client APCOP.

A question immediately arises concerning the excess funds, if any, paid by A.P.A. per the schedule of payments to APCOP or risk management. Who holds these funds? For whose account are they invested if indeed they are invested?

According to the schedule of payments the following have been paid:

Payments	12/81	$ 540,000.
	7/82	$ 580,000.
	9/82	$ 570,000.
	?	$ 180,000.
Total paid today 10/29/82		$1,860,000.

There remains a balance to be paid of $1,914,602 if the estimate of premiums for the Project is correct.

If A.P.A. has already paid $1,870,000 an audit should be undertaken to determine when and where (to whom) premiums have been paid and/or expenses have been incurred.

At this point we have learned that: Pac Mar should have $150.000 in a Trust account per retro agreement. Pac Mar should have $25,000 in a claims Trust account.

Some premiums have been paid to insurance companies providing:

- Excess Liability Insurance
- Non-owned Aviation Insurance
- Inland & Marine Cargo Insurance
- Builders Risk Insurance

plus

Additionally Pac Mar's estimated premiums for work to date presumably have been paid. But according to the various contracts/agreements reviewed only limited funds are required to date.

Certain claims have been paid. But according to a loss run (provided by S.W.S.) for the period July 1, 1982, to September 30, 1982, the following is recorded:

- Worker's Compensation	- total incurred	$125,614.
- State Property ??	-	$ 43,500.
		$169,114

Of this amount $15,666 has been (recovered) ? leaving a net incurred of $153,448.

One can assume that some earned fees have been paid from funds provided by A.P.A. But the questions arise:

- Which premiums due insurance companies have been paid?
- What total losses have been paid?
- What fees and to whom have been paid?

If we start with $1,870,000 paid by A.P.A., what deductions should be made? What is the remaining balance and when will additional funds ($1,914.602) be due and payable.

The fee schedule, in my opinion, is a liberal schedule. Other schedules have been at about a 1/3 less rate per claim.

For the period reported, i.e. July 1, 1982 to September 30, 1982, there were a total of 23 worker's compensation claims reported. If Pac Mar adjusts all of these claims the fee totals:

Estimated lost time accidents 20 x $310.00	$6,200.00
Estimated medical only accidents 3 x $60.00	180.00
Total fee	$6,380.00

Pac Mar

It is most difficult to estimate the loss conversion factor that could have been negotiated had Pac Mar provided a "conventional" retro program. A conservative LCF however would be 1.10. Charges for claims adjusting would be made 6 months following the term of the Project. A conservative estimate of reserve to paid claims would be 60% of incurred or about $75,400. 1.10 = $82,940.

The present plan costs for these would be $81,780. In the very short term, therefore, the present arrangement is slightly ($1,160.) more favorable.

Certain expenses, travel, lodging, etc. would be absorbed by the insurance company as a cost of doing business.

Recovery of allocated claims expense would be about the same under a conventional retro plan.

On balance, I feel that total costs under this arrangement will be greater than could otherwise have been negotiated.

Claims Consulting Contract

The agreement is dated August 5, 1982 by and between Shepard and Associates and APCOP. It is a continuous contract, until completion of the Project; it may be cancelled upon 90 days notice.

This is a straight forward claims supervision consulting contract relating to claims in excess of $50,000.

The retainer fee is $10,000 for the life of the contract, subject to additional fees for "extraordinary" services which may be required.

It would appear that "normal and prudent expenses" are reimbursable.

Appendix A provides for two (2) trips to Alaska, among other services.

Agreement Regarding Technical Assistance to APCOP.

The agreement is dated November 1, 1982, by and between Lewison and Associates and expires on November 1, 1983.

The essential services to be provided under this contract are:

- "Review of monthly progress reports prepared by construction managers.
- Preparation of reports shall include major construction activity, status of the project and contract costs.
- Provide technical assistance as requested by APCOP services."

The fee is $30.00/hour, plus expenses mutually agreed upon.

The agreement does not spell out what constitutes "technical assistance" other than indicated above.

I have no idea what this amounts to or of its value to APCOP. Information regarding these items could be acquired otherwise through a proper system of communication with the Project.

There is no total value shown in the contract.

Agreement for Data Processing Services

The agreement is dated October 12, 1982, for Manus and October 22, 1982, for APCOP, by and between Manus Services Corporation and APCOP. The term is for 1 year with cancellation provisions of 90 day notice. Automatic 1 year extensions are provided for.

This agreement provides for an EDP system for what appears to be an accounting system.

Exhibit I contains the schedule of services and fees. This exhibit appears to be a boiler plate type of schedule and the agreement does not specifically indicate what services are provided. The headings are for an accounting system and include such items as journal entries, budgets, chart of accounts trial balances, balance sheet, etc.

The monthly fee could range from a low of $35.00 to a high of $195.00 depending upon APCOP's needs.

As with the technical services contract, I find it difficult to understand the need for this contract. It appears APCOP's fee of $151,000 is for that of a general manager and all ancillary services provided through it are on a service by service fee basis.

Item 4 - Comment on the System of Separate Services Contracts.

A wrap-up program can be organized in several ways. Its organization is pretty much a function of its organizer's ingenuity.

There is value in engaging experts in a given discipline under separate contract from the insurance contract, although some insurance companies have highly qualified and experienced people in disciplines such as safety and loss control.

It is my opinion that Pacific Marine Insurance Company probably lacks expertise in certain areas of normally provided services. Hence APCOP entered into the several contracts for services needed for the Tyee wrap-up. There are three observations on this:

- First, the selection of the insurance company. If APCOP had chosen another carrier some of the separate service contracts could have been avoided.

- Secondly, the fees allowed in all cases appear to be extremely liberal increasing costs and results to A.P.A. in APCOP's role being that of a general manager and not a servicing broker for its $151,000 fee.

- Thirdly, this approach results in a very cumbersome program and difficult to understand and in some cases duplicative contract arrangement, again resulting in increased costs to A.P.A.

The Pac Mar insurance retro policy and trust agreements are of particular concern to me for the following reasons:

- For its two separate fees, $150,000 Basic premium and $100,000 Trust fees, Pac Mar essentially issues two pieces of paper, i.e. a policy and a trust agreement.

- Pac Mar earns interest on both accounts for its own account.

- According to the agreement between APCOP and Pac Mar, APCOP is paid a fee or investment income on the trust account on funds excess $150,000. (Dave Carlson denies this).

- APCOP placed specific reinsurance for Pac Mar for this wrap-up program, indicating its capacity limitations. According to Dave Carlson, APCOP received a commission for this placement.

Apart from the above, another concern surfaces, that is the concern for accounting for $1,870,000 referenced earlier in this report. Based on my meager understanding of this program, resulting from reading various documents, there exists the possibility that A.P.A. may have over paid actual incurred premiums and expenses. If this possibility has merit, the question arises, "who holds these funds and for what purpose"? Are they invested? If so, for whose account?

As suggested earlier in this report a meeting should be held to explore all aspects of this program and require full disclosure of all financial aspects of it.

Item 5 - Comment on the Selection of Pacific Marine Insurance Company of Alaska for the Tyee Wrap-up Program.

Presumably Pac Mar was selected as the insurance company for the basic Worker's Compensation and General Liability Insurance because it is an Alaska company. Its headquarters, however, are in Seattle.

The company is a relatively recently formed company having incorporated in August of 1979 and licensed in December 1979.

Paid-in capital was $2,500,000 and surplus was established at $2,500,000, resulting in total capital and surplus of $5,000,000.

It has had exceptional growth in the short time it has been in business. In 1981 it had "net" premium writings of just over $19,000,000 with a loss ratio of 84% and underwriting expense of 19% of net premium income. This combined ratio of 1.03% can be considered exceptional compared to most companies in the casualty business today.

As of December 31, 1981, Pac Mar had total assets of $33,644,677; in-occured liabilities amounted $24,658,505. This according to its audit firm of Pete, Marwick, Mitchell & Co. The 1981 Annual Statement to Insurance Departments reports current assets of $28,345,468 on a statutory basis and total liabilities of $22,584,802. Paid-in capital is unchanged; surplus is $5,023,631 as of December 31, 1981.

The company will be eligible for Bests Key Ratings in 1985.

Its principal business writings are maritime workers' compensation and ocean marine insurance. It is licensed in Alaska. Its "net" line of risk is $100,000 with a gross line of $5,000,000 indicating a prudent amount of reinsurance and a nominal "in-house" retention. It cedes and assumes reinsurance from foreign insurance companies.

Insuring construction projects appears to be unusual for Pac Mar, at least prior to insuring the Tyee Lake Project. Insuring such projects requires more than usual engineering and claims adjusting services.

Pac Mar, one might say, is "in the risk" business as compared to being in both risk and service business, as compared to major casualty insurance companies. These other companies have full time experienced staff in construction safety engineering. Their "net line" retention is far in excess of that of Pac Mar, thus providing in-house capacity and expertise without the need to engage in contracted service for safety engineering, loss adjustment supervision, usable data processing.

According to Bests Guide, premium income in Alaska is second only to California, i.e. approximately $4,700,000. to $7,030,000. This may be because Pac Mar underwrites both maritime and ocean marine risks in greater amounts than other risks.

It would appear, except for the desire to utilize Alaska companies, that another qualified and adequately staffed insurance company could have been chosen to insure this major construction risk.

Comment and Evaluate Possible Cancellation of Tyee Wrap-up Program.

Pac Mar's retro plan provides for severe cancellation penalties i.e. "Short Rate" penalties are applied to "Standard Premium" extended to the estimated completion of the Project.

The retro plan was modified to provide for the terms of the Plan to extend to competion of the Project. Originally the plan was a Three Year Plan "D".

What this means is that the "Standard Premium" becomes the "Minimum Premium" with "Short Rate" penalties applied to this premium.

If the Project required less than three years to complete and the Retro Plan and policy were terminated, there would be no "Short Rate" penalties applied to the "Earned Premium".

If losses were such as to develop a Retro Premium greater than the Standard Premium, the premium would be extended pro rata to the nominal term with Short Rate penalties then applied to that developed premium. Only if the "Maximum Premium" were earned, due to incurred losses, would there not be these penalties applied.

To quantify this in terms of dollars at this time is most difficult if not impossible because audited payroll and premium development is not available; nor are current losses. Additionally there is that separate agreement with Pac Mar establishing a trust fund from which losses are paid.

This latter agreement is silent as respects penalties if cancellations were affected prior to completion of the Project. It only provides for what is known as a "Paid Loss Retro" following completion of the Project.

During the November 8 meeting in Marsh & McLennan's offices, Mr. Jim Helm of that office made available his estimates of the costs to A.P.A. should the program be cancelled.

In a telephone conversation with a member of the Legislative Audit Committee, I reported that I could not agree or disagree with these estimates. I still cannot, although I disagree with the percentage of construction costs used in those estimaes.

Mr. Helm suggests that wrap-up insurance costs are 4.25% of construction costs; that if contractors replaced the wrap-up program the percentage of construction costs would increase to 6.5%.

He also estimated total wrap-up insurance costs at $3,820.000 and if the program were cancelled a 10% penalty would be applied, increasing costs by $382,000.

Does this mean into on wrap-up insurance invalid

The estimate of 4.25% of construction costs is about double the wrap-up costs in the lower 48 States. In the lower 48, these costs are usually less than 2%.

I just can't agree that this estimate is accurate. Estimated cost of the Project is $130,000,000; 4.25% x this cost is $5,525,000.; yet according to APCOP budgets the wrap-up insurance costs are estimated $3,784,602. This figure represents approximately 2.91% of construction costs. The 10% penalty and estimated dollar amount of $382,000 is reasonable and probably correct as far as it goes. But if all phases of the Project are not now under way, I believe the penalty would be less.

BUT

All other services contracts/agreements I reviewed do not provide for short rate penalties.

As to the estimate of 6.5% should contractors provide the insurance I believe is unrealistic. First because majority of the premium is in the Worker's Compensation coverages for which the going-in premiums would be the same. The ending premium is a function of losses and developed retro premium for the Project which could be less or equal contractor premiums. It is true that A.P.A. would probably not benefit from a contractor's retro plan refund, if this were not negotiated into the various contracts.

It appears that as of November 8, a survey of participating contractors relative to this matter was not undertaken. Therefore, it is pure conjecture that additional penalties would be invoked by contractors' insurance companies, particularly in the current market.

Conclusionary Comment.

Although I cannot agree with APCOP in these assumptions and estimates, I believe the wrap-up program should remain in affect until completion of the Project. I hasten to add, however, that extensions of the program should not be made under present conditions.

A new undertaking should be made from start to finish should A.P.A. decide to continue with the wrap-up approach. This includes broker and carrier selection process; a policy of purpose and administration of the program; contract preparation; safety programs; insurance manual; claims handling/processing; medical facilities and services among others required for the proper undertaking and administration of a wrap-up program.

Separate wrap-up programs for separate construction projects is not feasible.

This program lacks proper communication systems, reporting systems; it has a multitude of service contracts. It just isn't meeting the needs of A.P.A. in these terms, but I cannot recommend its termination at this time.

I feel strongly that the audit system to be developed be implemented and the meeting I suggested be held. Among other reasons, the construction contracts should be reviewed; an understanding of how S.W.S. conducts its inspects and contractor contracts should be made. This may be the time also to set minimum safety standards to be in total compliance with all Federal and State Safety Regulations.

Perhaps following this meeting and audit and the establishment of a communication and reporting system all involved will be more comfortable with the Tyee Wrap-up Insurance Program.

AMENDMENT NO. 1

Professional Services Contract
82-0815 CC08-2307

APR - 7 1982
ALASKA POWER AUTHORITY

The contract between the ALASKA POWER AUTHORITY and MARSH & McLENNAN INCORPORATED and CORROON and BLACK/DAWSON & COMPANY INCORPORATED, dated 22 December 1981 is amended as follows:

APPENDIX C Exhibit A, Article 4

Consideration:

Change total contractor premium from $1,790,000.00 to $1,690,000.00 premium discount $100,000.00.

All other terms and conditions remain unchanged.

Executed this 22ND day of MARCH, 1982.

FOR CONTRACTOR:

MARSH & McLENNAN and
CORROON & BLACK/DAWSON & CO. INC.

By: [signature]

Date: March 22, 1982

OWNER:

ALASKA POWER AUTHORITY

By: [signature]
Executive Director

Date: [redacted]

DEPARTMENT OF COMMERCE AND
ECONOMIC DEVELOPMENT

By: _____

Date: _____

APPROVED:

By: [signature]
Department of Administration

Date: APR 0 1 1982

FOR THE CONTRACT REVIEW COMMITTEE

Original Contract	$1,790,000.00
Amendment #1 Premium Discount	-(100,000.00)
New Contract Total	$1,690,000.00

ATN 82-0815
CC 08-2307

AMENDMENT NO. 2

The contract between the ALASKA POWER AUTHORITY and MARSH & MCLENNAN, INC. and CORROON & BLACK/DAWSON & COMPANY INCORPORATED dated December 22, 1981 is hereby amended and agreed to:

APPENDIX C, Article 4 - Delete and substitute the following:

Insurance payments for services provided under this contract shall be specified in written exhibits attached to and made a part of this contract upon agreement of all parties to this contract. Exhibit A (attached) represents consideration for services associated with the major civil construction contract, for the Lake Tyee project, between the Alaska Power Authority and Southeast-Harrison Western. Exhibit B (attached) represents consideration for services associated with the major civil construction contract, for the Lake Tyee project, between the Alaska Power Authority and Mitsui & Company USA Inc. & D. W. Close, Company, Inc. J. V. Exhibit C (attached) represents consideration for services associated with the major civil construction contract, for the Lake Tyee Project, between the Alaska Power Authority and Power City Construction, Inc./Power Constructors, Inc., J. V., dba Power Two.

Subsequent exhibits may be appended to this contract from time to time as required for services provided under this contract associated with subsequent construction contracts or change orders connected with the Lake Tyee Project.

All outstanding insurance payments represented in Exhibits A, B and C will be transferred from the Alaska Power Authority to the Department of Administration, Division of Risk Management through a Reimbursable Services Agreement (RSA). Risk Management will be responsible for administration of this contract including but not limited to payments to the Contractor.

When billing Risk Management, the Contractor shall refer to the contract number and send billing to:

John Haywood
Director
Department of Administration
Division of Risk Management
Pouch C (MS 0218)
Juneau, AK 99811

APPENDIX C Exhibit A

Article 4 - Consideration

Item 3 is deleted.

APPENDIX C Exhibit B

Article 4 - Consideration

1. The State shall pay the Contractor premium in the amount of $598,000. Said premium payments shall constitute full satisfaction and payment for all services performed pursuant to this contract associated with the major civil construction contract for the Lake Tyee Project, between Alaska Power Authority and Mitsui & Company (USA), Inc. and D. W. Close Company, Inc.; A Joint Venture.

2. Schedule of Premium Payments:

$598,000.00	March 1, 1983.

APPENDIX C Exhibit C

Article 4 - Consideration

1. The State shall pay the Contractor premium in the amount of $1,496,602. Said premium payment shall constitute full satisfaction and payment for all services performed pursuant to this contract associated with the major civil construction contract for the Lake Tyee Project between Alaska Power Authority and Power City Construction, Inc./Power Constructors, Inc. A Joint Venture, dba Power Two.

2. Schedule of Premium Payments:

$750,000	August 4, 1982
$746,602	January 1, 1983

FOR CONTRACTOR

MARSH & MCLENNAN AND
CORROON & BLACK/DAWSON & CO., INC.

By: _____
Marsh & McLennan, Inc.

By: _____
Corroon & Black/Dawson & Co., Inc.

Date: August 6, 1982

Original Contract	$1,790,000
Amendment No. 1 Discount	- 100,000
Sub Total	$1,690,000
Amendment No. 2	2,094,602
New Contract Total	$3,784,602

ALASKA POWER AUTHORITY

By: _____
Executive Director

Date: August 11, 1982

APPROVED:

By: _____
Department of Administration

Date: 8/12/82

FOR THE CONTRACT REVIEW COMMITTEE AUG 1 2 10

Henry Master

CERTIFIED MAIL NO. P 272 201 215

December 20, 1982

Mr. John McCadam
Vice President
Special Client Division
Corroon & Black/Dawson & Company
P.O. Box C-34201
Seattle, WA 98124

AND

Mr. David Carlson
Vice President
Marsh and McLennan, Inc.
Norton Building
Seattle, WA 98104

Dear John and Dave:

Re: State of Alaska
Professional Services Contract
#CC 08-2304

This letter of agreement is in lieu of proposed Amendment No. 3 to the Tyee Lake Professional Services Contract.

In consideration of a flat fee of $50,000.00 it is agreed that Corroon & Black's responsibility for services under the referenced professional services contract are limited after December 15, 1982 to marketing broker only, as defined in separate agreement between Corroon and Black and Marsh and McLennan, Inc., as respects course of construction policy number PRP-ST-U-AL-F82 (APA) and aviation non-ownership policy number SOAAV-F82- A (APA).

Corroon & Black is hereby authorized to receive payment up to $50,000.00 less any amount previously received for period ending December 15, 1982. Special assignments outside of the original marketing responsibilities shall be individually negotiated between State of Alaska, Division of Risk Management, Marsh and McLennan, Incorporated and Corroon and Black.

It is agreed that, pursuant to the scope of services under the referenced contract, Marsh and McLennan, Incorporated will assume full responsibility effective December 15, 1982, with the exception of marketing broker service responsibilities as defined in a separate agreement between Marsh and McLennan, Incorporated and Corroon and Black.

As the consideration for performing your proportionate share of services prior to the close of business December 15, 1982 and for services after that date, Marsh and McLennan, Incorporated shall receive a flat fee of $151,000.00 and additional commission income up to $40,000.00.

Marsh and McLennan is hereby authorized to receive payment, subject to the following schedule: November 23, 1982 - $121,000.00; January 1, 1983 - $15,000.00; April 1, 1983 - $15,000.00; July 1, 1983 - $20,000.00; and January 1, 1984 - $20,000.00. The two payments of $20,000.00 are subject to the terms and conditions of the contract between Marsh and McLennan, Incorporated and Pacific Marine Insurance Company dated December 17, 1982.

Sincerely,

John Haywood
Director

JH/je
5/1217-02/RM1

PS Form 3811, Dec. 1980

RETURN RECEIPT, REGISTERED, INSURED A

● SENDER: Complete items 1, 2, 3, and 4.
Add your address in the "RETURN TO" space on reverse.

(CONSULT POSTMASTER FOR FEES)

1. The following service is requested (check one).
   - ☐ Show to whom and date delivered ..... ___¢
   - ☒ Show to whom, date, and address of delivery.. ___¢
2. ☐ RESTRICTED DELIVERY ___¢
   (*The restricted delivery fee is charged in addition to the return receipt fee.*)

TOTAL $_____

3. ARTICLE ADDRESSED TO:
Mr. David Carlson
Marsh & McLennan
Norton Building
Seattle Wa. 98104

4. TYPE OF SERVICE:
☐ REGISTERED ☐ INSURED
☐ CERTIFIED ☐ COD
☐ EXPRESS MAIL

ARTICLE NUMBER
P 272.201.215

(Always obtain signature of addressee or agent)

I have received the article described above.
SIGNATURE ☐ Addressee ☐ Authorized agent

5. DATE OF DELIVERY DEC 22 1982

POSTMARK

6. ADDRESSEE'S ADDRESS (*Only if requested*)

7a. TIME TO DELIVER BECAUSE:

7b. EMPLOYEE'S INITIALS

ATN 82-0815
CC 08-2307

AMENDMENT NO. 2

The contract between the ALASKA POWER AUTHORITY and MARSH & MCLENNAN, INC. and CORROON & BLACK/DAWSON & COMPANY INCORPORATED dated December 22, 1981 is hereby amended and agreed to:

APPENDIX C, Article 4 - Delete and substitute the following:

Insurance payments for services provided under this contract shall be specified in written exhibits attached to and made a part of this contract upon agreement of all parties to this contract. Exhibit A (attached) represents consideration for services associated with the major civil construction contract, for the Lake Tyee project, between the Alaska Power Authority and Southeast-Harrison Western. Exhibit B (attached) represents consideration for services associated with the major civil construction contract, for the Lake Tyee project, between the Alaska Power Authority and Mitsui & Company USA Inc. & D. W. Close, Company, Inc. J. V. Exhibit C (attached) represents consideration for services associated with the major civil construction contract, for the Lake Tyee Project, between the Alaska Power Authority and Power City Construction, Inc./Power Constructors, Inc., J. V., dba Power Two.

Subsequent exhibits may be appended to this contract from time to time as required for services provided under this contract associated with subsequent construction contracts or change orders connected with the Lake Tyee Project.

All outstanding insurance payments represented in Exhibits A, B and C will be transferred from the Alaska Power Authority to the Department of Administration, Division of Risk Management through a Reimbursable Services Agreement (RSA). Risk Management will be responsible for administration of this contract including but not limited to payments to the Contractor.

When billing Risk Management, the Contractor shall refer to the contract number and send billing to:

John Haywood
Director
Department of Administration
Division of Risk Management
Pouch C (MS 0218)
Juneau, AK 99811

APPENDIX C Exhibit A

Article 4 - Consideration

Item 3 is deleted.

APPENDIX C Exhibit B

Article 4 - Consideration

1. The State shall pay the Contractor premium in the amount of $598,000. Said premium payments shall constitute full satisfaction and payment for all services performed pursuant to this contract associated with the major civil construction contract for the Lake Tyee Project, between Alaska Power Authority and Mitsui & Company (USA), Inc. and D. W. Close Company, Inc.; A Joint Venture.

2. Schedule of Premium Payments:

$598,000.00	March 1, 1983.

APPENDIX C Exhibit C

Article 4 - Consideration

1. The State shall pay the Contractor premium in the amount of $1,496,602. Said premium payment shall constitute full satisfaction and payment for all services performed pursuant to this contract associated with the major civil construction contract for the Lake Tyee Project between Alaska Power Authority and Power City Construction, Inc./Power Constructors, Inc. A Joint Venture, dba Power Two.

2. Schedule of Premium Payments:

$750,000	August 4, 1982
$746,602	January 1, 1983

FOR CONTRACTOR

MARSH & MCLENNAN AND
CORROON & BLACK/DAWSON & CO., INC.

By: _____
Marsh & McLennan, Inc.

By: _____
Corroon & Black/Dawson & Co., Inc.

Date: August 6, 1982

Original Contract	$1,790,000
Amendment No. 1 Discount	- 100,000
Sub Total	$1,690,000
Amendment No. 2	2,094,602
New Contract Total	$3,784,602

ALASKA POWER AUTHORITY

By: _____
Executive Director

Date: August 11, 1982

APPROVED:

By: _____
Department of Administration

Date: 8/12/82

FOR THE CONTRACT REVIEW COMMITTEE AUG 1 2 19

CERTIFIED MAIL NO. P 272 201 215

December 20, 1982

Mr. John McCadam
Vice President
Special Client Division
Corroon & Black/Dawson & Company
P.O. Box C-34201
Seattle, WA 98124

AND

Mr. David Carlson
Vice President
Marsh and McLennan, Inc.
Norton Building
Seattle, WA 98104

Dear John and Dave:

Re: State of Alaska
Professional Services Contract
#CC 08-2304

This letter of agreement is in lieu of proposed Amendment No. 3 to the Tyee Lake Professional Services Contract.

In consideration of a flat fee of $50,000.00 it is agreed that Corroon & Black's responsibility for services under the referenced professional services contract are limited after December 15, 1982 to marketing broker only, as defined in separate agreement between Corroon and Black and Marsh and McLennan, Inc., as respects course of construction policy number PRP-ST-U-AL-F82 (APA) and aviation non-ownership policy number SOAAV-F82- A (APA).

Corroon & Black is hereby authorized to receive payment up to $50,000.00 less any amount previously received for period ending December 15, 1982. Special assignments outside of the original marketing responsibilities shall be individually negotiated between State of Alaska, Division of Risk Management, Marsh and McLennan, Incorporated and Corroon and Black.

It is agreed that, pursuant to the scope of services under the referenced contract, Marsh and McLennan, Incorporated will assume full responsibility effective December 15, 1982, with the exception of marketing broker service responsibilities as defined in a separate agreement between Marsh and McLennan, Incorporated and Corroon and Black.

As the consideration for performing your proportionate share of services prior to the close of business December 15, 1982 and for services after that date, Marsh and McLennan, Incorporated shall receive a flat fee of $151,000.00 and additional commission income up to $40,000.00.

Marsh and McLennan is hereby authorized to receive payment, subject to the following schedule: November 23, 1982 - $121,000.00; January 1, 1983 - $15,000.00; April 1, 1983 - $15,000.00; July 1, 1983 - $20,000.00; and January 1, 1984 - $20,000.00. The two payments of $20,000.00 are subject to the terms and conditions of the contract between Marsh and McLennan, Incorporated and Pacific Marine Insurance Company dated December 17, 1982.

Sincerely,

John Haywood
Director

JH/je
5/1217-02/RM1

PS Form 3811, Dec. 1980

RETURN RECEIPT, REGISTERED, INSURED A

● SENDER: Complete items 1, 2, 3, and 4.
Add your address in the "RETURN TO" space on reverse.

(CONSULT POSTMASTER FOR FEES)

1. The following service is requested (check one).
   - ☐ Show to whom and date delivered ..... ___¢
   - ☒ Show to whom, date, and address of delivery.. ___¢
2. ☐ RESTRICTED DELIVERY ___¢
   (The restricted delivery fee is charged in addition to the return receipt fee.)

TOTAL $_____

3. ARTICLE ADDRESSED TO:
Mr. David Carlson
Marsh & McLennan
Norton Building
Seattle, Wa. 98104

4. TYPE OF SERVICE:
- ☐ REGISTERED ☐ INSURED
- ☐ CERTIFIED ☐ COD
- ☐ EXPRESS MAIL

ARTICLE NUMBER
P272.201.215

(Always obtain signature of addressee or agent)

I have received the article described above.
SIGNATURE ☐ Addressee ☐ Authorized agent

5. DATE OF DELIVERY DEC 22 1982

POSTMARK

6. ADDRESSEE'S ADDRESS (Only if requested)

E TO DELIVER BECAUSE:

EMPLOYEE'S INITIALS

AMENDMENT NO. 1

Professional Services Contract
82-0815 CC08-2307

APR - 7 1982

ALASKA POWER AUTHORITY

The contract between the ALASKA POWER AUTHORITY and MARSH & McLENNAN INCORPORATED and CORROON and BLACK/DAWSON & COMPANY INCORPORATED, dated 22 December 1981 is amended as follows:

APPENDIX C Exhibit A, Article 4

Consideration:

Change total contractor premium from $1,790,000.00 to $1,690,000.00 premium discount $100,000.00.

All other terms and conditions remain unchanged.

Executed this 22ND day of MARCH, 1982.

FOR CONTRACTOR:

MARSH & McLENNAN and
CORROON & BLACK/DAWSON & CO. INC.

By: [signature]

Date: March 22, 1982

OWNER:

ALASKA POWER AUTHORITY

By: [signature]
Executive Director

Date: [redacted]

DEPARTMENT OF COMMERCE AND
ECONOMIC DEVELOPMENT

By: _____

Date: _____

APPROVED:

By: [signature]
Department of Administration

Date: APR 0 1 1982

FOR THE CONTRACT REVIEW COMMITTEE

Original Contract	$1,790,000.00
Amendment #1 Premium Discount	-(100,000.00)
New Contract Total	$1,690,000.00

STATE OF ALASKA
DEPARTMENT OF ADMINISTRATION
STANDARD AGREEMENT FORM
FOR PROFESSIONAL SERVICES CONTRACT

-cc 08-2307
82-0815

This contract, which is effective only if it is approved by the Department of Administration, is between the State of Alaska,

Department of: Commerce & Economic Development - Alaska Power Authority *hereafter, The State, and*

Contractor: Marsh & McLennan, Inc. and Corroon and Black/Dawson & Co., Inc. *hereafter, the Contractor*

Mailing Address: Street or P. O. Box: City: State: Seattle, Washington Zip Code:

Alaska Business License Number: Internal Revenue Service Number:

This is a contract for professional services. AS 37.05.230(I)(c)(VI) *authorizes the State to make this contract. The parties to the contract agree as follows:*

ARTICLE 1. Appendices. Appendices referred to in this contract and attached to it are considered part of it.

ARTICLE 2. Performance of Services.

2.1 Appendix A, Articles 1 through 16, governs the performance of services under this contract.

2.2 Appendix B sets forth the services to be performed by the contractor.

ARTICLE 3. Period of Performance. The period of performance under this contract begins October 1, 19 81, and ends until cancelled, 19___. Performance may be extended for additional periods by the written agreement of the parties.

ARTICLE 4. Consideration.

4.1 In full consideration of the Contractor's performance under this contract, the State shall pay the Contractor in accordance with the provisions of Appendix C.

4.2 When billing the State, the Contractor shall refer to the State Contract Number and send the billing to:

Department of: Commerce & Economic Development — Attn: Division of: Alaska Power Authority

Mailing Address: 333 West 4th Avenue, Suite 31, Anchorage, Alaska 99501

CONTRACTOR	STATE
Name of Firm: Marsh & McLennan, Inc. Corroon and Black/Dawson & Co., Inc.	Department or Agency: Alaska Power Authority, Dept. of Commerce & Economic Development
Signature of Authorized Representative: David D. Carlson / Lynn E. Burgess	Signature of Certifying Officer: Eric P. Yould
Typed or Printed Name of Authorized Representative: David D. Carlson / Lynn Burgess	Typed or Printed Name of Certifying Officer: ERIC P YOULD
Title: Vice President Marsh & McLennan / Vice President Corroon & Black/Dawson	Title: Executive Director / Deputy Commissioner

APPROVAL BY THE DEPARTMENT OF ADMINISTRATION

NOTICE! This contract has no effect except as an offer by the Contractor until it is approved by the Department of Administration.

Signature of Authorized Official of the Department of Administration: Henry Mastin — Date: DEC 22 1981

Typed or Printed Name of Authorizing Official: FOR THE CONTRACT REVIEW COMMITTEE

APPENDIX A

Article 1. Definitions.

1.1. In this contract and appendices, "Certifying Officer" means the person who signs this contract on behalf of the Department and includes a successor or authorized representative.

1.2 "Department" means the agency for which this contract is to be performed and for which the Certifying Officer acted in signing this contract.

Article 2. Inspection and Reports.

2.1 The Department may inspect, in the manner and at reasonable times it considers appropriate, all the Contractor's facilities and activities under this contract.

2.2 The Contractor shall make progress and other reports in the manner and at the times the Department reasonably requires.

~~Article 3. State Saved Harmless.~~

~~The Contractor shall indemnify and hold harmless the State from all claims of any nature and including costs and expenses for or on account of any suits or judgments rendered against the State for losses or damages sustained by the Contractor or by any other person in connection with the performance of this contract.~~

(OVER)

Article 4. Disputes.

4.1.* Any dispute concerning a question of fact arising under this contract which is not disposed of by mutual agreement shall be decided without bias by the Director of the Department's Division of Administrative Services (or, if none, the Department's Administrative Officer), who shall reduce his decision to writing and mail or otherwise furnish a copy of it to the Contractor. The decision of the Director is final and conclusive unless, within 30 days from the date of receipt of that copy, the Contractor mails or otherwise furnishes to the Certifying Officer a written appeal addressed to the Commissioner of the Department. The Commissioner shall appoint a three-person board from the Department to hear the appeal, none of whom may be from the Division of Administrative Services. The decision of the board is final and conclusive, unless it is fraudulent or not supported by substantial evidence. In any proceeding under this article, the Contractor has a right to be heard by an unbiased panel and to offer evidence in support of his appeal. Pending final decision of a dispute, the Contractor shall proceed diligently with the performance of the contract and in accordance with the Director of the Division of Administrative Services decision.

4.2. This disputes article does not preclude consideration of questions of law in connection with decisions provided for in paragraph 4.1 above. However, this article does not make the decision of any administrative official, representative or board on a question of law final or conclusive.

Article 5. Equal Employment Opportunity.

5.1. The Contractor may not discriminate against any employee or applicant for employment because of race, religion, color, national origin, or because of age, physical handicap, sex, or marital status, change in marital status, pregnancy or parenthood when the reasonable demands of the position do not require distinction on the basis of age, physical handicap, sex, or marital status, changes in marital status, pregnancy, or parenthood. The Contractor shall take affirmative action to insure that the applicants are employed and that employees are treated during employment without regard to their race, color, religion, national origin, ancestry, age, sex, or marital status. This action must include, but need not be limited to, the following: employment, upgrading, demotion, transfer, recruitment or recruitment advertising, layoff or termination, rates of pay or other forms of compensation, and selection for training including apprenticeship. The Contractor shall post in conspicuous places, available to employees and applicants for employment, notices setting out the provisions of this paragraph.

5.2. The Contractor shall state, in all solicitations or advertisements for employees to work on State of Alaska contract jobs, that it is an equal opportunity employer and that all qualified applicants will receive consideration for employment without regard to race, religion, color, national origin, age, physical handicap, sex, or marital status.

5.3. The Contractor shall send to each labor union or representative of workers with which the Contractor has a collective bargaining agreement or other contract or understanding a notice advising the labor union or workers' representative of the Contractor's commitments under this article and post copies of the notice in conspicuous places available to all employees and applicants for employment.

5.4. The Contractor shall include the provisions of this article in every contract, and shall require the inclusion of these provisions in every contract entered into by any of its subcontractors, so that those provisions will be binding upon each subcontractor. For the purpose of including those provisions in any construction, maintenance, or service contract or subcontract, as required by this contract, "contractor" and "subcontractor" may be changed to reflect appropriately the name or designation of the parties of the contract or subcontract.

5.5. The Contractor shall cooperate fully with the office or agency of the State of Alaska which seeks to deal with the problem of unlawful discrimination, and with all other State efforts to guarantee fair employment practices under this contract, and promptly comply with all requests and directions from the State Commission for Human Rights or any of its officers or agents relating to prevention of discriminatory employment practices.

5.6. Full cooperation in paragraph 5.5 includes, but is not limited to, being a witness in any proceeding involving questions of unlawful discrimination if that is requested by any official or agency of the State of Alaska; permitting employees of the Contractor to be witnesses or complainants in any proceeding involving questions of unlawful discrimination, if that is requested by any official or agency of the State of Alaska; participating in meetings; submitting periodic reports on the equal employment aspects of present and future employment; assisting in inspection of the Contractor's facilities; and promptly complying with all state directives considered essential by any office or agency of the State of Alaska to insure compliance with all federal and state laws, regulations, and policies pertaining to the prevention of discriminatory employment practices.

5.7. Failure to perform under this article constitutes a material breach of the contract.

Article 6. Termination.

The Certifying Officer, by written notice, may terminate this contract, in whole or in part, when it is in the best interest of the State. The State is liable only for payment in accordance with the payment provisions of this contract for services rendered before the effective date of termination.*

Article 7. No Assignment or Delegation.

This contract is personal and the Contractor may not assign or delegate this contract, or any part of it, or any right to any of the money to be paid under it, except with the written consent of the Certifying Officer.

Article 8. No Additional Work or Material.

No claim for additional services, not specifically provided in this contract, performed or furnished by the Contractor, will be allowed, nor may the Contractor do any work or furnish any material covered by the contract unless the work or material is ordered in writing by the Certifying Officer and approved by the Department of Administration.

Article 9. Independent Contractor.

The Contractor and any agents and employees of the Contractor act in an independent capacity and are not officers or employees or agents of the State in the performance of this contract.

Article 10. Payment of Taxes.

As a condition of performance of this contract, the Contractor shall pay all federal, state, and local taxes incurred by the Contractor and shall require their payment by any subcontractor or any other persons in the performance of this contract. Satisfactory performance of this paragraph is a condition precedent to payment by the State under this contract.

Article 11. Workmen's Compensation Insurance.

During the life of this contract, the Contractor shall provide and maintain, for all employees of the Contractor engaged in work under this contract, workmen's compensation insurance as required by AS 23.30. The Contractor shall require any subcontractor to provide and maintain for its employees workmen's compensation insurance as required by AS 23.30. That coverage must remain in force from the day services begin under this contract and shall provide for written notice to the Certifying Officer at least 30 days before cancellation or non-renewal. Failure to furnish satisfactory evidence of insurance or lapse of the policy is a material breach and grounds for termination of the Contractor's services before performing under this contract. The Contractor shall furnish the Certifying Officer with certificates of insurance as proof of compliance with this article. The certificates of insurance must include an All States Broad Form Endorsement.

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Before this contract may be approved, the Contractor shall furnish a certificate of liability insurance evidencing coverage satisfactory to the Risk Manager of the Department of Administration.

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All designs, drawings, specifications, notes, and other work developed in the performance of this agreement are and remain the sole property of the State of Alaska and may be used by the State for any other purpose without additional compensation to the Contractor. The Contractor agrees not to assert any rights and not to establish any claim under the design patent or copyright laws. The Contractor, for a period of three years after final payment under this contract, agrees to furnish and provide access to all retained materials at the request of the Certifying Officer. Unless otherwise directed by the Certifying Officer, the Contractor may retain copies of all the materials.

Article 14. Governing Law.

This contract is governed by the laws of the State of Alaska.

Article 15. Officials not to Benefit.*

No member of or delegate to Congress, United States Commissioner, or officials of the state or federal government may be admitted to any share or part of this contract or to any benefit to arise therefrom.

Article 16. Covenant Against Contingent Fees.

The Contractor warrants that no person or agency has been employed or retained to solicit or secure this contract upon an agreement or understanding for a commission, percentage, contingent fee, or brokerage except employees or agencies maintained by the Contractor for the purpose of securing business. For the breach or violation of this warranty, the State may terminate this contract without liability or in its discretion deduct from the contract price or consideration the full amount of the commission, percentage, brokerage, or contingent fee.

* Articles 15 and 16 are to be used only if the professional services contract is federally funded.

APPENDIX A

3. State Saved Harmless

The Contractor shall indemnify and hold and save the State, its officers, agents and employees harmless from liability of any nature or kind, including costs and expenses, for or on account of any and all legal actions or claims of any character whatsoever resulting from injuries or damages sustained by any person or persons or property arising from its performance of this contract in any way whatsoever.

APPENDIX B

SCOPE OF SERVICES

The Alaska Power Authority acting as owner, sponsor and general contractor for major hydro-electric projects is responsible for managing the projects in a cost effective manner. As part of this responsibility, it is necessary to provide a safe and secure work environment at the job sites to control the magnitude and frequency of injuries and resulting claims and to secure broad catastrophic insurance coverage to provide protection for both the state and its prime contractors.

The Alaska Power Authority (APA) will use the State Risk Management Division as a consultant for Risk Management Services which will meet its objectives. Risk Management has assisted in the selection of the contractors to administer the Alaska Power Construction Program (APCOP):

MMc+CB

The contractor shall provide the following services by project which may be subcontracted as needed to carry out the provisions of this contract:

1. Provide Risk Management and insurance programs for the Alaska Power Authority and prime contractors.

2. Structure services which will maximize the use of Alaska based insurance contractors and companies.

how?

3. Provide a companion program which will permit local Alaska construction companies and their insurance brokers the opportunity to participate in the APCOP program.

4. Provide administration of Alaska Power Construction Program (APCOP).

5. Will cooperate and coordinate with State Division of Risk Management and its brokers to properly integrate Alaska Power Construction Program with the State Risk Management Program.

6. Will use the combined purchasing power of the State and the prime contractors to maximize cost effectiveness of the program.

7. Will provide to Alaska Power Authority and prime contractors a cost of Risk Management by project.

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8. Will provide Alaska Power Authority and prime contractors with complete premium and loss summaries on a quarterly basis.

9. Will provide Alaska Power Authority and the prime contractors with safety incentive formula prior to contract inception and an estimate of the amount of the safety dividend due the prime contractor at contract expiration with a final adjustment six months after contract expiration.

10. Monitor all insurance as respects cost, coverage and financial integrity.

11. Furnish other special services as may be periodically required by Alaska Power Authority or State Division of Risk Management, subject to agreement by all parties.

12. Provide Alaska Power Authority a certificate of professional liability insurance prior to any service pursuant to agreement on behalf of the State.

13. See that qualified individuals are available for consultation on a daily basis in carrying out the obligations under this agreement.

14. Be responsible for continuing risk identification and analysis and make appropriate recommendations to the Alaska Power Authority.

15. May subcontract for services which include but are not limited to:

    a. Claims Adjusting.

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APPENDIX C

4.0

Before commencing work under this agreement, the Consultant and any subcontractors employeed by it must submit evidence acceptable to the Authority that they have provided and shall maintain insurance for the duration of the agreement as required by law, including a provision for a thirty-day advance notification to the Authority in the event of cancellation or any material change in the coverage of the insurance. The coverage shall in no case be less than the following limits:

Required Coverages:

I. Workers' Compensation Insurance

a. Statutory coverage for states in which employees are engaging in work.

b. Employers liability protection in the amount of $10,000,000 per person/$10,000,000 per occurrence.

c. Broad Form All States Endorsement.

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e. Broad Form Property Damage.

f. Personal Injury.

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a. Coverage for all errors or omissions which the contractor, employees, or the subcontractors may make which produce financial loss to the State of Alaska.

IV. Comprehensive Automobile Liability Limits ($10,000,000 per occurrence).

a. All Owned Vehicles.

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APPENDIX C

ARTICLE 4

CONSIDERATION

Insurance premiums or payments for services provided under this contract shall be specified in written exhibits attached to and made a part of this contract upon agreement of all parties to this contract. Exhibit A (attached) represents consideration for services associated with the major civil construction contract, for the Lake Tyee project, between the Alaska Power Authority and Southeast-Harrison Western. Subsequent exhibits will be appended to this contract from time to time as required for services provided under this contract associated with subsequent construction contracts and/or projects.

EXHIBIT A TO APPENDIX C

ARTICLE 4

CONSIDERATION

1. The State shall pay the Contractor premium in the amount of $1,790,000.00. Said premium payment shall constitute full satisfaction and payment for all services performed pursuant to this contract.

2. Schedule of Premium Payments:

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3. When billing Alaska Power Authority, the Contractor shall refer to the Contract Number and send the billing to:

Mr. Terry J. McGuire
Director of Finance
Alaska Power Authority
333 West 4th Avenue, Suite 31

APPENDIX D

PROFESSIONAL SERVICES CONTRACT

ALASKA POWER AUTHORITY

ARTICLE 5. ADDITIONAL CONTRACT PROVISIONS.

Appendix D attached hereto and made a part hereof, sets forth additional general contract provisions of this contract.

ARTICLE 6. CHANGES.

Appendix E and Appendix F attached hereto and made a part hereof, sets forth any changes or additions that were made in this contract prior to its execution. (If Appendix E and F are not attached hereto, there have been no such changes or additions.)

APPENDIX E

Marsh & McLennan, Incorporated and Corroon and Black/Dawson & Co., Inc. have been appointed Broker of Record for the Alaska Power Authority Construction Program known as (APCOP) on the following areas of insurance effective October 1, 1981:

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B. Non-Owned Marine Hull and Liabilities

C. Multi-Line Excess of Aggregate Insurance

D. Transit and Marine Cargo Insurance

E. Non-Owned Aviation Insurance

F. Property including Builders' Risk Insurance

January 11, 1983

SAFETY STATUS REPORT TYEE LAKE HYDROELECTRIC PROJECT

The following provides a general overview of the status of the project safety programs, and a review of the efforts of the contractors in providing and ensuring a safe and healthy work environment.

Safety on any construction job is a highly emotional subject about which there are many strong opinions. The day to day pressure to maintain production, hold down costs and run a safe job, is borne largely by contractor project people. Most established contractors make a genuine effort to run safe jobs. Good safety can and does produce positive, tangible results.

PHASE I TUNNEL & POWERHOUSE

During the course of driving the tunnel, the safety was above average with minimal accident frequency. Tunnel operations were, in most cases, ahead of schedule.

On April 9, 1982, the State of Alaska Department of Labor, Division of Occupational Safety and Health conducted an inspection of the project and issued 5 citations of a minor nature (no fines). The overall report was complimentary to the safety efforts of all concerned.

In mid summer of 1982, the Safety coordinator was promoted ot a superintendent position and the coordination of the safety program was divided between two project engineers. This developed into a letdown in safety oriented activities. Working with the project management, i.e., the contractor, the Engineer and the Power Authority, we were able to work out the problems and assist the two Safety Coordinators to get the program back on tract.

During our last visit to the project, 12/2-3/82, we noted continued interest in the program, however, there is increase of injuries coming from the powerhouse construction, due primarily to increase in employees, manhours and the weather. Tunnel safety appeared to be an orderly, professionalized process with every employee taking an active part. It should be noted that the contractor has corrected all deficiencies brought to his attention. As of 12 /82, the accident rate for the project (Phase I) is 60 incidents, 16 lost time, 46 lost days, 43 medical cases and 1 fatality. This compares favorably with other states and national averages.

On 10/27/82, an explosion took place at the project. At 5:45 AM, four magazines holding about 70,000 lbs. of explosives blew up causing the death of the powder man. The cause of the blast is under investigation at the present time. The Department of Labor, Division of Occupational Safety and Health, investigated the accident and issued no citations to the contractor.

This project (Phase I) overall, has tracked well with the concept of owner controlled programs.

Cooperation has been above average, though the project is far from finished. We look to continued contractor cooperation and interest in safety. We will continue to visit the project based on need and the time and action calendar developed.

PHASE III TRANSMISSION LINES

Cooperation with construction management has been above average. It is apparent that they will continue to provide the necessary leadership to ensure that all areas of operation are safe places in which to work.

Since the project started, clearing, logging, footing installations, etc., accidents have been minimal. Regular safety meetings have been held, and helicopter operations are above average. Care is taken to assure that each employee is aware of the danger involved in the operations. Floating and base camps are kept in a clean and orderly manner. To date there have been 15 incidents, 7 lost time, the rest medical.

The project (Phase III) is compatible with the concept of the Alaska Power Construction Program.

(NOTE: Phase II - The Sub-Marine Cable - is not yet under construction)

Thomas J. Laskowski, P.E.
Safety Management Consultant
Scott Wetzel Services, Inc.

STATE OF ALASKA
DEPARTMENT OF ADMINISTRATION

STANDARD AGREEMENT FORM
FOR PROFESSIONAL SERVICES CONTRACT

-cc 08-2307
82-0815

This contract, which is effective only if it is approved by the Department of Administration, is between the State of Alaska,

Department of: Commerce & Economic Development - Alaska Power Authority — *hereafter, The State, and*

Contractor: Marsh & McLennan, Inc. and Corroon and Black/Dawson & Co., Inc. — *hereafter, the Contractor*

Mailing Address: Street or P. O. Box: City: State: Seattle, Washington: Zip Code:

Alaska Business License Number:

Internal Revenue Service Number:

37.05.230(1)(c)(VI)

This is a contract for professional services. AS_____ authorizes the State to make this contract. The parties to the contract agree as follows:

ARTICLE 1. Appendices. Appendices referred to in this contract and attached to it are considered part of it.

ARTICLE 2. Performance of Services.

2.1 Appendix A, Articles 1 through 16, governs the performance of services under this contract.

2.2 Appendix B sets forth the services to be performed by the contractor.

ARTICLE 3. Period of Performance. The period of performance under this contract begins October 1, 19 81, and ends until cancelled, 19___. Performance may be extended for additional periods by the written agreement of the parties.

ARTICLE 4. Consideration.

4.1 In full consideration of the Contractor's performance under this contract, the State shall pay the Contractor in accordance with the provisions of Appendix C.

4.2 When billing the State, the Contractor shall refer to the State Contract Number and send the billing to:

Department of: Commerce & Economic Development — Area Division of: Alaska Power Authority

Mailing Address: 333 West 4th Avenue, Suite 31, Anchorage, Alaska 99501

CONTRACTOR	STATE
Name of Firm: Marsh & McLennan, Inc. Corroon and Black/Dawson & Co., Inc.	Department or Agency: Alaska Power Authority, Dept. of Commerce & Economic Development
Signature of Authorized Representative: David D. Carlson / Lynn Burgess	Signature of Certifying Officer: Eric P. Yould
Typed or Printed Name of Authorized Representative: David D. Carlson / Lynn Burgess	Typed or Printed Name of Certifying Officer: ERIC P YOULD
Title: Vice President Marsh & McLennan / Vice President Corroon & Black/Dawson	Title: Executive Director / Deputy Commissione

APPROVAL BY THE DEPARTMENT OF ADMINISTRATION

NOTICE! This contract has no effect except as an offer by the Contractor until it is approved by the Department of Administration.

Signature of Authorized Official of the Department of Administration: Henry Mastin — Date: DEC 22 1981

Typed or Printed Name of Authorizing Official: FOR THE CONTRACT REVIEW COMMITTEE

APPENDIX A

Article 1. Definitions.

1.1. In this contract and appendices, "Certifying Officer" means the person who signs this contract on behalf of the Department and includes a successor or authorized representative.

1.2 "Department" means the agency for which this contract is to be performed and for which the Certifying Officer acted in signing this contract.

Article 2. Inspection and Reports.

2.1 The Department may inspect, in the manner and at reasonable times it considers appropriate, all the Contractor's facilities and activities under this contract.

2.2 The Contractor shall make progress and other reports in the manner and at the times the Department reasonably requires.

[illegible]

(OVER)

Article 4. Disputes.

4.1.* Any dispute concerning a question of fact arising under this contract which is not disposed of by mutual agreement shall be decided without bias by the Director of the Department's Division of Administrative Services (or, if none, the Department's Administrative Officer), who shall reduce his decision to writing and mail or otherwise furnish a copy of it to the Contractor. The decision of the Director is final and conclusive unless, within 30 days from the date of receipt of that copy, the Contractor mails or otherwise furnishes to the Certifying Officer a written appeal addressed to the Commissioner of the Department. The Commissioner shall appoint a three-person board from the Department to hear the appeal, none of whom may be from the Division of Administrative Services. The decision of the board is final and conclusive, unless it is fraudulent or not supported by substantial evidence. In any proceeding under this article, the Contractor has a right to be heard by an unbiased panel and to offer evidence in support of his appeal. Pending final decision of a dispute, the Contractor shall proceed diligently with the performance of the contract and in accordance with the Director of the Division of Administrative Services decision.

4.2. This disputes article does not preclude consideration of questions of law in connection with decisions provided for in paragraph 4.1 above. However, this article does not make the decision of any administrative official, representative or board on a question of law final or conclusive.

Article 5. Equal Employment Opportunity.

5.1. The Contractor may not discriminate against any employee or applicant for employment because of race, religion, color, national origin, or because of age, physical handicap, sex, or marital status, change in marital status, pregnancy or parenthood when the reasonable demands of the position do not require distinction on the basis of age, physical handicap, sex, or marital status, changes in marital status, pregnancy, or parenthood. The Contractor shall take affirmative action to insure that the applicants are employed and that employees are treated during employment without regard to their race, color, religion, national origin, ancestry, age, sex, or marital status. This action must include, but need not be limited to, the following: employment, upgrading, demotion, transfer, recruitment or recruitment advertising, layoff or termination, rates of pay or other forms of compensation, and selection for training including apprenticeship. The Contractor shall post in conspicuous places, available to employees and applicants for employment, notices setting out the provisions of this paragraph.

5.2. The Contractor shall state, in all solicitations or advertisements for employees to work on State of Alaska contract jobs, that it is an equal opportunity employer and that all qualified applicants will receive consideration for employment without regard to race, religion, color, national origin, age, physical handicap, sex, or marital status.

5.3. The Contractor shall send to each labor union or representative of workers with which the Contractor has a collective bargaining agreement or other contract or understanding a notice advising the labor union or workers' representative of the Contractor's commitments under this article and post copies of the notice in conspicuous places available to all employees and applicants for employment.

5.4. The Contractor shall include the provisions of this article in every contract, and shall require the inclusion of these provisions in every contract entered into by any of its subcontractors, so that those provisions will be binding upon each subcontractor. For the purpose of including those provisions in any construction, maintenance, or service contract or subcontract, as required by this contract, "contractor" and "subcontractor" may be changed to reflect appropriately the name or designation of the parties of the contract or subcontract.

5.5. The Contractor shall cooperate fully with the office or agency of the State of Alaska which seeks to deal with the problem of unlawful discrimination, and with all other State efforts to guarantee fair employment practices under this contract, and promptly comply with all requests and directions from the State Commission for Human Rights or any of its officers or agents relating to prevention of discriminatory employment practices.

5.6. Full cooperation in paragraph 5.5 includes, but is not limited to, being a witness in any proceeding involving questions of unlawful discrimination if that is requested by any official or agency of the State of Alaska; permitting employees of the Contractor to be witnesses of complainants in any proceeding involving questions of unlawful discrimination, if that is requested by any official or agency of the State of Alaska; participating in meetings; submitting periodic reports on the equal employment aspects of present and future employment; assisting in inspection of the Contractor's facilities; and promptly complying with all state directives considered essential by any office or agency of the State of Alaska to insure compliance with all federal and state laws, regulations, and policies pertaining to the prevention of discriminatory employment practices.

5.7. Failure to perform under this article constitutes a material breach of the contract.

Article 6. Termination.

The Certifying Officer, by written notice, may terminate this contract, in whole or in part, when it is in the best interest of the State. The State is liable only for payment in accordance with the payment provisions of this contract for services rendered before the effective date of termination.*

Article 7. No Assignment or Delegation.

This contract is personal and the Contractor may not assign or delegate this contract, or any part of it, or any right to any of the money to be paid under it, except with the written consent of the Certifying Officer.

Article 8. No Additional Work or Material.

No claim for additional services, not specifically provided in this contract, performed or furnished by the Contractor, will be allowed, nor may the Contractor do any work or furnish any material covered by the contract unless the work or material is ordered in writing by the Certifying Officer and approved by the Department of Administration.

Article 9. Independent Contractor.

The Contractor and any agents and employees of the Contractor act in an independent capacity and are not officers or employees or agents of the State in the performance of this contract.

Article 10. Payment of Taxes.

As a condition of performance of this contract, the Contractor shall pay all federal, state, and local taxes incurred by the Contractor and shall require their payment by any subcontractor or any other persons in the performance of this contract. Satisfactory performance of this paragraph is a condition precedent to payment by the State under this contract.

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PROFESSIONAL SERVICES CONTRACT

ALASKA POWER AUTHORITY

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F. Property including Builders' Risk Insurance

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DEPUTY RISK MANAGER
JUNEAU AK
INSURANCE PREMIUMS AND RELATED MANAGEMENT SERVICES TYPICALLY RUN 8 TO 10 PERCENT OF TOTAL CONSTRUCTION PROJECT COSTS IF CONVENTIONAL PROGRAMS ARE USED. WRAP UP COSTS ARE IN FOUR TO SIX PERCENT RANGE ON THESE PROJECTS. WORKER COMPENSATION USUALLY MAKES UP 50 TO 60 PERCENT OF TOTAL PROGRAM COST. ASSUMPTION THAT NET SAVINGS BECAUSE OF WRAP UP USE WILL EQUAL TWO PERCENT OF OVERALL PROJECT SEEMS TO BE VERY CONSERVATIVE. BALTIMORE MTA SAVING IS 6 PERCENT.

PROPOSED ALASKIAN HYDRO-ELECTRIC PROJECTS INVOLVING ROCK TUNNELING, UNDERWATER WORK, AND COMPRESSED AIR CONSTRUCTION CONDITIONS WILL BE RATED SAME AS TRANSIT PROJECTS BY INSURANCE COMPANIES. ARGUMENT THAT THIS IS DIFFERENT FROM TRANSIT IS NOT ACCEPTED BY INSURANCE UNDERWRITERS. THEY DON'T CARE WHETHER TUNNEL IS TO CARRY WATER, POWERLINES, SEWERAGE, AUTOS OR TRANSIT CARS. IT IS THE SAME SET OF CONSTRUCTION HAZARDS FOR ALL.

HERE ARE SPECIFICS ON FOUR RECENT MAJOR PUBLIC CONSTRUCTION PROJECTS, ALL INVOLVING HEAVY UNDERGROUND WORK.

PROJECT	CONVENT'L	WRAP UP	SAVINGS 0/0
SAN FRANCISCO	46.3	29.8	35.6
WASHINGTON	98.4	62.2	60.0
ATLANTA	61.3	39.9	34.9
BALTIMORE	46.0	27.5	40.2

($MILLIONS)

JIM BARRETT
CRESHEIM
PHILADELPHIA

1751 EST

IPMAFUB AHG

#305P
+
DEPT ADM JNU

James E. Barrett

A career consultant since 1962, and president of Cresheim Company since 1968, he has worked with more than 140 corporate, public and private clients in North America, Europe, Latin America and the Far East. Some client relationships extend for fifteen years.

MANAGEMENT CONSULTING. Projects involve questions of organization, business strategy, corporate development and planning for manufacturers, process industry firms, and service businesses.

MANAGEMENT DEVELOPMENT. Widely known in executive and management development circles, he conducts workshops in business negotiating, problem-solving and decision-making, market planning, and individual productivity for corporations, public agencies and trade associations.

VENTURE MANAGEMENT. He participates in Cresheim's venture work, managing service industry projects, and is a veteran of 26 startups. These range from computers to early learning, food distribution, insurance, microfilm, optical scanning, printing, retail distribution, training and wine making.

CLOSELY HELD CORPORATIONS. Mr. Barrett also is well known in the independent business sector of the United States and Canada for his work on family business continuity, development of young executives in independent firms, and organization and ownership problems of partnerships and private firms.

MARKETING CONSULTING. Projects involve market plans, implementation of new approaches, sales force size and productivity, customer services, sales systems, market share, pricing, competition, and growth options.

DEALERS, DISTRIBUTORS AND AGENTS. A by-product of his management development work, and long experience with independent businesses has been requests by major corporations to help in development of their dealers, distributors and agents. Some of this work involves workshops; some is consulting.

INTERNATIONAL WORK. Projects with multinational corporations made him a frequent world traveler in the late Sixties and he continues this work with several overseas trips each year. His experience includes periods of extended residence in England and Germany while managing startups in 1966 and 1967.

SPONSORED RESEARCH. A continuing activity is management of multidisciplinary research projects of a predominantly economic nature. Recent examples which led to publicly available results include, in 1976, *Tunneling; The State of the Industry* (with R.S. Mayo and R.J. Jenny) and, in 1977, *Insurance for Urban Transportation Construction.*

PRIVATE RESEARCH AND WRITING. Current research interests are in joint ventures, continuing development for senior executives, and advanced negotiating tactics. Mr. Barrett's published papers have appeared in the *AMA Management Review, American Archivist, Boardroom Reports, Business Horizons, Cresheim Comment, Sales Management,* and *Training.* He is the author of three books: *Managing Problems* (1970), *Improving Negotiating Skills* (1971), and *Managing Action* (1972, co-authored).

CMC DESIGNATION. He is a Certified Management Consultant, having met the demanding requirements of the Institute of Management Consultants, the profession's certifying body.

UNIVERSITY FACULTY AFFILIATIONS. He was an assistant professor at Harvard College and a visiting lecturer at the State University of Iowa; the University of Michigan; and the Air Command and Staff College.

EARLY EXPERIENCE. From 1951, he served in the United States and Korea with the Air Force; taught at Harvard College (1954-58); was a systems analyst, records management specialist and systems and procedures manager for Raytheon Company; and general manager of a beverage wholesaling firm, before entering consulting.

VOLUNTEER ACTIVITIES. Active in alumni, community and professional affairs, he serves as president of the Wyndmoor Community Association, as president of the Philadelphia Chapter of the American Association of Small Research Companies, and on AASRC's committee for the 1980 White House Conference on Small Business.

PERSONAL BACKGROUND. He and his wife, Dorothy, have four children. Both New Englanders, they have lived in Philadelphia since 1968. He was born in December, 1929, in Lowell, Massachusetts, graduated from Harvard in economics, from the USAF's Command and Staff College, and did graduate work at Washington University in St. Louis.

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1.0 TREND ANALYSIS OF CLAIMS

	FY82 NUMBER	FY82 AMOUNT	FY83 TO 12/31 NUMBER	FY83 TO 12/31 AMOUNT
***** 1.1 TREND ANALYSIS BY COVERAGE *****				
WORKERS COMPENSATION	24	264,416	64	245,867
STATE PROPERTY	1	43,500	1	115,000
TOTAL	25	307,916	65	360,867
***** 1.2 TREND ANALYSIS BY NEXT ORGANIZATIONAL LEVEL *****				
UNKNOWN APA				
MISC KNOWN APA				
ADMINISTRATION				
TREE PROJECT	25	307,916	65	360,867
TOTAL	25	307,916	65	360,867
***** 1.3 TREND ANALYSIS BY CIRCUMSTANCE RELEVANT TO PREVENTION *****				
FALLS & SLIPS	1	71,385	9	41,348
HAND TOOLS	4	448	3	25,485
MANUAL MATERIAL HDLG	3	590	9	48,793
MOTOR VEHICLE	1	3,040		
FIRE OR EXPLOSION			1	115,000
ILLNESS	1	2,429	2	6,893
OTHER	15	230,025	41	123,348
TOTAL	25	307,917	65	360,867

The above losses have not had a trending or development factor applied to them. Therefore, these losses will increase when the trending analysis is performed.

3.0 LISTING OF CLAIMS

CLAIMANT / CLAIM NUMBER	ACC DATE	TOTAL INCURRED	STATUS	ORGANIZATION / DESCRIPTION OF THE CLAIM
***** LISTING OF CLAIMS BY COVERAGE - REPORTED IN THE PERIOD October-December *****				
***** WORKERS COMPENSATION *****				
BASKETT JAMES	12/05/82	300.00	OPEN	TYEE PROJECT
P0318323	MECHANIC BRADFIELD CANA			FELL FROM LADDER ON CRANE/L-SHOULDER CONTUSION
BENOIT GREG C	11/30/82	650.00	OPEN	TYEE PROJECT
P0318320	TUNNEL MINER/BRADFIELD			STRUCK BY FALLING ROCK/RT/EAR LACERATION
BOON DANIEL R	10/28/82	6,791.00	OPEN	TYEE PROJECT
P0318312	IRON WORKER/BRADFIELD C			OPRTNG AIR DRILL-LEFT CARPAL TUNNEL SYNDROME
BROOKS TOM E	11/23/82	400.00	OPEN	TYEE PROJECT
P0318316	TUNNEL MECHANIC/BRADFIE			LIFTNG 8'LENGTHS OF ANGLE IRON-MUSCLE STRAIN
CZARNECKI CLYDE A	11/26/82	672.00	OPEN	TYEE PROJECT
P0318315	CIVIL LABORER/BRADFIELD			STRUCK BY CHAIN-LACERATION-R/INDEX FINGER
DAUENHAUER MICHAEL L	11/19/82	4,881.00	OPEN	TYEE PROJECT
P03018309	CHASER/TYEE TRANSMISSIO			SLPD/FELL-ICE COVERED RD/L/EYE LACERATION
DE GRANDI ALONSO	11/18/82	450.00	OPEN	TYEE PROJECT
P0318319	SERVICE OILER/BRADFIELD			UNPLGNG CEMENT AUGER WHN CEMENT FLEW INTO L/EYE
DIGGLES LEONARD G	11/19/82	500.00	OPEN	TYEE PROJECT
P0318317	TUNNEL MINER-BRADFIELD			SLIPPED/FELL WHILE LOADING STEEL-L/KNEE SPRAIN
DUCIC JONNIE R	11/03/82	350.00	OPEN	TYEE PROJECT
P03018306	CIVIL ENGINEER/BRADFIEL			JUMPED OFF OF RAMP/LUMBAR STRAIN
DUKES ARDITH ANNE	12/12/82	20,950.00	OPEN	TYEE PROJECT
P0303024 0	COOK/BRADFIELD CANAL AL			SLPD-WET SPOT-FLR/FELL-TORE LIGAMENTS R/KNEE
HERRERA EFRAIN R	10/11/82	130.00	CLOSED	TYEE PROJECT
P0303513	RIGGER/TYEE TRANSMISSIO			BUMPED BY SAW BAR/FOREHEAD LACERATION
HURD BEN	07/21/82	98.07	CLOSED	TYEE PROJECT
P0303370	MINER/BRADFIELD CANAL			DROPPED TOW LINE-L/FOOT CONTUSION
HURD BENNY H	08/12/82	37,135.00	OPEN	TYEE PROJECT
P0303398	MINER/BRADFIELD CANAL			STRUCK BY FALLING ROCK-SEVERE LACERATION-L/HAND
HURD BENNY H	10/20/82	300.00	OPEN	TYEE PROJECT
P0303512	MINER/BRADFIELD CANAL			JUMPED OFF MUCKER/BANGED KNEE/CONTUSION-L/KNEE
JONES GERALD E	07/28/82	301.92	CLOSED	TYEE PROJECT
P0303377	ELECTRICIAN/BRADFIELS C			PINNED BY RR TIES/COMPRESSION INJURY R/LEG
KIEDROWSKI RONALD C	10/27/82	21,000.00	OPEN	TYEE PROJECT
P0303514	POWDERMAN			EXPLOSION/FATALITY RESULTED

3.0 LISTING OF CLAIMS

CLAIMANT / CLAIM NUMBER	ACC DATE / DESCRIPTION OF THE CLAIM	TOTAL INCURRED	STATUS	ORGANIZATION
***** LISTING OF CLAIMS BY COVERAGE - REPORTED IN THE PERIOD October-December *****				
KUEPPER RICHARD J P0318314	11/15/82 SHOP FOREMAN/BRADFIELD	500.00 SLIPPED/FELL WHILE CARRYING IRON/LUMBAR STRAIN	OPEN	TYEE PROJECT
MACLAY PHILLIP P0303385	07/30/82 ELECTRICIAN/BRADFIELD C	65.21 FOREIGN BODY R EYE	CLOSED	TYEE PROJECT
MARQUETTE LEE A P03018305	09/25/82 CHAIN SAW OPERATOR TYEE	200.00 STRUCK IN EYE WITH STICK WHILE CLEARING BRUSH	OPEN	TYEE PROJECT
MASSIE CLYDE A P03018303	10/30/82 MECHANIC/TYEE TRANSMISS	900.00 GAS FUMES EXPLDED WHL SLDRNG BATRY TERMINALS	OPEN	TYEE PROJECT
MC DONALD GREG H P0318322	10/27/82 CIVIL LABORER/BRADFIELD	500.00 STRUCK BY BROKEN JACK LEG-L/WRIST CONTUSION	OPEN	TYEE PROJECT
MC LEAN LEROY P0303386	08/02/82 MECHANIC/BRADFIELD CANA	238.65 HIT BY ROCK/SCALP LACERATION	CLOSED	TYEE PROJECT
OCHNER FRED S P0318310	11/25/82 IRON WORKER/BRADFIELD C	12,802.00 FELL FROM REBAR-APPROX 15'-FRACTURED RIBS	OPEN	TYEE PROJECT
OCHSNER FRED S P0303523	10/26/82 IRON WORKER/BRADFIELD C	250.00 POKED BY TIE WIRE/LACERATION R/ARM	OPEN	TYEE PROJECT
PARK HUNT P0303384	08/01/82 GENERAL LABORER/TYEE LA	28.15 SWUNG SPIKE HAMMER TO HARD/UPPER BACK STRAIN	CLOSED	TYEE PROJECT
PARK HUNT P0318318	11/17/82 GENERAL LABORER/BRADFIE	1,432.00 TWSTD NECK WHL WLKNG UP STEPS/CERVICAL STRAIN	OPEN	TYEE PROJECT
PETERS JON S P0303522	10/21/82 CARPENTER/BRADFIELD CAN	101.90 KNEELING ON CONCRETE/FOLLICULITIS OF THE KNEES	CLOSED	TYEE PROJECT
PETERS JON S P0318313	11/14/82 CARPENTER/BRADFIELD CAN	170.50 WATER DRIPPED INTO EYE/FOREIGN BODY R/EYE	CLOSED	TYEE PROJECT
PETTICREW ETHAN P0303382	08/02/82 TUNNEL LABORER/BRADFIEL	179.80 STRUCK BY ROCK/SCALP LACERATION	CLOSED	TYEE PROJECT
READ KENNETH E P0303391	08/03/82 SAWYER/TYEE LAKE PROJEC	88.25 BUCKING TREE/RIGHT HIP CONTUSION	CLOSED	TYEE PROJECT
SHERMAN MARK S P0303521	10/26/82 APPRENTICE LINEMAN/TYEE	680.00 USING BLOW PIPE/FOREIGN BODY R/EYE	CLOSED	TYEE PROJECT
SIGSTAD LEIF G P0318311	11/20/82 CAMP MAINTENANCE/BRADFI	800.00 SLIPPED FROM LADDER/GRADE II L/ANKLE SPRAIN	OPEN	TYEE PROJECT
WHITE TIM M P0303375	07/28/82 AIR TRACK DRILLER/TYEE	41,750.00 TWSTD BACK WHILE LIFTING RR TIE/ACUTE BACK INJURY	OPEN	TYEE PROJECT

3.0 LISTING OF CLAIMS

CLAIMANT / CLAIM NUMBER	ACC DATE	TOTAL INCURRED	STATUS	ORGANIZATION
	DESCRIPTION OF THE CLAIM			

***** LISTING OF CLAIMS BY COVERAGE - REPORTED IN THE PRIOR October-December *****

WITHINGTON THOMAS D	11/02/82	300.00	OPEN	TYEE PROJECT
P03018301	SHAW DRIVER/BRADFIELD C	SMASHED FINGER TIPS WHILE LOADING DRILL STEEL		

***** STATE PROPERTY *****

S.C.HARRISON WESTERN	10/27/82	115,000.00	OPEN	TYEE PROJECT
84-131	TYEE LAKE	EXPLSN-MAGAZINES CONTENTS:EQUIP/VICNTY VAPORIZ		

ALASKA POWER AUTHORITY
ALASKA POWER CONSTRUCTION PROGRAM (APCP)
MARKETING CONCEPTS

1. Use State forms with seperate Alaska fronting company and reinsurance with State's current underwriters. $10,000,000 limit with a $5,000 deductible on front policy. Current State S.I.R.'s.

2. Paid Loss Retro on Workers' Compensation portion fronted by a seperate Alaska company.

3. Seperate combined Workers' Compensation and Casualty placement scheduled under State excess of $10,000,000.

4. $1,800,000 backed out "Premium" - Deposit premium = $1,200,000.

   - Including SIR loss fund
   - Including safety incentive program
   - Excess premiums
   - Fronting fees

5. Look for loss control and claims handling incentives, etc.

6. Cut construction contract amendment.

7. Letter to Harrison-Western with wrap-up (APCP) specs.

8. Cut Broker of Record letter.

McLennan

Date: December 14, 1981

From: Lawrence L. Drake

To: John C. Day

Alaska Power Authority - APCOP

Last month our brokerage appointment for the State of Alaska was extended along with Corroon & Black to the Alaska Power Authority. This newly formed division of the state is responsible for $8,000,000 of hydro-electric construction during the next ten years. 1660

As you know, we have jointly brokered the State of Alaska business for the past nine years with Corroon & Black, and have been notified that the existing arrangement will continue for some time, as the state perceives this arrangement as politically advantageous as well as workable professionally.

We have done ~~proposed~~ initially to extend the state programs to the Alaska Power Authority, using them to back up a series of owners wrapup projects. As we are responsible for the marine transit, liability and workers compensation, the majority of the fee billings will accrue to our benefit. We estimate that the total brokerage income over the ten year period will exceed $5,000,000, and therefore this represents a major prospect for us. We have already secured one contract to review documents, and are faced with the possibility of billing another $100,000 on a fee basis for a preliminary consultation on this program.

While there is nothing unusual in working on a co-brokerage basis with Corroon & Black, the State of Alaska is particularly sensitive to the issue of using "outside firms." The Corroon & Black operation has over ninety people in Alaska and is perceived as being located in the state, while we are still viewed, or should I perhaps say suspected, as being "outsiders." In arranging this construction program the legislature has specifically instructed the Alaska Power Authority that preference be given to Alaskan firms. We have therefore been instructed to utilize Alaskan insurance companies with whom we have negotiated a fronting arrangement which we back

J.C
12-15-81

by reinsurance. We have also been asked to develop a presence in Alaska under the trade style of APCOP, a ~~synonym~~ ACRONYM for the Alaska Power Construction Project. The intent of this trade name and Alaska presence is to allow the Alaska Power Authority to promote the program as an Alaska venture.

I have contacted Barry Furst and provided him with preliminary documents as to how we can utilize this trade style while at the same time maintaining an existing conventional joint brokerage arrangement. Barry and I are working on the actual details of this, as well as considering special production because of the nature of the working relationship with Corroon & Black. For one instance I believe it advisable for us to secure an errors and omissions policy for this particular project, simply because of its nature and the trade style of APCOP increasing the possibility of a Marsh & McLennan errors and omissions claim, which could be triggered by Corroon & Black.

While this project poses substantial revenue potential at favorable project margins, I felt that its nature required your specific approval. We have already signed the aforementioned contract for contract review with the state and will have an opportunity to execute several other larger contracts in the near future. The peculiar nature of the relationship with Corroon & Black suggests that we have an agreement spelling out the duties and responsibilities as well as having a mutual hold harmless.

The actual billings of the state will go under the name of APCOP - Marsh & McLennan, as we must use that trade style to establish the necessary Alaskan identity. From my initial conversations with Barry Furst, and the primary research we have done, we can work out this agreement and protect Marsh & McLennan while complying with the instructions to use the trade style and to work jointly with Corroon & Black.

LLD/ps

Item 4 of Assignment II is the preparation of a report on the PROS and CONS of a wrap-up or Owner controller insurance program (OCIP).

The response to this assignment follows; however, what is not contained in the PROS and CONS of such a program are other matters which I perceive to be of utmost importance before a discussion of the assignment is undertaken. These are:

1.- The single most important consideration of such a program is the proper preparation of all contracts relating to the Project: procure, procure and construct and construct only contracts. The proper risk management and owner controlled contract language must be prepared before the OCIP is undertaken.

2.- These provisions must be communicated thoroughly to all bidding contractors.

3.- A project insurance and safety manual is a necessity. The contractors should know what is expected of them in terms of life safety and property loss control including their participation in a fire brigade. This manual should contain a requirement for on-site verification of certified payroll, claims procedures and the method by which safety matters will be communicated.

4.- The "project" should be one of an on-going nature which is of sufficient size and duration in terms of values, payrolls, etc. to make possible the successful use of an OCIP. One project of relatively short duration and low values does not meet this test.

5.- Proper manuscripting of insurance policies is needed to meet the obligations undertaken in the project contracts and to protect all facts of the project, the owners and contractors.

6.- This report may be academic if the Alaska Legislature passes legislation prohibiting the OCIP approach for construction projects.

PROS

1) More control over quality of insurance program through centralization of authority.

A major advantage in the Owner or Wrap-up controlled insurance program (OCIP) is the ability of the owner to control the quality of the insurance program. The owner can choose the approach to insurance needs, and a company that will fulfill the needs of the program.

The centralization that such a program provides can benefit the owner in many areas. Such as loss control, claims settlement, public relations, etc. Centralization also has the potential to provide cost benefits to the owner through less duplication of efforts, resulting in reduced administrative cost, and better bargaining power with brokers and insurance companies because of the size of the program. These areas are discussed separately in this report.

2) Likely reduction of premiums because of large size of project.

A major advantage of the owner controlled insurance is the opportunity to reduce construction insurance premiums. This is simply a result of the competition that is generated for a project with high premium volume for Casualty Insurance. A large number of smaller individual contractors and subcontractors policies do not have the attraction of those with premiums in the millions of dollars.

The size of the premiums allow the owner bargaining power which can benefit the project not only in the cost, but in timing of premium payments, size of deposits etc.

This latter reference is especially the case with respect to course of construction insurance. If separate builders risk or course of construction insurance were purchased by each contractor and subcontractor, the owner would experience an increase in total cost of construction due to the pyramiding of these premiums. These premiums are a function of values at risk; as each succeeding contractor becomes involved, the value of risk increases and consequentially the cost of insurance.

3) Potential for saving money as a result of controlled administrative costs.

Consolidation of Project's insurance coverage can result in savings in administrative costs because paperwork is reduced. The owner does not have to renew all the contractors and subcontractors insurance programs to assure their compliance limits, in coverage, choice of insurers, etc. There can be a reduction of files, correspondence and meetings concerning renewals and cancellation of contractors insurance programs. The owner-controlled program can avoid expensive and time-consuming delays and shutdowns that can result from non-bonding or non-compliance to standards of insurance by contractors.

4) Improvement in loss control and safety coordination through project-wide program.

A large construction project contains many potential hazards, and an effective safety and loss control program can result in great savings in money, time, and injuries. An owner-controlled program of insurance allows standardization of loss control and safety procedures, which would not be possible with the numbers of parties that would be involved in insuring each contractor and subcontractor individually. This standardization can benefit the project by eliminating unnecessary duplication of engineering by the individual parties involved in overlapping areas and also by increasing the authority of enforcement of loss prevention standards. In addition, because of the size of the insurer's stake in such a project, the insurer is more likely to involve itself in an effective loss control program.

The program can also be planned under the loss control philosophy of the owner and is not involved with many conflicting methods of reaching the same goal.

The owner of the program receives any dividends from favorable Workers Compensation experience. Effective loss control and safety engineering programs can result in this direct saving.

5) Reduction of litigation in claims from accidents that involve questions of liability because of unity of insurance interests.

An OCIP can reduce litigation in claims from accidents that involve questions of liability because it unifies the insurance interests of different contractors or subcontractors that might be involved.

It eliminates the need for subrogation by insurers of each party in disputes involving liability for accidents and thus saves money and time required for litigation. There is also less litigation over grey areas of coverage or questions of which carrier is liable or which subcontractor is responsible.

A wrap-up plan is especially useful in states that have "safe place to work" statutes because many suits of this type can be avoided by use of this type of plan.

6) Standardization of claims settlements because of centralized loss control.

An OCIP can provide better investigation of claims because the same adjusters who are familiar with project handle all claims. Standardized handling of claims can result in more equitable settlements and the process can be less expensive. When a question of Worker's Compensation and/or liability coverage arises, the claims adjuster could work with both aspects of the claim. Fewer insurers to work with should result in more efficient and less expensive claims settlement procedures.

7) Safeguard of good public relations with community.

A project requiring a wrap-up plan of insurance will be a large one which will require several years to complete, and once completed, the owner will probably be associated with the location for a longer period. For this reason, public relations are important on large projects and an owner-controlled insurance plan will allow the owner to conduct his project to result in the best possible relations with the community.

Any large construction project will be met with a certain amount of resistance from the area because of inconvenience, but if a project involves relocation of peoples homes, hazardous materials, explosives, or other especially sensitive issues it behooves the owner to plan a careful campaign of public relations to make the community aware that the owner is doing everything possible to minimize accidents, eliminate health hazards and protect the environment.

When accidents occur at a site, the publicity usually falls on the owner rather than the particular contractor or subcontractor who employs the injured worker. Since the owner will probably get the blame, it makes sense for him to exercise as much control over the situation as possible.

Handling of claims from accidents requires the awareness that an economically advantageous settlement for the owner may cost a lot in public relations. These can be weighed by the owner in a OCIP in a way not possible if a contractor or subcontractor is settling claims against him.

An OCIP gives the owner the opportunity to coordinate a positive public relations plan and gives the owner the maximum control over community relations.

CONS

The OCIP holds few disadvantages for the owner of the project. The owner must be careful to assure himself that the wrap-up program really is more cost-effective than individual insurance of contractors and subcontractors. This is not always easy to determine because the information is not always readily available for comparison. The bids of the contractors with and without insurance which are necessary to make this decision could lead the owner to inadvertently overlook the lowest bidder, so care must be taken in the investigation of the implementation of the program.

There has been some discussion that the OCIP restrains trade by placing the contractors and subcontractors insurance with unknown carriers without giving them any choice or input. Agents of contractors may feel that the wrap-up program takes their business unfairly. The size of the wrap-up program gives the owner an unfair advantage by giving "group" rates when the risk is the same but would cost more to individual parties. These criticisms are not really disadvantages to the owner, but are brought out in the literature and could become important.

The major disadvantage to the owner is the opposition of contractors and subcontractors to OCIP programs. Some of their criticisms include the interference of the wrap-up in their regular insurance programs, the addition of administrative expenses for which they are not compensated, the lack of individual consideration which could result in coverage that is not really appropriate for a specific party involved, and the possible deterioration of a contractor's experience modification because of the carelessness of others in the program. For these and other reasons, many contractors do not favor OCIPs, and this may cause conflict with the owner that would be to the owner's disadvantage.

Cost Comparison for OCIPs

Although other savings may accrue through use of an OCIP, the basis for a decision on whether or not to use such a program is a comparison of estimated premiums for all parties insured individually versus those of the OCIP.

A formula to assist in this comparison is:

$$\left(\sum_{i=1}^{n} \text{PV of } B_i - \sum_{i=1}^{n} \text{PV of } B'_i \right) > \left(\text{PV of } P_w - \text{PV of } P_o \right)$$ [1]

B_i is the amount bid on construction contract i by the contractor(s) who wins the job when insurance is paid for by the contractor(s).

B'_i is the amount bid on construction contract i by the contractor(s) who wins the job when insurance is paid for by the owner.

$\sum_{i=1}^{n}$ is the summation of the elements in the series, i.e. cost of bid of contractor A + bid of contractor B, etc.

PV is the present value with each amount discounted at a specific rate of interest from the time of future payment to the present.

P_w is the premiums the owner would pay for the wrap-up.

P_o is the premiums the owner would pay to cover his interest if there was no wrap-up.

For a wrap-up plan to be feasible the left side of the equation should be significantly larger than the right side unless there are other factors that make a wrap-up plan especially desirable. If the right side is larger, then money would be lost rather than saved by use of such a plan.

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[1]Whitford, George W. "Wrap-Up of Insurance Programs," Issues in Insurance Vol. II. (Malvern, Pa. : American Institute for Property and Liability Underwriters, 1978), p. 315.

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The James Bay Project: A Symbol of Engineering and Risk Management Expertise

by Marc Darby

It began in 1971, when a Quebec government law created the Société d'énergie de la Baie James (SEBJ) and mandated the construction and exploitation of the hydroelectric resources of an immense, nearly inaccessible and practically uninhabited territory in northern Quebec. La Grande Complex, as it has come to be known, is almost 110,000 square miles in area, 450 miles from east to west and 400 from north to south. It forms an enormous jigsaw puzzle—the pieces of which are all essential. When work was at its peak in 1978 and 1979, 18,000 workers braved isolation, solitude and extreme cold to double Quebec's hydroelectric power.

Evolution of the La Grande Complex

The La Grande Complex is being constructed around the La Grande River, which is Quebec's third largest major watercourse. The river has a drainage basin of approximately 55,000 square miles and an average flow of 5,500 cubic feet per second. The La Grande, the main tributary of James Bay, flows over 497 miles, with a drop in elevation of 1,235 feet.

Construction was divided into two phases. The first of which included construction of three power stations on the La Grande River: LG 2, LG 3 and LG 4, each with its large forebay.

To increase the potential of the La Grande River, the La Grande Complex also involves the diversion of two other rivers—the Eastmain to the south and the Caniapiscau to the east—resulting in the formation of two immense reservoirs. However, to hold the waters of the forebays and reservoirs, the construction of 203 dikes and eight dams was necessary. The longest of these structures is nearly 2.5 miles and the highest is approximately 525 feet. All are constructed of natural materials found in the area, including moraine, sand, gravel and rockfill.

By January 1982, construction was 77 percent completed. With its 37 generating units, Phase I of the La Grande Complex has an installed capacity of 10,282 megawatts, and its annual production will reach 62 billion kilowatt-hours. The La Grande Complex will enable the province of Quebec to increase its installed capacity by 61 percent and its generation of electricity by about 70 percent.

Converting Water to Power

Located about 70 miles from the mouth of the La Grande River, LG 2 is the largest of the three generating stations of the La Grande Hydroelectric Complex Phase I, and, in fact, is the largest underground powerhouse in the world. Its 16 generating units, each with a capacity of 333 kilowatts, have already been delivered to Hydro-Québec for operation. With its total installed capacity of 5,328 mega-

Marc Darby is director of risk management and insurance for La Societe d'energie de La Baie James, Montreal. Mr. Darby has served as president of the RIMS Quebec Chapter, has been a member of the Society's board since 1977 and is currently the first vice president of RIMS.

The LG 3 reservoir as it looks when it is partially filled: the main dam, spillway and power house.

watts, LG 2 can generate 35.8 billion kilowatt-hours annually. The site also features an impressive spillway where water cascades down what looks like a gigantic stairway. This structure can discharge up to 53,411 cubic feet of water per second.

LG 3 is the site of the longest dam of the La Grande Complex. Engineers chose a location where an island once divided the river. This island, because of its rockbed, was also chosen to be the seat of the spillway that appears to divide the dam into two sections. The LG 3 powerhouse was built on the southern bank of the river in a deep trench excavated just below the downstream toe of the dam. It houses 12 generating units that will generate 12.3 billion kilowatt-hours annually, and its installed capacity is 2,304 megawatts. The first generating unit became operative in June, 1982.

The LG 4 powerhouse, which is planned to be commissioned in February, 1984, is also a surface structure. With its installed capacity of 2,650 megawatts, it will become the second most powerful power station in Quebec after LG 2. Annual uninterruptible energy from the nine generating units to be installed there will reach approximately 14.1 billion kilowatt-hours.

Harnessing River Power

About 93 miles south of the La Grande River, the Eastmain and its tributaries, the Opinaca and Petite Opinaca, have been diverted into the LG 2 forebay. This additional inflow increases the generating capacity of LG 2 by 25 percent.

Located at the northeast end of the territory, the Caniapiscau River used to flow north into Ungava Bay. Engineers, however, cut it off and directed the water flow towards La Grande river resulting in the formation of a reservoir more than 2,485 square miles, the largest surface of water in Quebec. Its usable storage of 124 billion cubic feet contributes 35 percent of all the electricity generated by the three powerhouses.

The energy transmission system, which brings the electricity to the consumption centers, required the construction of five 735-kilovolt lines in three separate corridors. These lines, 3,200 miles long, required 11,650 towers.

The overall cost of the La Grande Complex, including the energy transmission system and interest, will finally be $14.6 billion (Can.).

Infrastructures and Living Conditions

The rivers of the James Bay territory were not uncharted. Between 1965 and 1971, Hydro-Quebec had sponsored several exploration campaigns and, when it was decided to develop the potential of the La Grande River, SEBJ inherited this data. SEBJ then conducted further exploration work.

The first task was to build a road to the sites of the future hydroelectric projects. In 1971, an army of men and machines went to work to build the road linking LG 2 and the town of Matagami. This road, approximately 450 miles long, was built in 450 days at a cost of $450 million (Can.). While construction of this north-south road was being completed, SEBJ began construction of an east-west axis which led to the other job sites of the La Grande Complex. A total of 932 miles of roads was required to be constructed during this stage of the project. A fleet of planes was also acquired. And, when work was at its peak, SEBJ's six Convair 580 aircraft transported more

than 100,000 workers annually. Between 1972 and 1980, SEBJ used its own Hercules aircraft to transport freight.

Coinciding with road construction activities, preparations were made for the arrival of the thousands of project workers. This hardy lot would be living in isolated and remote areas, far from their families, in an inhospitable environment and harsh climate. In order to offer workers as many of the comforts of modern life as possible, SEBJ resolved to devote special attention to living conditions.

Major resources were invested so that every large campsite (a minimum of 1,000 residents for three years or more) could be favorably compared to an average town. Besides municipal services, a whole range of community services, including a hospital, laundry, administrative center and chapel, were provided. Equally significant investments were spent on recreation, to provide pleasant forms of relaxation for the workers. To direct these activities, SEBJ hired recreation and sports specialists. Even in the early years, a satellite and microwave communications system was in place, so that workers could receive radio and television programs and communicate with their families by telephone. Major daily newspapers are also available on the sites only a few hours after publication.

Obviously, construction of the La Grande Complex has been an immense logistical problem. A final example: 110,000 tons of food will be consumed between 1972 and 1985. In 1978, the 18,000 workers breakfasted on some 80,000 eggs and a ton of bacon!

SEBJ--A Project Management Company

SEBJ acts as the project management company on behalf of Hydro-Quebec, Quebec's state-owned monopoly electrical utility. Its role consists of supervising all activities, from exploration to the delivery of the powerhouses and supporting structures to Hydro-Quebec, and assuring that budgets and schedules are respected.

An overview of project's various construction sites.

The first challenge faced by SEBJ in building the La Grande Complex was the formation of an appropriate administrative structure. This structure had to be flexible and dynamic, because of the limited duration of the construction and the fluctuations in the size of the work force.

SEBJ decided to fill its manpower needs with available Hydro-Quebec resources and two outside firms: Lalonde, Valois, Lamarre, Valois et Associés, Inc. and Bechtel Quebec Ltd.

The construction of the first phase of the La Grande Complex, which is now nearing completion, has had a major economic impact. Of the overall cost of $14.6 billion (Can.), actual construction will take some $10.75 billion (Can.), $3.7 billion in wages and $7.0 billion for the purchase of goods and services. Since SEBJ entrusts all work to outside firms, Quebec contractors and manufacturers have greatly benefited from the development of the La Grande River. Companies located outside Quebec Province have also benefited from the project. For instance, purchases of goods and services outside Canada have amounted to nearly $1.72 billion (Can.).

Phase I of the La Grande Complex is only the first of the hydroelectric projects to be built by SEBJ. During the next 10 years, whenever requested by Hydro-Quebec, the company will undertake construction of three other hydroelectric projects: Phase II of the La Grande Complex, the Grande Baleine project and the Nottaway-Broadback-Rupert (NBR) project. These three projects will require investments of at least three times those required to build Phase I.

The Risk Management Program

The risk management mechanisms that must be developed when starting a project of the scope and nature of the James Bay project are as varied as they are complex. Since SEBJ was ordered to build this "megaproject" according to a budget approved in 1971, it was essential to cushion the financial losses a disaster might entail, in order to minimize the risks of exceeding this budget's parameters. It was decided that insurance would be one of the major financial tools. Thus, the mechanisms to cover potential risks were progressively instituted shortly after the creation of SEBJ.

In early 1972, an Insurance Committee was formed and given the mandate to take the steps necessary to protect the company against risks resulting from expanding activities. The committee's

Wrapping Up Big Construction Projects*

Wrap-up insurance, an idea that first was popular in the late 1940s and early 1950s, is again proving attractive to owners of some of today's most imposing construction ventures.

Hospitals, synfuel projects, shopping malls, office towers, industrial facilities—even gambling casinos—have all found "wrap-up" ideal for their purposes.

Wrap-up insurance combines key units of construction coverage, such as workers' compensation, general liability and builder's risk, into a single package placed and financed by the project owner. The general contractor and subcontractors are thus relieved of the necessity to buy required insurances for that particular project.

When first developed, wrap-up insurance appealed to owners because they realized they were paying for contractors' coverages in any case (since these costs were part of the construction companies' bids). The idea of marketing a coordinated program to a single underwriter made practical sense.

Because of the larger dollars involved, the owners obtained reduced premium rates and better coverages and the underwriter, who got more dollars to work with, could afford to give the owner more services.

Wrap-up insurance hit a lull in the early 1970s when construction activity declined and underwriters became indifferent to the coverage due to economic conditions.

In 1974, however, many states passed enabling legislation that revitalized the wrap-up concept. These laws allowed the combination of several construction premiums to be viewed as a group premium for discount and retrospective rating purposes. Prior to this, each premium had been viewed individually.

Ensuing activity in office construction, trade centers and other large projects caused "wrap-up" to return in style. Owners of those projects valued at a construction cost of $25 million (minimum) in suburban areas, and $50 million (minimum) in urban centers were the first buyers.

The owners achieve five key benefits:

- *A coordinated loss control and claims handling program that applies to all work at the site.* Each party in the construction project is thoroughly familiarized with the loss control program and agrees to support it. With the owner's unqualified support, the single, well-structured safety program usually reduces the ultimate project cost. The coordinated claims program allows a uniform approach to claims handling. This, in turn, reduces intercompany insurance disputes and costly subrogation, and results in rapid and satisfactory claim settlements. Uniformity and reduced claims costs also contribute to sound relationships among all parties to the project.
- *Concurrent and uniform coverage for the owner, contractor and all subcontractors.* The greatly reduced administrative requirements of the insurance program also cuts costs.
- *Improved public image.* The owner, who will be identified with the site for many years, is seen by the public as the one responsible for prevention of serious injury or damages. The contractor or subcontractor is less visible. The combination of an effective safety program and a responsive claims procedure that yields fair and equitable settlements avoids adverse publicity. Centralized communication with media by one insurance company in case of an incident avoids the problem of several underwriters seeking to lay financial responsibility on each other.
- *Contractor involvement.* Since wrap-up makes insurance available to all approved contractors, those who might not otherwise be able to secure insurance are covered automatically. This helps promote the use of minority contractors on major projects.
- *Reduced cost.* Mass buying from one underwriter gives the owner leverage with insurance companies. A combination of safety, claims control and mass buying often produces significantly lower costs.

Keys to the cost efficiency of wrap-up insurance are both the safety program and the rating plan developed by the insurance broker and accepted by the underwriter. Because there is a substantial premium to be placed with one underwriter, the broker can design a variety of premium funding mechanisms.

Wrap-up insurance is a time-tested construction coverage concept. It is having a well-deserved revival, not only for its convenience and efficiencies, but also for its broader advantages—building protection for human life and keeping the owner's image at its brightest.

*This article appeared in the Spring 1982 edition of *Private Opinion*, published quarterly by Johnson & Higgins, and is reprinted with its permission.

first task was to arrange for the selection of the broker(s) best able to provide adequate services to insure property under construction. The insurance of other risks was relegated to relatively minor status.

In order to obtain a versatile "talent", it was decided to innovate and, instead of selecting a single broker, a consortium of brokers was formed. In May, 1972, the brokerage firms of Dupuis, Parizeau, Tremblay, Inc., Gerard Parizeau Ltée. and Stewart Smith (Canada) Ltée. were selected to form Le Con-

sortium des Courtiers d'assurances de la Société d'énergie de la Baie James. This brokerage group became known as the Consortium.

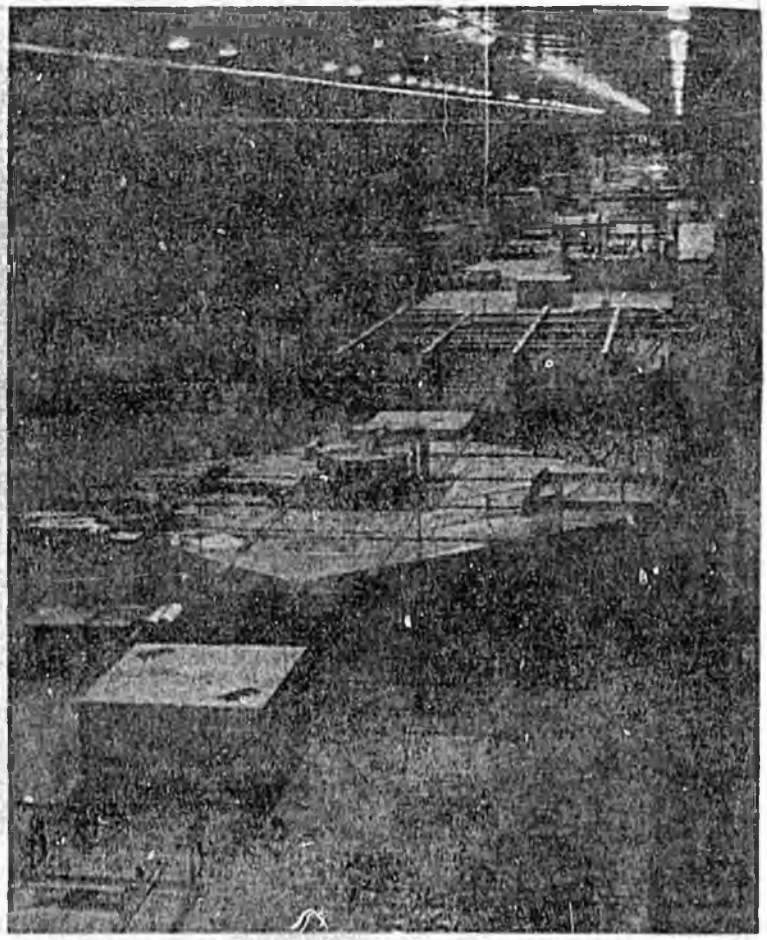
Working in close collaboration, the Insurance Committee and the Consortium were responsible for:

- evaluating the potential risks as construction progressed;
- drafting the texts of insurance policies for builder's risks and public liability that were adapted to the project; and
- underwriting and renewing various other insurance policies necessary for protection against incipient risks.

Meanwhile, a risk management and insurance consultant was hired to evaluate this approach, make a risk evaluation of the projected construction activities and submit any recommendation to cope with the corporation's eventual risk management exposure.

The consultant confirmed that most of risk treatment measures, taken to that point, were satisfactory, and further recommended the appointment of an insurance coordinator. The title of this position, filled on November 5, 1973, has since been changed to Director of Risk Management and Insurance to more accurately reflect the department's activities.

By the end of 1973, the texts of the policies, as well as the negotiations with the numerous insurers, were nearing completion. In fact, the policies were underwritten on May 1, 1974.



A view of the underground power house in LG 2.

Underwriting the Builder's Risk and CGL Policies

The eventual adjudication of numerous contracts to consulting engineers, contractors and various suppliers presented a situation of a special nature.

In order to avoid a situation wherein each company under contract underwrites its own policy, each with its different conditions, and to prevent the premiums split among many insurers, the two policies were designed to insure each and every company—engineers, contractors and suppliers—under contract with SEBJ.

The errors or omissions of consulting engineers or architects entering into contract with SEBJ presented a different and specific problem. Since most of these contracts were long-term, SEBJ wanted to avoid that a claim be publicly discussed in a court of law. Therefore, the Builder's Risk policy was drafted with a section insuring SEBJ against damages resulting from the error or omission of an engineer without having to prove the legal liability of the engineer or the architect.

Since the Builder's Risk policy insured the properties of all those working on the project site, the Comprehensive General Liability (CGL) policy was designed to exclude the indemnification of damages to goods or properties owned by any of the insured. Thus, a substantial reduction of the CGL premium was obtained. The CGL was to indemnify only for damages to residents of the territory, to visitors or, in case of damages, to any person not insured under the Builder's Risk policy.

The two policies contained, among others, the following conditions:

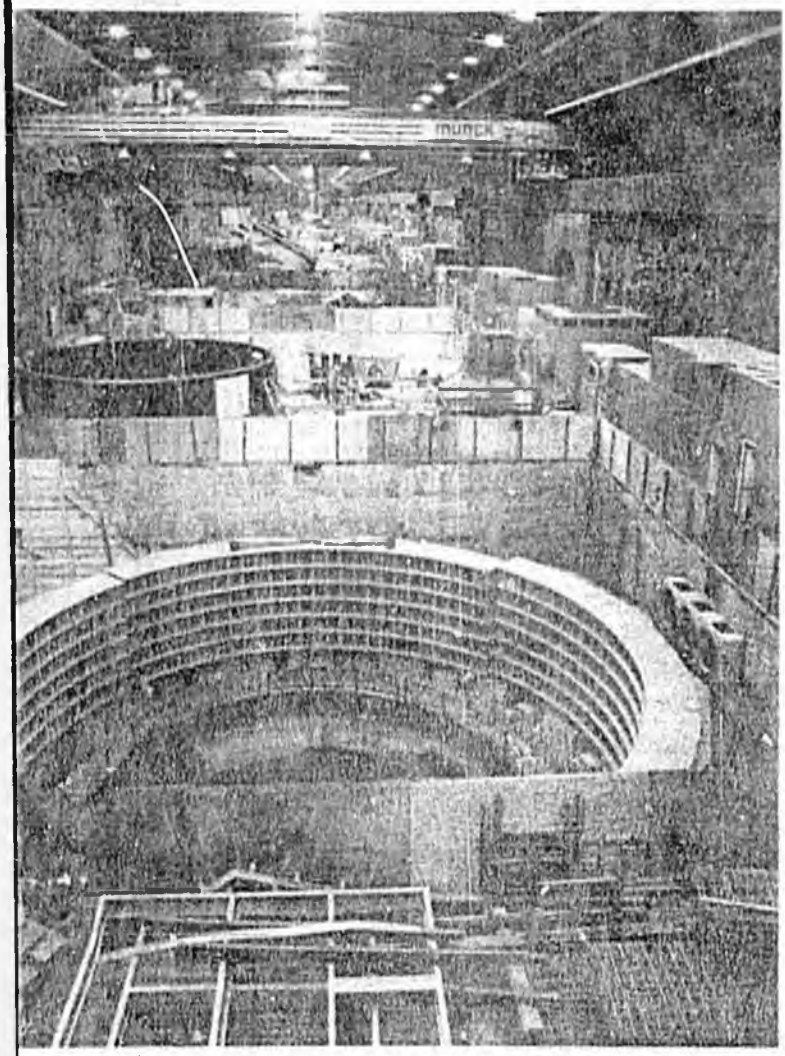
- wrap-up form, insuring the SEBJ, its constituent corporations and any engineer architect, contractor or supplier to perform on the territory;
- specific waiver of subrogation by the insurers against any insured person or legal entity; and
- designation of SEBJ as agent of all other insured for any negotiation relative to the policies.

The underwriting of the policies coincided with the start of construction. The policy limits, therefore,

had to reflect the possible maximum loss to which the properties were to be exposed over the next two or three years. All parties concerned were cognizant of the fact that a revision of said limits was possible and, in fact, probable.

The Builder's Risk policy was underwritten with an original limit of $15 million (Can.) with a sub-limit of $30 million (Can.) for damages caused by an engineer or architect error or omission. Since works were to be performed in a remote area and most of the properties were insured by the Builder's Risk policy, the limit of the CGL policy was chosen to be $25 million (Can.).

The projected annual investments of the corporation (approx. $1.25 billion), the premium credits for different levels of deductibles and SEBJ's capacity to assume losses were some of the considerations that led to the selection of a $1 million (Can.) deductible under the Builder's Risk policy and $100,000 (Can.) under the CGL policy.



The underground power house in LG 2 is shown with its partially assembled unit in the foreground.

Disseminating Information to Insureds

Since these policies were underwritten by SEBJ to its benefit and that of others insured, it became necessary to fully inform all other insureds. This was accomplished by supplying them with excerpts of the policies. Since then, extracts of the policies are supplied to all bidders by means of a section of the call for tender document. This insurance section eventually becomes part of the contract between SEBJ, its engineers, contractors or suppliers. This section also describes the obligations of SEBJ and that of other insureds in insurance matters (quotashare, loss reporting procedures, etc.).

With policy deductible levels too high to be fully absorbed by any of the other insureds, it became necessary to set a lower quota-share for them. However, the level of this different deductible had to be high enough to keep the other insureds aware of the necessity for them to install adequate safety measures. At the same time, the deductible had to be at a level such that the other insureds would not look to insurance to cover the financial losses and thus defeat the advantages of the wrap-up program. The self-assumed or imposed deductibles to other insureds was set at $5,000 (Can.). The bid document imposes such obligations on all parties to the contract.

On July 1, 1977, SEBJ underwrote a new CGL policy to replace the one in force since 1974. Certain insurers, experiencing reinsurance difficulties, withdrew. The new policy carried a $1,000,000 (Can.) deductible as opposed to the previous $100,000 (Can.).

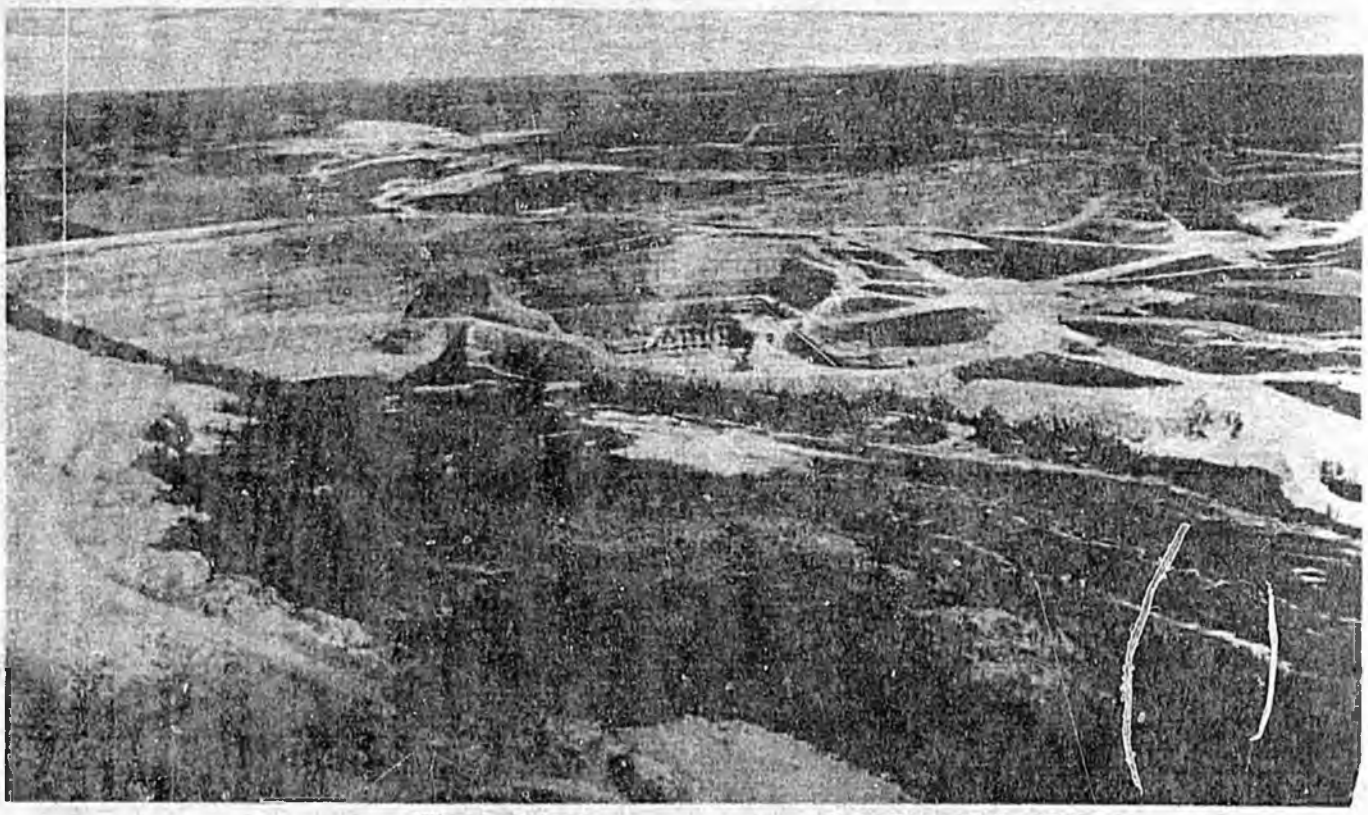
Major Insurance Revisions in 1981

The aforementioned insurance program remained in full force until the end of 1981 when a major revision of the loss financing tools was undertaken.

During the course of the project, SEBJ became a wholly owned subsidiary of Hydro-Quebec, and the Crown Corporation was mandated to generate and distribute electricity to the residents of Quebec Province. Furthermore, the approaching completion of the first powerhouse (LG 2) and its transfer to Hydro-Quebec was changing the whole context.

Considering the above factors, plus the fact that the loss experience was uniquely good, it was decided to:

- terminate the underwriting of the errors or omissions insurance;
- increase the levels of the self-assumed retention;



An aerial view of the LG 4 main dam. The power house is in the center, with the spillway to the right.

- look for increased policy limits commensurate with the possible maximum loss.

The levels of deductible or self-insured retention for damages to properties under construction have been set at $10 million (Can.) and at $30 million (Can.) for damages to fully operative completed properties. The quotations received from the underwriters, as well as their reaction, seemed satisfactory. They were to participate only to losses above the levels of operation type of losses. At the same time, these self-assumed levels could be safely assumed by SEBJ and/or Hydro-Quebec. A new policy wording, a technical report and a projected investment schedule were prepared and presented to different insurers. And, much to SEBJ's satisfaction, two policies, one primary with a limit of $300 million (Can.) in excess of the self-assumed retention, the other with a $700 million (Can.) limit in excess of the primary, were underwritten on January 1, 1982. In addition, the higher self-assumed retention levels, plus the fact that the errors or omissions insurance was not needed anymore, considerably reduced the insurance premium volume.

Thus, an additional retention of $9 million (Can.) meant a premium saving of $22.6 million (Can.) over the next five years. Based on the same investments, the premium for the program cancelled on January 1, 1982, would have been $30.4 million (Can.) while the projected cost of the new program is $7.8 million (Can.).

Good loss experience, the safest construction methods selected and the confidence in the expertise of SEBJ's designers and managers allowed such high levels of self retention.

Satisfactory Loss Experience

The losses incurred previously, considering the scope of the works and related activities, are most satisfactory.

As of May 1, 1982, 5,066 incidents have been reported. They represent all kinds of losses, from car accidents to damages to permanent structures; from fires in dormitory to the cost of forest fire fighting expenses. The net total expenditures, plus reserves for losses that have not yet been paid for, total $9,171,208 (Can.).

In most cases, contractors or suppliers are responsible for the first $5,000 (Can.) of damages caused, and such recoveries are deducted from the totals of damages caused. Thus, as mentioned above, there is approximately $9 million (Can.) left for net disbursements.

With that commendable loss experience, coupled with the success of the construction project, it can now be safely said that SEBJ's policy on safety is bringing its dividends. Electricity has been generated some six months ahead of the original schedule, and the company now assumes a greater self retention.

The good loss record, as well as insurance coverage above a known self-assumed level, provide all SEBJ managers their "quiet night's sleep". RM

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INSURANCE PREMIUMS AND RELATED MANAGEMENT SERVICES TYPICALLY RUN 8 TO 10 PERCENT OF TOTAL CONSTRUCTION PROJECT COSTS IF CONVENTIONAL PROGRAMS ARE USED. WRAP UP COSTS ARE IN FOUR TO SIX PERCENT RANGE ON THESE PROJECTS. WORKER COMPENSATION USUALLY MAKES UP 50 TO 60 PERCENT OF TOTAL PROGRAM COST. ASSUMPTION THAT NET SAVINGS BECAUSE OF WRAP UP USE WILL EQUAL TWO PERCENT OF OVERALL PROJECT SEEMS TO BE VERY CONSERVATIVE. BALTIMORE MTA SAVING IS 6 PERCENT.

PROPOSED ALASKIAN HYDRO-ELECTRIC PROJECTS INVOLVING ROCK TUNNELING, UNDERWATER WORK, AND COMPRESSED AIR CONSTRUCTION CONDITIONS WILL BE RATED SAME AS TRANSIT PROJECTS BY INSURANCE COMPANIES. ARGUMENT THAT THIS IS DIFFERENT FROM TRANSIT IS NOT ACCEPTED BY INSURANCE UNDERWRITERS. THEY DON'T CARE WHETHER TUNNEL IS TO CARRY WATER, POWERLINES, SEWERAGE, AUTOS OR TRANSIT CARS. IT IS THE SAME SET OF CONSTRUCTION HAZARDS FOR ALL.

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PROJECT	CONVENT'L	WRAP UP	SAVINGS 0/0
SAN FRANCISCO	46.3	29.8	35.6
WASHINGTON	98.4	62.2	60.0
ATLANTA	61.3	39.9	34.9
BALTIMORE	46.0	27.5	40.2

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James E. Barrett

A career consultant since 1962, and president of Cresheim Company since 1968, he has worked with more than 140 corporate, public and private clients in North America, Europe, Latin America and the Far East. Some client relationships extend for fifteen years.

MANAGEMENT CONSULTING. Projects involve questions of organization, business strategy, corporate development and planning for manufacturers, process industry firms, and service businesses.

MANAGEMENT DEVELOPMENT. Widely known in executive and management development circles, he conducts workshops in business negotiating, problem-solving and decision-making, market planning, and individual productivity for corporations, public agencies and trade associations.

VENTURE MANAGEMENT. He participates in Cresheim's venture work, managing service industry projects, and is a veteran of 26 startups. These range from computers to early learning, food distribution, insurance, microfilm, optical scanning, printing, retail distribution, training and wine making.

CLOSELY HELD CORPORATIONS. Mr. Barrett also is well known in the independent business sector of the United States and Canada for his work on family business continuity, development of young executives in independent firms, and organization and ownership problems of partnerships and private firms.

MARKETING CONSULTING. Projects involve market plans, implementation of new approaches, sales force size and productivity, customer services, sales systems, market share, pricing, competition, and growth options.

DEALERS, DISTRIBUTORS AND AGENTS. A by-product of his management development work, and long experience with independent businesses has been requests by major corporations to help in development of their dealers, distributors and agents. Some of this work involves workshops; some is consulting.

INTERNATIONAL WORK. Projects with multinational corporations made him a frequent world traveler in the late Sixties and he continues this work with several overseas trips each year. His experience includes periods of extended residence in England and Germany while managing startups in 1966 and 1967.

SPONSORED RESEARCH. A continuing activity is management of multidisciplinary research projects of a predominantly economic nature. Recent examples which led to publicly available results include, in 1976, *Tunneling; The State of the Industry* (with R.S. Mayo and R.J. Jenny) and, in 1977, *Insurance for Urban Transportation Construction*.

PRIVATE RESEARCH AND WRITING. Current research interests are in joint ventures, continuing development for senior executives, and advanced negotiating tactics. Mr. Barrett's published papers have appeared in the *AMA Management Review, American Archivist, Boardroom Reports, Business Horizons, Cresheim Comment, Sales Management*, and *Training*. He is the author of three books: *Managing Problems* (1970), *Improving Negotiating Skills* (1971), and *Managing Action* (1972, co-authored).

CMC DESIGNATION. He is a Certified Management Consultant, having met the demanding requirements of the Institute of Management Consultants, the profession's certifying body.

UNIVERSITY FACULTY AFFILIATIONS. He was an assistant professor at Harvard College and a visiting lecturer at the State University of Iowa; the University of Michigan; and the Air Command and Staff College.

EARLY EXPERIENCE. From 1951, he served in the United States and Korea with the Air Force; taught at Harvard College (1954-58); was a systems analyst, records management specialist and systems and procedures manager for Raytheon Company; and general manager of a beverage wholesaling firm, before entering consulting.

VOLUNTEER ACTIVITIES. Active in alumni, community and professional affairs, he serves as president of the Wyndmoor Community Association, as president of the Philadelphia Chapter of the American Association of Small Research Companies, and on AASRC's committee for the 1980 White House Conference on Small Business.

PERSONAL BACKGROUND. He and his wife, Dorothy, have four children. Both New Englanders, they have lived in Philadelphia since 1968. He was born in December, 1929, in Lowell, Massachusetts, graduated from Harvard in economics, from the USAF's Command and Staff College, and did graduate work at Washington University in St. Louis.

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March 15, 1982

John Haywood, Director
Division of Risk Management
Department of Administration
State of Alaska
Pouch C
Juneau, Alaska 99811

Dear John:

OWNER-CONTROLLED INSURANCE PROGRAMS

During my experience of approximately 10 years as a Risk Management Consultant and several years prior to that as a Safety Engineer with a major insurance company, I have been familiar with a number of owner-controlled (wrap up) insurance programs on various construction projects. In all of these cases, the programs have been successful in terms of meeting the two basic objectives of this type of program. These are:

1. To reduce the pain and suffering as a result of injuries to workers and members of the general public.

2. To reduce the cost of the project.

These objectives are mutually supportive in that if the injuries are reduced, costs are reduced and if costs are reduced, it is only through a reduction in injuries. It is only through effective control over the workplace that injuries can be reduced. This control is achieved principally as a result of the interest of the owner and the general contractor in the overall safety program and claim control efforts on the construction site.

The improved loss control and claim management programs which are developed as part of an owner-controlled insurance program create benefits for all participants.

1. First, the owner receives the direct monetary benefit of dividends and return premiums as a result of the low-loss ratios.

2. The general contractor and the subcontractors obtain a lower experience modification factor for their workers' compensation programs as a result of the improved loss ratios and these lower modification factors can then be utilized by them in offering lower bids on future projects.

3. The employee benefits through a safer place to work with less time off and economic suffering as a result of on-the-job injuries.

In a recently completed coal fired electrical generating plant, the total premium paid for general liability, workers' compensation and builders' risk coverage was $15,846,464. As a result of a 23% loss ratio during the course of this project, dividends were returned to the owner in the amount of $6,185,954. In another project, a nuclear generating station, the subcontractors are all insured in the general contractors policy and their combined loss ratio has stayed at a level of 14%. A total premium of 1.3 million dollars has been paid for the workers' compensation and general liability coverages for these subcontractors and $664,000 has been returned to the owner through the general contractor as a result of this combined insurance program. At this same project, the general contractor's loss ratio has been at the 40% level.

The advantages of an owner-controlled (wrap up) insurance program can be listed as follows:

1. Lower insurance costs through concentration and coordination of the buying effort to take full advantage of premium size discounts, combined rating plans and the elimination of overlapping and pyramiding coverages and charges.

2. Adequate, uniform policy limits and coverages with generally rather broad provisions for all on-site contractors regardless of size and scope of participation.

3. Centralize safety program through the use of one insurer to coordinate all loss-control efforts on a full-time, on-site basis.

4. Centralize on-site medical treatment and claims handling facilities through a single insurer eliminating differing interpretations of coverage, costs, and jurisdictions.

5. Hold harmless and waiver of subrogation requirements are minimized, reducing litigation among subcontractors over subrogation rights.

6. Owner has stronger position to control claims and public and employee relations' problems as they arise.

7. Reduced administrative costs and functions through standardization of forms, coverages, reporting procedures.

8. Insurance brokerage and agency commissions are reduced due to a single brokerage placement.

9. Possible tax advantages in that premiums may be treated as an expense rather than a part of a capital value.

10. All premium discounts and dividends are returned to the owner as purchaser of the wrap up, instead of to the subcontractors.

The disadvantages of an owner-controlled insurance program are several and can be very important depending on the perspective. They are:

1. Dilution and disruption of subcontractors' insurance programs through their participation in a wrap up, which diminishes their leverage with their own insurance carriers and brokers.

   Comment: While this is true, the lower loss ratios which have historically been developed as part of a wrap up will lower the experience modification factor for the subcontractor so that his future insurance costs will be lower.

2. Wrap-up coverages may not be as broad as the coverage maintained by the contractors and may require that supplemental coverages or excess limits be maintained or purchased with the costs buried in their contract prices.

   Comment: In most cases, the purchasing power of the wrap up will enable the owner to obtain extremely broad coverage eliminating the need for any supplemental coverages. Also, high liability limits are ordinarily a part of a wrap-up program and are much higher than that maintained by individual contractors. A wrap-up program will also provide a cross liability endorsement and an adequate annual aggregate property damage liability limit.

3. All premium discounts and dividends are returned to the owner.

4. Additional time and expenses are required to initiate, administer and audit each contractors' participation in a wrap-up plan and this will be charged back to the owner in the overall job costs.

   Comment: This time and expense is relatively insignificant compared to the potential savings under the wrap-up program.

5. Subrogation actions are not necessarily eliminated by a wrap up as prudent contractors may attempt to protect their workers' compensation experience rating modification by attempting to shift a compensation claim to the project wrap-up liability insurer where contributory or sole negligence of other contractors or the owner are involved.

   Comment: A few of these situations may arise under the wrap up but will be substantially less than the number of situations under a program with individual insurance coverages.

For any major construction project with a total cost of $100,000,000 or more, we recommend to our clients that they seriously consider the advantages of an owner-controlled insurance program for general liability, workers' compensation and builders' risk insurance coverage. In most cases, the direct cost comparison will favor the owner-controlled program and when the difficult to define costs are included in the considerations, the owner-controlled program becomes the obvious choice.

Respectfully submitted,

Dick Huntington

Richard R. Huntington, CPCU
Manager, Western Operations
Risk Management Services

RRH:cf

Warren, McVeigh & Griffin, Inc.
Risk Management Consultants

March 15, 1982

Mr. John Haywood
Director of Risk Management
State of Alaska
Department of Administration
Division of Risk Management
Pouch "C"
Juneau, Alaska 99811

OWNER-CONTROLLED WRAP-UP INSURANCE PROGRAM

This report is in response to your telephone inquiry of March 8, 1982 and supplements our report on the same subject, dated March 2, 1982. You have requested that we: (1) research our library and survey personnel who have been actually involved in wrap-up insurance programs and (2) report to you their actual experience with wrap-ups and their reasons for having chosen a wrap-up insurance program.

A. TELEPHONE CONTACT

The following quotations were received from interviewed parties:

1. Virgil A. Wellborn -- Tri-County Metropolitan Transportation, District of Oregon.

   "We have selected a wrap-up insurance program for the Banfield Light Rail Project for a number of reasons, the most important being:

   a. Estimated savings of 30%-40% on insurance premiums.

   b. Contractor employee's, our employee's and the general public deserve the coordinated safety program which the wrap-up provides.

   c. As a public agency we must constantly strive to wisely use our revenues. To do less can only invite suits against our public officials."

2. Norman Cocanour -- Arizona Public Service.

   "Fantastic way to involve an owner in the safety, claims and cost control aspects of the project. From a quality control standpoint, (a wrap-up) not only helps assure a safe jobsite but also a safe operating facility after construction.

   ". . . I can document premium savings of 30% to 50%."

1420 Bristol Street North, Newport Beach, California 92660 • (714) 752-1058

3. William Hughes — Southern California Edison.

   "I can demonstrate savings of 30% on workers' compensation premium equating to several million dollars annually. General liability rates are running 25% below the market rates — even considering the present soft market.

   "Much easier coordination of safety at the jobsite, comprehensive safety engineering provided by the wrap-up insurer. Safety record among the best for utility construction projects in the U.S.

   "From the risk manager's viewpoint, much better to have wrap-up, because you know all contractors are properly insured once they arrive at the jobsite."

4. William P. Noone — Pacific Gas & Electric.

   "We have used wrap-ups on every major construction project for over 20 years. We're completely satisfied with the results and will continue to use wrap-ups in the future."

5. Marc Darby — Director, Risk Management & Insurance Societe d'energie de la Baie James, Montreal, Quebec.

   "Our wrap-up program has served us very well. We have saved many millions of dollars in premiums while running a very safe jobsite.

   "I have recently remarketed my insurance coverage resulting in an additional $22 million in premium savings to the project."

6. David Ashbey — Department of Civil Engineering, Massachusetts Institute of Technology.

   "I have been a consultant to the Department of Transportation as well as a number of other clients . . . convinced that a wrap-up insurance program makes sense for any major construction project."

7. Russell McFarland — Southern California Rapid Transit District, Los Angeles, California.

   "While I was at the DOT in Washington, D.C., I had the opportunity to see a number of wrap-up insurance programs in operation for various projects which involved DOT funds. Without exception these programs saved the taxpayers millions of dollars.

   "The Southern California Rapid Transit System contemplates using a wrap-up insurance program on our major construction projects."

B. WRITTEN COMMENTS

Written comments include the following:

1. Roy A. Westram, "Advantages of Wrap-Up Plans" The Annals of Chartered Property and Casualty Underwriters, Vol. 18, No. 4 (Winter, 1965) pp. 317-338.

"Why are owners' representatives and managers of insurance for large construction companies becoming increasingly interested in the wrap-up approach to construction insurance and construction contracts? The survey indicated that possibly the major reasons, in addition to savings, for this trend result from (1) the concern for good relations with the public residing in the immediate area of the project and (2) their responsibilities to employees as well as those of all contractors on the project. The advantages of wrap-up coverage from the viewpoint of production of the corporate image produce both direct and indirect benefits."

2. Ralph E. Becker and Herbert S. Denenberg, "Wrap-Up of the Wrap-Up" The Annals of the Society of Chartered Property and Casualty Underwriters, No. 3 (September, 1967), pp. 197-217.

"The authors conducted a survey among owners who had used the wrap-up and found that all but one of sixteen contacted endorsed the wrap-up approach enthusiastically . . . The group generally was convinced that most of the claimed advantages of the wrap-up were realized. Further, those that were engaged in continuous building programs stayed with the wrap-up, and their enthusiasm waxed rather than waned over time . . . an intelligently designed wrap-up can do the job which its proponents claim. In a nutshell, that job is the best insurance at the lowest price."

3. Long & Gregg, "Property & Liability Insurance Handbook," p. 505.

"Mixed and sometimes quite strong viewpoints both pro and con exist within the insurance community as to the propriety, or even legality, of combining under one set of policies protection for the diverse interests of a project owner, the general contractor, and various subcontractors. However, the weight of logic seems clearly to rest with those supporting the wrap-up concept."

4. Charles F. Levinson, Business Insurance, June 28, 1968, p. 20.

"At the (New York) Port Authority we are firmly convinced that on a large project a considerable savings can be made for the owner. In addition, it simplifies the insurance certificate handling procedures, eliminating the need for checking into the insurance program of each contractor before they are allowed to start work on your behalf. I doubt that it would be possible for any contractor to buy, individually, as broad a coverage as the property owner could purchase by putting all his eggs into one basket."

5. Robert W. Self, The National Insurance Buyer, November, 1966, p. 26.

"It goes almost without saying that there are mixed and sometimes quite strong viewpoints on the pros and cons of a "Wrap-Up" both within the confines of the insurance community and within the construction industry. It is also evident, however, that the plan does work to the benefit of the owner when properly established. If these were not so, the whole concept would disappear from the insurance scene."

metro

Washington Metropolitan Area Transit Authority

600 Fifth Street, N.W., Washington, D.C. 20001

(202) 637-1234

August 28, 1981

Mr. John Haywood
Division of Risk Management
Department of Administration
State of Alaska
Pouch C
Junean, AK 99811

Re: Safety Awareness Program

Dear Mr. Haywood:

I am enclosing copies of our "Safety Awareness Program" and supportive information as discussed in our telephone conversation of August 26, 1981.

Our insurance coverage is a loss responsive wrap-up policy and we are able to confirm the contractors reporting documentation by review of our loss runs at the close of the contract.

For the program to be effective a base incidence rate must be established for each type of construction. Thru July our contractors have worked a total of 83,329,296 man - hours, we break down the man - hours to type of construction and accident experience, then establish an incidence rate for each new contract.

To date our program has assisted with a sizeable reduction in our lost workday cases and insurance costs.

If I can be of further assistance, please contact me.

Sincerely,

Donald M. Lahr
Safety Engineer
Office of Design and Construction

1.0 TREND ANALYSIS OF CLAIMS

	FY82 NUMBER	FY82 AMOUNT	FY83 TO 12/31 NUMBER	FY83 TO 12/31 AMOUNT
***** 1.1 TREND ANALYSIS BY COVERAGE *****				
WORKERS COMPENSATION	24	264,416	64	245,867
STATE PROPERTY	1	43,500	1	115,000
TOTAL	25	307,916	65	360,867
***** 1.2 TREND ANALYSIS BY NEXT ORGANIZATIONAL LEVEL *****				
UNKNOWN AFA				
MISC KNOWN AFA				
ADMINISTRATION				
TEE PROJECT	25	307,916	65	360,867
TOTAL	25	307,916	65	360,867
***** 1.3 TREND ANALYSIS BY CIRCUMSTANCE RELEVANT TO PREVENTION *****				
FALLS & SLIPS	1	71,385	9	41,348
HAND TOOLS	1	448	3	25,435
MANUAL MATERIAL HDLG	3	590	9	48,793
MOTOR VEHICLE	1	3,040		
FIRE OR EXPLOSION			1	115,000
ILLNESS	1	9,129	2	6,893
OTHER	15	230,025	41	123,348
TOTAL	25	307,917	65	360,867

The above losses have not had a trending or development factor applied to them. Therefore, these losses will increase when the trending analysis is performed.

3.0 LISTING OF CLAIMS

CLAIMANT / CLAIM NUMBER	ACC DATE / DESCRIPTION OF THE CLAIM	TOTAL INCURRED	STATUS	ORGANIZATION
***** LISTING OF CLAIMS BY COVERAGE - REPORTED IN THE PERIOD October-December *****				
***** WORKERS COMPENSATION *****				
BASKETT JAMES P0318323	12/05/82 MECHANIC BRADFIELD CANA	300.00	OPEN FELL FROM LADDER ON CRANE/L-SHOULDER CONTUSION	TYEE PROJECT
BENOIT GREG C P0318320	11/30/82 TUNNEL MINER/BRADFIELD	650.00	OPEN STRUCK BY FALLING ROCK/RT/EAR LACERATION	TYEE PROJECT
BOON DANIEL R P0318312	10/28/82 IRON WORKER/BRADFIELD C	6,791.00	OPEN OPRTNG AIR DRILL-LEFT CARPAL TUNNEL SYNDROME	TYEE PROJECT
BROOKS TOM E P0318316	11/23/82 TUNNEL MECHANIC/BRADFIE	400.00	OPEN LIFTNG 8'LENGTHS OF ANGLE IRON-MUSCLE STRAIN	TYEE PROJECT
CZARNECKI CLYDE A P0318315	11/26/82 CIVIL LABORER/BRADFIELD	672.00	OPEN STRUCK BY CHAIN-LACERATION-R/INDEX FINGER	TYEE PROJECT
DAUENHAUER MICHAEL L P03018309	11/19/82 CHASER/TYEE TRANSMISSIO	4,881.00	OPEN SLPD/FELL-ICE COVERED RD/L/EYE LACERATION	TYEE PROJECT
DE GRANDE ALONSO P0318319	11/18/82 SERVICE OILER/BRADFIELD	450.00	OPEN UNPLGNG CEMENT AUGER WHN CEMENT FLEW INTO L/EYE	TYEE PROJECT
DIGGLES LEONARD G P0318317	11/19/82 TUNNEL MINER-BRADFIELD	500.00	OPEN SLIPPED/FELL WHILE LOADING STEEL-L/KNEE SPRAIN	TYEE PROJECT
DUCIC JONNIE R P03018306	11/03/82 CIVIL ENGINEER/BRADFIEL	350.00	OPEN JUMPED OFF OF RAMP/LUMBAR STRAIN	TYEE PROJECT
DUKES ARDITH LYNE P0303024 0	12/12/82 COOK/BRADFIELD CANAL AL	20,950.00	OPEN SLPD-WET SPOT-FLR/FELL-TORE LIGAMENTS R/KNEE	TYEE PROJECT
HERRERA EFRAIN R P0303513	10/11/82 RIGGER/TYEE TRANSMISSIO	130.00	CLOSED BUMPED BY SAW BAR/FOREHEAD LACERATION	TYEE PROJECT
HURD BEN P0303370	07/21/82 MINER/BRADFIELD CANAL	98.07	CLOSED DROPPED TOW LINE-L/FOOT CONTUSION	TYEE PROJECT
HURD BENNY H P0303398	08/12/82 MINER/BRADFIELD CANAL	37,135.00	OPEN STRUCK BY FALLING ROCK-SEVERE LACERATION-L/HAND	TYEE PROJECT
HURD BENNY H P0303512	10/20/82 MINER/BRADFIELD CANAL	300.00	OPEN JUMPED OFF MUCKER/BANGED KNEE/CONTUSION-L/KNEE	TYEE PROJECT
JONES GERALD E P0303377	07/28/82 ELECTRICIAN/BRADFIELS C	301.92	CLOSED PINNED BY RR TIES/COMPRESSION INJURY R/LEG	TYEE PROJECT
KIEDROWSKI DONALD C P0303514	10/27/82 POWDERMAN	21,000.00	OPEN EXPLOSION/FATALITY RESULTED	TYEE PROJECT

3.0 LISTING OF CLAIMS

CLAIMANT / CLAIM NUMBER	ACC DATE / DESCRIPTION OF THE CLAIM	TOTAL INCURRED	STATUS	ORGANIZATION
***** LISTING OF CLAIMS BY COVERAGE - REPORTED IN THE PERIOD October-December *****				
KUEPPER RICHARD J P0318314	11/15/82 SHOP FOREMAN/BRADFIELD	500.00 SLIPPED/FELL WHILE CARRYING IRON/LUMBAR STRAIN	OPEN	TYEE PROJECT
MACLAY PHILLIP P0303385	07/30/82 ELECTRICIAN/BRADFIELD C	65.21 FOREIGN BODY R EYE	CLOSED	TYEE PROJECT
MARQUETTE LEE A P03018305	09/25/82 CHAIN SAW OPERATOR TYEE	200.00 STRUCK IN EYE WITH STICK WHILE CLEARING BRUSH	OPEN	TYEE PROJECT
MASSIE CLYDE A P03018303	10/30/82 MECHANIC/TYEE TRANSMISS	900.00 GAS FUMES EXPLDED WHL SLDRNG BATRY TERMINALS	OPEN	TYEE PROJECT
MC DONALD GREG H P0318322	10/27/82 CIVIL LABORER/BRADFIELD	500.00 STRUCK BY BROKEN JACK LEG-L/WRIST CONTUSION	OPEN	TYEE PROJECT
MC LEAN LEROY P0303386	08/02/82 MECHANIC/BRADFIELD CANA	238.65 HIT BY ROCK/SCALP LACERATION	CLOSED	TYEE PROJECT
OCHNER FRED S P0318310	11/25/82 IRON WORKER/BRADFIELD C	12,802.00 FELL FROM RESC.-APPROX 15'-FRACTURED RIBS	OPEN	TYEE PROJECT
OCHSNER FRED S P0303523	10/26/82 IRON WORKER/BRADFIELD C	250.00 POKED BY TIE WIRE/LACERATION R/ARM	OPEN	TYEE PROJECT
PARK HUNT P0303384	08/01/82 GENERAL LABORER/TYEE LA	28.15 SWING SPIKE HAMMER TO HARD/UPPER BACK STRAIN	CLOSED	TYEE PROJECT
PARK HUNT P0318318	11/17/82 GENERAL LABORER/BRADFIE	1,632.00 TWSTD NECK WHL WLKNG UP STEPS/CERVICAL STRAIN	OPEN	TYEE PROJECT
PETERS JON S P0303522	10/21/82 CARPENTER/BRADFIELD CAN	101.20 KNEELING ON CONCRETE/FOLLICULITIS OF THE KNEES	CLOSED	TYEE PROJECT
PETERS JON S P0318313	11/14/82 CARPENTER/BRADFIELD CAN	170.50 WATER DRIPPED INTO EYE/FOREIGN BODY R/EYE	CLOSED	TYEE PROJECT
PETTICREW ETHAN P0303382	08/02/82 TUNNEL LABORER/BRADFIEL	179.80 STRUCK BY ROCK/SCALP LACERATION	CLOSED	TYEE PROJECT
READ KENNETH E P0303391	08/03/82 SAWYER/TYEE LAKE PROJEC	88.25 BUCKING TREE/RIGHT HIP CONTUSION	CLOSED	TYEE PROJECT
SHERMAN MARK S P0303521	10/26/82 APPRENTICE LINEMAN/TYEE	680.00 USING BLOW PIPE/FOREIGN BODY R/EYE	CLOSED	TYEE PROJECT
SINGSTAD LEIF G P0318311	11/20/82 CAMP MAINTENANCE/BRADFI	800.00 SLIPPED FROM LADDER/GRADE II L/ANKLE SPRAIN	OPEN	TYEE PROJECT
WHITE TIM M P0303375	07/26/82 AIR TRACK DRILLER/TYEE	41,750.00 TWSTD BACK WHILE LIFTING RR TIE/ACUTE BACK INJURY	OPEN	TYEE PROJECT

3.0 LISTING OF CLAIMS

CLAIMANT / CLAIM NUMBER	ACC DATE	TOTAL INCURRED	STATUS	ORGANIZATION
		DESCRIPTION OF THE CLAIM		

***** LISTING OF CLAIMS BY COVERAGE - REPORTED IN THE PERIOD October-December *****

WITHINGTON THOMAS D	11/02/82	300.00	OPEN	TYEE PROJECT
F03018301	SHAG DRIVER/BRADFIELD C	SMASHED FINGER TIPS WHILE LOADING DRILL STEEL		

***** STATE PROPERTY *****

S.E.HARRISON WESTERN	10/27/82	115,000.00	OPEN	TYEE PROJECT
83-131	TYEE LAKE	EXPLSN-MAGAZINES CONTENTS:FOWIP/VICNTY VAPORIZ		

process of paying Anchorage lawyer Bill Cook about $20 000 to conduct an "intensive investigation of Gorsuch Asked his reaction to thi

maker's allegations that Gor

Anchorage Daily News 3/15/83 (B-1)

Dam insurance costs called questionable

By RICHARD FINEBERG
Daily News correspondent

JUNEAU — A controversial method of providing insurance coverage for the $125 million Tyee Lake hydroelectric project may have resulted in unnecessary expense to the state, an Alaska Power Authority consultant says in a draft report.

A legislative audit conducted last year and the study in progress by power authority consultant Dan McCarthy of Los Angeles question the way in which the state put together the $3.8 million insurance package for the project.

However, the company that took the lead in arranging th insurance program, Marsh & McLennan of Seattle, called McCarthy's draft report "totally erroneous."

The hydropower project is under construction in Southeast Alaska near Petersburg.

McCarthy says his on-going review of documents related to the insurance plan does not give him a clear understanding of all expenditures in the complicated insurance package.

Among the arrangements McCarthy questioned are two $20,000 payments of investment income and $78,000 designated for a safety program.

McCarthy's draft report does not make it clear whether he believes the funds were mismanaged, or simply buried in an unnecessarily complicated bookkeeping system. He is still studying the issue.

The Tyee insurance package uses a form of coverage called wrap-up insurance. Under a wrap-up, the owner acquires the insurance. On other construction projects, contractors provide their own insurance.

Using the wrap-up insurance method can save the

See Page B-2, INSURANCE

Insurance package for Southeastern hydroelectric project questioned by state official

Continued from Page B-1

owner millions of dollars on large projects, says John Haywood, director of the state's Risk Management Division.

On a wrap-up, Haywood says, the state can use the leverage gained by the large size of the insurance package to secure a custom-designed program, and thereby save money.

Haywood recommended the wrap-up program for Tyee and helped the Alaska Power Authority put it together. He is convinced the state will save at least $3 million on Tyee insurance costs, and that Tyee will have a safety program as good — or better — than standard insurance would provide.

"The final chapter on Tyee is going to be there for everybody to see," he says.

But the advantages of wrap-up insurance coverage are not universally accepted.

Wrap-up insurance is opposed by some segments of the insurance industry, unions and general contractors because it interferes with their normal business practices. Last year the legislature passed a bill prohibiting wrap-ups, but the governor vetoed the measure.

For the Tyee wrap-up, McCarthy, the power authority's California-based insurance consultant, is having difficulty tracing expenditures for the $3.8 million insurance program.

In November, McCarthy met with Haywood and representatives of the primary insurance companies handling the Tyee program for the state — Marsh & McLennan, Corroon-Black/Dawson and Pacific Marine Insurance. Then he examined documents on the complex insurance program.

"Based on my meager understanding of this program," McCarthy wrote in a Jan. 3 draft report to the power authority, "... there exists the possibility that APA may have overpaid ... premiums and expenses."

"The Tyee package," McCarthy wrote is "very cumbersome ... difficult to understand and in some cases duplicative." When he wrote his report, McCarthy noted, he still lacked important information. He received some of that information late last week at his home in California, but he has not yet had time to evaluate it.

"There are still unanswered questions that require further analysis," McCarthy said Monday. "I'm not sure whether it's impropriety, or the rather unusual structure of the program and its cumbersome reporting system."

Wrap-up programs typically involve many layers of insurance with separate insurance policies.

The finance director of the power authority, Ray Benish, says he is troubled by the lack of clear accounting for insurance expenditures on Tyee to date. In view of past investigations of the program, he said, it is particularly surprising that the documentation for the Tyee insurance contracts still raises questions.

"If we spent X dollars, we should be able to account for them all," Benish says. At the moment, power authority consultant McCarthy is telling Benish he still can't do that.

McCarthy's questions have drawn an angry response from Marsh & McLennan vice president David Carlson, who wrote McCarthy March 2 that he has provided all of the information McCarthy requested and stands ready to provide more.

."Your "draft report makes implications and innuendoes that are totally erroneous and based apparently (to quote from your report) 'on your meager understanding of this program,' " Carlson wrote.

McCarthy was in Juneau Monday to look through four boxes of documents the House Labor and Commerce Committee obtained last year from the insurance companies and the Risk Management Division.

The industry documents were obtained through a rare use of a legislative subpeona, issued by the House Labor and Commerce Committee.

Billy Berrier, director of legal services for the legislature, says subpoenas are drafted from time to time at legislative request, but are rarely issued.

A recommendation by legislative auditors in 1982 launched the power authority's internal investigation. The 1982 legislative audit "found the allegations that APA, Risk Management, or brokers/agents acted improperly to be unsubstantiated." But the audit also identified problems and unanswered questions concerning the complicated insurance program.

According to the legislative audit, the power authority "acted hastily in its decision to employ owner-provided (wrap-up) insurance for Tyee."

In his Jan. 3 draft report this year, McCarthy said APA officials should examine in greater detail payments by Marsh & McLennan and Corroon-Black/Dawson, who manage the program for the power authority, to principal insuror Pacific Marine.

The Fund for Investigative Journalism provided financial support for the research on this article.

ALASKA POWER AUTHORITY

334 WEST 5th AVENUE - ANCHORAGE, ALASKA 99501

Phone: (907) 277-7641
(907) 276-0001

April 29, 1983

Senator Richard Eliason
c/o Sheila Peterson
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Senator Eliason:

Pursuant to your request, enclosed is the draft report from our insurance consultant, Mr. Dan McCarthy, regarding the Tyee Wrap Up Insurance Program. Again, this is a draft report for discussion purposes only.

Sincerely,

R. J. Benish

Raymond J. Benish
Director of Finance

RJB:kjs

Encl. as stated

cc: Eric P. Yould, APA
Commissioner Dick Lyon, Chairman
APA Board of Directors

SENT BY DHL 4/29/83

McCARTHY & ASSOCIATES, INC.
RISK PREPAREDNESS CONSULTANTS
4108 Monet Avenue
Woodland Hills, California 91364

(213) 738-9973
(213) 348-6005

Daniel R. McCarthy
President

April 27th, 1983

Mr. Raymond J. Benish
Director of Finance
The Alaska Power Authority
334 West 5th Avenue
Anchorage, Alaska 99501

DRAFT
for discussion purposes only

Dear Ray:

Here is the report on the Tyee Wrap-up Insurance Program.

It utilizes the prior draft report where the portions of that report did not change. This report expands the draft and analyzes the insurance protection afforded. It also contains recommendations in certain areas to bring the wrap-up insurance to a position of uniformity and clarification.

Perhaps not properly includable in the report is an observation relative to communications. This comes about as a result of the meeting I attended in Seattle on March 31, 1983 at Mitsui's offices.

I came away from that meeting with the feeling that the contractors in attendance at the meeting believed they were not listened to in regard to their concerns for the insurances provided them.

Since that meeting I have had a telephone conversation with one broker and a letter from another. A copy of the letter had also been sent to APCOP. I reported the contents of the telephone conversation to Dave Carlson. I was promised that the immediately doable concerns would be met and that a quotation for the changes in the builders risk and/or marine insurance would be available to me, today, before I depart for Anchorage. I hope this will be fact.

The point is that immediate communication by and between all parties involved in a wrap-up program is paramount. The goodwill and trust of contractors is essential to the successful administration of a wrap-up program.

...2.

The feeling I have is that this hasn't been the case for the Tyee wrap-up.

In an effort, however, to be responsible to Phase II contractors, Dave Carlson informed me that he had cooperated with the contractors involved in terms of letters, copies of policies, etc. provided contractors as long ago as approximately a year.

The need to communicate and to be responsible to contractor concerns is self evident. For the remainder of time involved at Tyee, therefore, I recommend a system of communication and responses to concerns be instituted and followed.

Sincerely,

Dan R. McCarthy

DRM/gbh

Encl.

TYEE LAKE HYDROELECTRIC WRAP-UP INSURANCE PROGRAM

This report has analyzed the various components of this Wrap-up Insurance Program and comments on its value in terms of its components and in financial terms.

The components include:

1.- Analysis of the various insurance policies, coverages and related supporting documents.

2.- Analysis of the "rating" plans for Workers' Compensation and General Liability.

3.- Analysis of the various contracts with the broker, the carrier, other entities and related fees.

4.- Comment on the system of separate service contracts for safety, loss reporting and claims handling and claims supervision.

5.- Comment on the selection of carrier and its reinsurance for this project; comment on the choice of Pac Mar as the carrier, dealing primarily with the class of business in which it is engaged, its domicile and the services rendered the Project.

The genesis of this wrap-up program is the agreement between State Risk Management and the Alaska Power Authority.

Risk Management in turn arranged for broker services employing the co-broker arrangement of Marsh & McLennan and Corroon & Black/Dawson, in a contract between the co-broker and the Alaska Power Authority, contract number CC08-2307.

These brokers were engaged in the premise that State Risk Management had recently undergone a "broker selection process" resulting in the selection of these brokers, not only for other State insurance matters, but also for the Tyee Project Wrap-up Program.

The co-broker adopted the acronym (APCOP) meaning Alaska Power Construction Program.

Item 1: Analysis of the various insurance policies, coverage, limits and related documents.

A.- General Liability/Workers' Compensation

The "Alaska Power Authority Insurance Information Manual and Coordination Procedure for Alaska Power Construction Program (APCOP)" prepared by APCOP Services Marsh & McLennan, Incorporated shows the following for each project phase:

Phase I - Power House and Tunnel

Comprehensive General Liability Insurance (excluding Automobile Liability and Physical Damage) subject to the following limits of liability:

$35,000,000 Bodily Injury/Each Occurrence per Contractor
$35,000,000 Property Damage/Each Occurrence per Contractor

and affording insurance for Premises - Operations; Owners/Contractors Protective; Independent Contractors; Products/Completed Operation (continued in force two years after the date of final acceptance of the work by owner); Blanket Contractual Liability: Broad Form Property Damage; Personal Injury Liability; Explosion, Collapse and Underground (XCU); Incidental Malpractice, Incidental Errors and Omissions; and Railroad Protective.

Phase II - Submarine Cable

Comprehensive General Liability Insurance (excluding Automobile Liability and Physical Damage) subject to the following limits of liability:

$10,000,000 Bodily Injury/Each Occurrence per Contractor
$10,000,000 Property Damage/Each Occurrence per Contractor

and affording insurance for premises - Operations; Owners/Contractors Protective; Independent Contractors; Products/Completed Operations (continued in force two years after the date of final acceptance of the work by owner); Blanket Contractual Liability; Broad Form Property Damage; Personal Injury Liability; Explosion, Collapse and Underground (XCU); Incidental Malpractice; Incidental Errors and Omissions; and Railroad Protective.

Phase III - Transmission System Construction

Comprehensive General Liability Insurance (excluding Automobile Liability and Physical Damage) subject to the following limits of liability:

$50,000,000 Combined Single Limit/each Occurrence

and affording insurance for Premises-Operations; Owners/Contractors' Protective; Independent Contractors; Products/Completed Operations (continued in force three years after the date of final acceptance of the work by owner); Blanket Contractual Liability; Broad Form Property Damage; Personal Injury Liability; Explosion, Collapse and Underground (XCU); Incidental Malpractice, Incidental Errors and Omissions; and Railroad Protective.

The Pac-Mar Liability Policy clearly shows a limit of $500,000 each occurrence for all insureds covered under this policy.

The Subscription Excess Liability Policy SOAMC - 1982 - APA - 1 shows a limit of $35,000,000 Bodily Injury Liability, per occurrence/$35,000,000 Property Damage Liability, per occurrence.

The APA schedule of Insurance indicates a limit of $55,000,000 excess the Pac Mar limit of $500,000. The excess limits apply on a "per occurrence" basis, not on the basis of "per insured, per occurrence."

The contract documents and the APCOP Insurance Manual prepared by Marsh & McLennan specify limits of $35,000,000 Bodily Injury (BI) per occurrence, per contractor and $35,000,000 Property Damage (PD) per occurrence, per contractor.

The insurance program as evidenced by the Pac Mar policy and the excess subscription policy is grossly inadequate. For example if in Phase I there is a total of ten contractors who are alleged to be involved in an occurrence at the job site the limit indicated in the manual and required by the contract is 10 times $35,000,000 or $350,000,000 for Bodily Injury and 10 times $35,000,000 for Property Damage Liability or $350,000,000 for a total limit of $700,000,000.

The same inadequacies exist in Phase II where the manual and contracts specify $10,000,000 BI/$10,000,000 PD per occurrence per contractor.

However as respects Phase III, the manual clearly calls for a limit of $50,000,000, combined single limit per occurrence, not per occurrence, per contractor.

If 10 contractors were alleged to be involved under these terms, the total limit required for all insured contractors, together would be $50,000,000.

It should be noted that if the occurrence occurred e.g. a completed operations claim or is alleged to have occurred during the period in which the policy was in force, the contractors have been told that the above limits of insurance have been provided.

Policy Terms and Conditions

There are coverage deficiencies in the policies when compared to the contract language, including no coverage for Railroad Protective Liability. Railroad Protective Liability Insurance, the exclusions for Explosion, Collapse and Underground Operations have not been deleted and there is no coverage for Incidental Errors and Omissions.

The Contractual Liability Coverage contains the following onerous exclusion:

> (4) to any obligation for which the insured may be held liable in an action on a contract by a third party beneficiary for bodily injury or property damage arising out of a project for a public authority; but this exclusion does not apply to an action by the public authority or any other person or organization engaged in the project;

There is no reference in contract language with contractors relative to the $5,000 Property Damage deductible for general liability insurance contained in the Pac Mar policy referenced above.

There are clearly major deficiencies in the coverages provided in the policy compared to the coverage agreed to by contract.

The excess policies clearly contain the same deficiencies as the primary Pac Mar policy.

Relative to Workers' Compensation coverage for Maritime exposures the primary Pac Mar policies properly includes coverage for the " . . . the liability of the insured to provide transportation, wages, maintenance and cure to any such employee." With a limit by accident of $500,000, whereas the excess policy clearly states that its coverage ". . . does not apply to the liability of the insured to provide transportation, wages, maintenance and cure to any such employee".

It is unclear as to what aggregate limits would apply as respects the excess subscription placement. Policy limits aggregate normally apply to Contractual Liability Property Damage and Completed operations.

It should be noted that only the schedule of insurance indicates a $55,000,000 limit; the excess policy indicates a $35,000,000 limit.

Endorsement #110A to the referenced excess liability policy mentioned above indicates a $35,000,000 limit for CGL - not $35,000,000 BI and $35,000,000 PD. Further, the "Limits of Liability" coverage part of this policy clearly states that the total limit for each occurrence is the policy limit for all insureds, not per each contractor/insured.

All the endorsements extending coverage in the standard Workers' Compensation and Employees Liability policy and the excess policies should be broadened to pick up coverage for liability under the Acts or Laws of Canada and its Provinces. It, also, should be noted that the insurance companies shown in the excess liability policy are not those shown in the schedule of insurance.

Inland and Marine Cargo

Subscription policy and Certificates of Insurance issued to Mitsui/D.W. Close transmitted by Dave Carlson's letter of March 2, 1983 shows a limit of $5,000,000 any one vessel (and presumably any one land conveyance), subject to a $5,000 deductible, with Lloyds of London as the insurance carrier.

The insureds include State of Alaska/Alaska Power Authority, Prime Contractors and their Subcontractors of all tiers.

Coverage analysis is impossible in view of the fact that the terms and conditions ". . . are per the Master State of Alaska Subscription Policy No. S.O.A.M.C.-1982," which has never been provided.

In the letter dated March 2, 1983, Dave Carlson provided a "Schedule of Insurance" and this schedule refers to:

> "Pacific Marine 7/15/82 to 10/1/83
> Cover Note M-2673 - - Ocean Cargo Certificate
> $10,000,000 any one tow single and/or Tandom"

The same letter provided a separate Certificate issued to APA Mitsui/ D.W. Close showing coverage for $10,000,000 any one vessel, any one tow with a $5,000 deductible any one vessel "Non-Owned Marine". "Coverage to include Protection & Indemnity" with Llyods shown as the carrier. Attached to this Certificate are numerous standard clauses and endorsements with all of the blanks as respects to Assureds, Loss Payee etc. left uncompleted.

The Schedule of Insurance shows;

> "Pacific Marine 7/15/82 to 10/1/83
> Cover Note M-2674 - $10,000,000 Charter's Liability
> Protection & Indemnity and Running Down Clause on any
> Vessels Bareboat Charter, Leased or Rented by the Assured:
> Stevedore's Liability."

Builder's Risk/Course of Construction Insurance

Two copies of Subscription Policy No. P.R.P.-ST-U AL - F82 (APA) were provided. Both show a Limit of Liability for Phase I of $45,000,000 and a deductible of $5,000. Nowhere in either of the policies is any reference made to any other deductible. However, Dave Carlson's letter of March 2, 1983 states "The deductibles are $250,000 Earthquake and Flood and $100,000 for all other Perils."

The insureds include State of Alaska/Alaska Power Authority, Prime Contractors and their Subcontractors of all tiers. One copy of the Subscription Policy has three endorsements attached to it. Endorsement No. 1 includes coverage for Mitsui/D.W. Close as respects exposures under "Tyee Lake Submarine Cable Contract" and raises the limit of liability to $65,000,000. Endorsement No. 2 adds coverage for Power City Construction/Power City Constructors as respects exposures under "Tyee Lake Transmission Lines Contract No. 2708-8" and raises the limit to $90,000,000. Endorsement No. 3 adds coverage for Mitsui & Co. (USA Inc.) and D.W. Close Company, Inc. with a limit of liability of $65,000,000.

The Schedule of Insurance shows two insurance companies providing all Risk Builder's Risk Insurance as follows:

"Allianz 10/1/82 to 1/4/84 Policy No. AIO-801511
All Risk Builders Risk - $90,000,000
Commonwealth 12/16/82 to 1/4/84 Policy No. RXMP62770
All Risk Builders Risk $400,000 Excess of $250,000 Earthquake & Flood - $150,000 Excess of $100,000 all other Perils."

Premium is based on value of material on site and constructed value prior to completion. The rate is $.06/$100 of referenced value on an annual basis.

Non-Owned Aviation

The Schedule of Insurance provides the following:

"Americas 10/1/82 to 1/4/84 Policy No. HA-2-0111
Non-Owned Aviation $1,000,000 Primary
Americas 10/1/82 to 1/4/84 Policy No. YA-1-0119
Non-Owned Aviation $4,000,000 Excess of $1,000,000
Puritan 10/1/82 to 1/4/84 Policy No. PZ-2181
Non-Owned Aviation $10,000,000 Excess of $5,000,000"

Item 2: Analysis of the "rating plans" for Worker's Compensation and General Liability

The standard three year "Rating Plan" has been revised to meet the needs of the Project in terms of the length of time the Project is expected to be completed.

Plan Expense Factors

The Plan has been further modified in terms of the applicable Rating Plan factors. These factors follow:

The Plan provides for a maximum chargeable loss of $300,000, any one occurrence, combined W/C and G/L. A single W/C or G/L loss of $300,000 is chargeable if they are separate and distinct occurrences.

State premium taxes are charged under the plan as follows: W/C 1.037 and G/L 1.03 times the developed ratio premium of Basic Premium + (Losses x LCF) x taxes of 1.037 & 1.03.

State premium taxes are charged on "earned" premium. It is my understanding that the State forgives premium taxes for a recently formed insurance company for a period of four years.

The Authority's maximum premium liability under this plan is $150,000 as the Basic Premium plus incurred losses, that is the liability for premium in unlimited.

Wrap-up Insurance Program for a Project of this size should have a maximum aggregate premium in the primary insurance program.

Since there are separate and unusual financial agreements controlling premium and investment income between Pac Mar and APCOP, the insurance policies and retro plan are not the controlling documents in the final analysis. However, as respects APA's liability for premium, the policies are the controlling documents.

General Comment:

All the major wrap-up programs with which I have any familiarity utilize a retrospective rating of some kind. The size of the project and therefore the amount of premium along with the broker's ability to negotiate determines the favorable or unfavorable plan factors.

The Tyee Plan factors are generally acceptable. But one must realize that Pac Mar is essentially issuing insurance policies and are compensated per terms of its agreement with APCOP as well as for certain plan costs and receive a premium.

The Tyee Plan contains severe cancellation penalties as well as what amounts to an open maximum premium in that the maximum premium is established at $150,000 plus incurred losses.

While the plan provides for final premium following completion of the Project, it also is conceivable that large amounts of money could be due and payable if severe incurred losses are outstanding at completion of the Project.

The normal maximum premium protection is obviated by this Plan's maximum and final premium provisions.

Item 3: Analysis of the various contracts with the broker, carrier (s) other entities and related fees.

The first agreement to be analized is Standard Agreement Forms for Professional Services Contract between Alaska Power Authority and Marsh & McLennan, Inc./ Carroon and Black/Dawson & Co., Inc. (APCOP) - number CC08-2307. All other service agreements for the Tyee Project flow from this Agreement.

These are:

- The purchase of various insurances referenced above.
- Agreement with Pacific Marine Insurance Company of Alaska (Pac Mar)
- Agreement with Scott Wetzel Services.
- Professional Services Contract with Pac Mar for claims adjusting.
- Claims Consulting Contract with Shepard and Associates.
- Agreement with Lewison & Associates for technical services.
- Agreement for Data Processing Services No. 210273C with Manus Services Corporation.

APCOP agreement No. CC08-2307

The effective date of this contract is October 1, 1981. There have been three amendments to the contract, since its inception, although amendment 3 has not been executed by APA.

The contract requires the Contractor to provide 18 separate services. Some worthy of note in this analysis are items 8, 9, 10 and 15.

Item 8 states that Contractor will provide Project contractors with complete premium and loss summaries on a quarterly basis.

If this is being done for contractors, it most certainly should be done for APA as part of an accounting and audit program. For the APA, the APCOP should summarize the separate reporting for Project contractors. No evidence of this has been supplied.

Item 3: (continued)

Item 9 requires the Contractor to provide a safety incentive formula for Project contractors which will include a safety dividend for them. This dividend is due six months following contract expiration.

This formula necessarily ties-in with the retro agreement with Pac Mar and would be affected should the Wrap-up Program be cancelled. It should include the contractors own loss experience but should also be related to over-all Project experience.

Care must be taken in developing such a formula and a preliminary draft should be undertaken as soon as possible for APA's review and approval. This draft should be as precise as possible in terms of the definitions contained in it.

Item 10 relates, implicitly to the entire wrap-up program and particularly to items 8 and 9. Also implicit in this item is the proper selection of insurance companies providing protection to the Project.

Financial integrity also implies that APA be prepared to pay various premium per Pac Mar contract and the retrospective plan in effect for the Project.

Item 15 of this contract delineates the services which may be subcontracted and include those referenced above; ie, safety, claims adjustment, insurance company selection, etc.

Appendix E of this contract is the appointment of the Brokers as Brokers of Record, allowing them to effecticate the insurances provided in the Tyee Wrap-up.

There is no specific reference to the fees or other compensation to be paid under this contract. The APCOP budget prepared for the Tyee Project does not contain a provision for fees or other compensation to the brokers. The budget for the project provides for total insurance expenditures of $3,784.602.

Amendment No. 3 does provide for a payment of $50,000 to Carroon & Black/ Dawson for services rendered to August 31, 1982 plus a flat fee of $151,000 to Marsh & McLennan for its services for the term of the Project.

Following execution of its contract, APCOP entered into the various contracts/ agreements referenced above.

Item 3: (continued)

APCOP also entered into an agreement with Pac Mar setting forth the fees to be paid Pac Mar, certain of its expenses and the establishment of a Trust Account. This will be discussed in the financial section of this report.

The various W/C Policies are stamped 0% commission. No such stamp appears on the G/L Policy. Nor does the subscription form policies for Inland & Marine Cargo and Builders Risk contain this note.

The budget for the Project provides for reimbursement for certain expenses incurred by the providers of services to the Project.

These questions of fees, commissions and expenses should be fully disclosed in an on-going format. Further the budget should be sufficiently detailed to identify all Project costs and provide for comparison of budget to actual expense incurred. This reporting should be provided at least quarterly and should contain premium and losses by contractor with all applicable expenses relating to insurance cost clearly identified.

Peat Marwick Mitchell have completed an account balance audit covering the period of inception of the wrap-up to January 31, 1983. Discussion of this will be included in the financial section of this report.

Agreement with Pac Mar

This is a most important agreement. I shall attempt to relate the agreement to the retro agreement in detail, particularly in financial terms. This agreement and the retro agreement require payments to Pac Mar for services to be performed by it on behalf of insured contractors and A.P.A.

It provides for certain fees to be paid Pac Mar in addition to certain expenses listed below. It must be considered in conjunction with the retro rating plan discussed earlier. One must have had a complete understanding of the role of Pac Mar in the Project, including what was intended by issuance of this agreement and the retro agreement.

The agreement is dated and effective September 17, 1982 by and between APCOP and Pac Mar.

Before listing payments Pac Mar required under this agreement, one should recall that the retro agreement requires payments to Pac Mar of a Basic Premium of $150,000; also requires payment of premium taxes. It also provides for a minimum and maximum premium.

Payments required under this agreement are:

$100,000 - Fee for insurance underwriting services for engaging in the Tyee Wrap-up Program - PLUS Boards, Bureaus and Commissions Taxes; Involvency/Guaranty Funds; Assigned Risk Plan Funds.

Normally these fees are charged in the insurance premiums or within the Basic Premium Charge in a Retrospective Plan. I find it difficult to understand why Pac Mar chooses to make these charges under this agreement. It is possible that duplicate charges are invoked, once in the insurance policy and retro agreement and again under this agreement.

It should be noted that Pac Mar is compensated separately for its loss adjustment services.

It should be noted, that per terms of this agreement that Pac Mar receives the investment income on $150,000 required by this agreement to form a Trust Account. Dave Carlson stated that this amount was changed to $100,000 by amendment. This has not been received. The purpose of this account is to pay claims liabilities. Contributions to this account, however, are based on "incurred" claims.

The agreement provides for a "run-off" of claims on a 6, 18 and 30 month basis following completion of the Project or July, 1984. Thereafter Pac Mar requires a letter of credit equal to the difference between $150,000 and estimated determined amount of claims to be paid. This is done again at 12 months following the first determination and the second and third determinations. Any excess funds in the Trust account, following the third determination are returned to APCOP.

At this important time Pac Mar assumes liability for payment of all outstanding liabilities with Pac Mar to be compensated in an amount agreed to at that time by Pac Mar and Broker on behalf of the Insured.

The agreement provides for payment of investment income by Pac Mar to APCOP on amounts in excess $150,000 in the Trust Account. These payments are $20,000 due July 1, 1983 and $20,000 due January 4, 1984. These payments are made in lieu of broker commissions, according to the agreement.

APCOP told me it was to receive $151,000 in fees from the Project, plus broker commission for placement of Pac Mar's Project insurance. Nothing else.

At best, this arrangement encourages a build-up of funds in the Trust account.

Secondly, according to paragraph 6(a) Pac Mar turns funds over to APCOP which are in excess of $150,000. Further discussion of this is contained in the financial section of this report.

Agreement with Scott Wetzel Services (SWS)

The agreement is dated June 14, 1982 by and between SWS and APCOP; it became effective, as to work, December 1, 1981.

This is a straightforward agreement providing safety and fire protection engineering services to the Project.

Phase I fees are	$ 46,000
Phase II fees are	12,500
Phase III fees are	19,500
Total fees	$ 78,000

These fees are set forth in amendment to the original contract. The amendment also establishes an expiration date to agreement - November 30, 1984. The copy of the amendment provided was not signed by APCOP.

The safety engineering portion of this contract is often provided by the W/C insurance company. Apparently APCOP believed these services would best be provided by an outside qualified technical organization. Also, apparently Pac Mar may feel its interests are best served by a firm such as S.W.S., although a reference to this effect is absent in the various policies, retro agreements, other documents I have reviewed. This absence of reference may be detrimental to Pac Mar in view of the requirement that W/C carriers are to provide safety engineering services to their insureds. Other arrangements, such as the S.W.S. agreement are acceptable when documented.

But this does make one wonder about the order of magnitude of the fees charged by Pac Mar in its retro and separate agreement with APCOP. Essentially these fees are for the issuance of policies and the providing of a Trust Account and issuance of claims drafts.

Although the agreement references a calendar of visits to the Site, it was not attached to the copy provided me. Assuming a reasonable frequency of site visits and acknowledging S.W.S. technical and practical expertise, the fees appear to be reasonable. A rough estimate of charges for these services, if provided by the W/C insurance company could range from 1/2 of 1% to 1% of total standard premium. This range would approximate S.W.S. fees and I believe S.W.S. services would be superior.

There exists a separate agreement providing data processing services. However, I believe SWS provided at least one loss run. Such a run was given to me during my visit to Marsh & McLennan offices in November.

Professional Services Contract Between Pac Mar and APCOP

The agreement is dated July 6, 1982, and expires June 30, 1983. It is by and between APCOP and Pac Mar for loss adjusting services. If these services are to continue the contract must be renewed or extended.

All reference to APCOP's "self insured claims program" is misleading and inappropriate since Pac Mar has issued policies of insurance.

This is a straight forward claims adjusting contract providing needed services in the adjustment of Workers' Compensation and General Liability claims.

The fees are:

Bodily Injury Liability per claim	$ 310.00
Property Damage Liability per claim	150.00
W/C Lost Time, including maritime	310.00
W/C Medical only, including maritime	60.00

The contract also provides for reimbursement of airfare and receipted expenses for lodging, etc.

Settlement authority is $10,000 to be paid from another Trust Fund established in the amount of $25,000 by the client APCOP.

At this point we have learned that: Pac Mar should have $150,000 in a Trust account per retro agreement. Pac Mar should have $25,000 in a claims Trust account.

Certain expenses, travel, lodging, etc. would be absorbed by the insurance company as a cost of doing business.

Recovery of allocated claims expense would be about the same under a conventional retro plan.

On balance, I feel that total costs under this arrangement will be greater than could otherwise have been negotiated.

Claims Consulting Contract

The agreement is dated August 5, 1982 by and between Shepard and Associates and APCOP. It is a continuous contract, until completion of the Project; it may be cancelled upon 90 days notice.

This is a straight forward claims supervision consulting contract relating to claims in excess of $50,000.

The retainer fee is $10,000 for the life of the contract, subject to additional fees for "extraordinary" services which may be required.

It would appear that "normal and prudent expenses" are reimbursable.

Appendix A provides for two (2) trips to Alaska, among other services.

The value of this contract is questionable.

Agreement Regarding Technical Assistance to APCOP

The agreement is dated November 1, 1982, by and between Lewison and Associates and expires on November 1, 1983.

The essential services to be provided under this contract are:

- "Review of monthly progress reports prepared by construction manager.
- Preparation of reports shall include major construction activity, status of the project and contract costs.
- Provide technical assistance as requested by APCOP services."

The fee is $30.00/hour, plus expenses mutually agreed upon.

The agreement does not spell out what constitutes "technical assistance" other than indicated above.

I have no idea what this amounts to or of its value to APCOP. Information regarding these items could be acquired otherwise through a proper system of communication with the Project.

There is no total value shown in the contract.

The value of this contract is questionable.

Agreement for Data Processing Services

The agreement is dated October 12, 1982, for Manus and October 22, 1982, for APCOP, by and between Manus Services Corporation and APCOP. The term is for 1 year with cancellation provisions of 90 day notice. Automatic 1 year extensions are provided for.

This agreement provides for an EDP system for what appears to be an accounting system.

Exhibit I contains the schedule of services and fees. This exhibit appears to be a boiler plate type of schedule and the agreement does not specifically indicate what services are provided. The headings are for an accounting system and include such items as journal entries, budgets, chart of accounts, trial balances, balance sheet, etc.

The monthly fee could range from a low of $35.00 to a high of $195.00 depending upon APCOP's needs.

As with the technical services contract, I find it difficult to understand the need for this contract. It appears APCOP's fee of $151,000 is for that of a general manager and all ancillary services provided through it are on a service by service fee basis.

Item 4: Comment on the System of Separate Services Contracts

A wrap-up program can be organized in several ways. Its organization is pretty much a function of its organizer's ingenuity.

There is value in engaging experts in a given discipline under separate contract from the insurance contract, although some insurance companies have highly qualified and experienced people in disciplines such as safety and loss control.

It is my opinion that Pacific Marine Insurance Company probably lacks expertise in certain areas of normally provided services. Hence APCOP entered into the several contracts for services needed for the Tyee wrap-up. There are three observations on this:

- First, the selection of the insurance company. If APCOP had chosen another carrier some of the separate service contracts could have been avoided.

- Secondly, the fees allowed in all cases appear to be liberal increasing costs to A.P.A.

- Thirdly, this approach results in a very cumbersom program and difficult to understand and in some cases duplicative contract arrangement, again resulting in increased costs to A.P.A.

The Pac Mar insurance retro policy and trust agreements are of particular concern to me for the following reasons:

- For its two separate fees, $150,000 Basic premium and $100,000 Trust fees, Pac Mar essentially issues two pieces of paper, i.e. a policy and a trust agreement.

- Pac Mar earns interest on both accounts for its own account.

- According to the agreement between APCOP and Pac Mar, APCOP is paid a fee and/or investment income on the trust account on funds excess $150,000.

- APCOP placed specific reinsurance for Pac Mar for this wrap-up program, indicating its capacity limitations. According to Dave Carlson, APCOP received a commission for this placement.

Item 5: Comment on the Selection of Insurance Companies for the Tyee Wrap-up Program

Presumably Pac Mar was selected as the insurance company for the basic Workers' Compensation and General Liability Insurance because it is an Alaska company. Its headquarters, however, are in Seattle.

The company is a relatively recently formed company having incorporated in August of 1979 and licensed in December 1979.

Paid-in capital was $2,500,000 and surplus was established at $2,500,000, resulting in total capital and surplus of $5,000,000.

It has had exceptional growth in the short time it has been in business. In 1981 it had "net" premium writings of just over $9,000,000 with a loss ratio of 84% and underwriting expense of 19% of net premium income. This combined ratio of 1.03% can be considered exceptional compared to most companies in the casualty business today.

As of December 31, 1981, Pac Mar had total assets of $33,644,677; incurred liabilities amounted to $24,658,505. This according to its audit firm of Pete, Marwick, Mitchell & Co. The 1981 Annual Statement to Insurance Departments reports current assets of $28,345,468 on a statutory basis and total liabilities of $22,584,802. Paid-in capital is unchanged; surplus is $5,023,631 as of December 31, 1981.

The company will be eligible for Bests Key Ragings in 1985.

Its principal business writings are maritime workers' compensation and ocean marine insurance. It is licensed in Alaska. Its "net" line of risk is $100,000 with a gross line of $5,000,000 indicating a prudent amount of reinsurance and a nominal "in-house" retention. It cedes and assumes reinsurance from foreign insurance companies.

Insuring construction projects appears to be unusual for Pac Mar, at least prior to insuring the Tyee Lake Project. Insuring such projects requires more than usual engineering and claims adjusting services.

Pac Mar, one might say, is in the business of fronting an insuranceprogram as compared to other major casualty insurance companies. These other companies have full time experienced staff in construction safety engineering. Their "net line" retention is far in excess of that of Pac Mar, thus providing in-house capacity and expertise without the need to engage in contracted service for safety engineering, loss adjustment supervision, usable data processing.

According to Bests Guide, premium income in Alaska is second only to California, i.e. approximately $4,700,000 to $7,030,000.

1981 Bests Key Ratings of Insurance Companies involved in the Tyee Wrap-up Program

Pacific Marine Insurance Company	Not rated
Nutmeg (Hartford Insurance Group)	A+ Class X
Protective National Insurance Company	A Class XI
National Union Fire Insurance Company	A+ Class XV
Lexington Insurance Company	A+ Class XII
Insurance Company of North America	A+ Class XV
Allianz Insurance Company	Will be rated in 1982
Commonwealth	Not listed
Americas Insurance Company	Not rated $19,920,000 Policyholder Surplus
Purtian Insurance Company	A+ XIII

A+ & A = Excellent

Surplus Rating:	X	$7.5,000,000	to 12,500,000
	XI	$12,500,000	to 25,000,000
	XII	$25,000,000	to 50,000,000
	XIII	$50,000,000	to 75,000,000
	XV	$100,000,000	& Over

FINANCIAL FACTORS

General Comment:

The Wrap-up Insurance costs were estimated to be 4.25% of construction costs. This resulted in estimated premiums of $3,784,602 for the total Project costs of approximately $89,000,000.

It appears that construction costs will be $94,339,000 which would indicate a wrap-up insurance cost of $4.009.408 using the 4.25% base.

Historically and on a continuing basis wrap-up insurance costs for wrap-ups have ranged from just over 1% to slightly higher than 2% of construction costs. These percentages do not include offsets of insurance costs generated from investment income.

Specific Tyee Lake Insurance costs.

One way of looking at wrap-up insurance cost is to compare total expenses to paid and incurred losses.

To date APA has paid premiums as of January 31, 1983 (Per P.M.M. Audit)	$3,186,602
Deduct: expenses other than paid losses	1,141,111
Funds available for losses	$2,045.491
add investment income	53,091
Total funds available to pay losses	$2,098,592
Paid losses as of December 31, 1982	$ 194,628

Per Peat, Marwick and Mitchell audit, expenses totalling $1,335,749 have been incurred to pay $194,628 in "paid" losses and available to pay incurred losses of approximately $653,117.

As of January 31, 1983 APA had paid $1,903,944 in funds excess of all required payments for losses, premiums and contract related expenses.

Ratio of expenses to paid losses $\frac{\$1,141,111}{\$194,491} = 5.86 : 1$

Ratio of expenses to incurred losses $\frac{\$1,141,111}{\$653,117} = 1.75 : 1$

The Project loss ratio, i.e. losses ÷ premiums appears to be excellent because the premiums were higher than needed as demonstrated by the percentage of construction cost they represent.

Incurred losses $\frac{\$653,117}{\$3,186,602} = .205$ loss ratio

Historically and continuing, costs under a wrap-up costs $.20 to $.25* for each dollar of loss payment. Under the Tyee Program these costs are $1.75 to $1.00 of incurred loss.

These comparisons would indicate that paid loss retro would have been more favorable to APA than the present program.

* These are conservative expense factors.

Peat, Marwick, Mitchell & Co. Audit.

As referenced, this audit is essentially an account balance audit per instructions it received. As the audit reports, verification was made of supporting documents such as general ledger, cash receipts and disbursements. The audit did not include an examination of activities included in the performance of service nor did it attempt to determine if the various payments to various loss, investment or expense accounts were made on a particular basis, i.e. incurred loss levels requiring deposit to the trust accounts.

Based on this audit, there is no doubt that APA funds expended are properly accounted for and verified for the various purposes scheduled in the APCOP budget.

Agreement with Pac Mar.

Page 4 of the Peat, Marwick, Mitchell audit contains a statement of assets and fund balances showing the fund balance at $1,903,944. Two funds are maintained by Pac Mar, one the investment account and the other self insured retention or claims account.

These fund balances should be audited at the time Pac Mar assumes claims liabilities for its account. The audit should include a thorough review of losses incurred and paid at that time. APA should participate in the review of the reserves for outstanding claims and agree to the amount of funds required by Pac Mar to pay the run-off of outstanding claims. APA should attend the meetings involving the amounts of the letters of credit at the 6, 18 and 30 month periods following completion of the Project.

In David Carlson's letter of March 2, 1983 on page three, in answer to my questions 8 and 9, contained in my February 14, 1983 letter; he states that Pac Mar's basic premium factor had reduced to $100,000 from $150,000 and that I would receive an amendment to the policy affecting this change. The amendment has not as yet been received. He also states that the "premium taxes are included in the $100,000 fronting fee". At the time of the audit of trust funds, care should be taken in determining the amount of these taxes and for the period of time the taxes will be charged.

Brokerage fees should be verified at this time to reach agreed levels of:

Marsh & McLennan fee	$151,000
Interest income to Marsh & McLennan	40,000
Corroon & Black	50,000
Total of all fees and income	$241,000

In that amendment 3 to the APCOP agreement has not been executed by APA, it should be determined if Corroon & Black have received the requested $50,000 for services to August 1982.

APA outlook:

On April 14, 1983 while in APA offices, Dave Carlson provided copies of letters written by John Haywood on November 25, 1981 and February 22, 1983 addressed to Corroon & Black and to APCOP Services respectively. He also provided a copy of his letter to John Haywood of March 1, 1983. He repeatedly stated he had provided literally everything asked for concerning the Tyee Wrap-up -- and more. But as late as April 14, these letters were provided which affect the entire insurance program provided the Project.

According to Dave Carlson the broker warranty policies for builders risk and transit and the Pac Mar Policy were issued in reliance on these letters. He referred to John Haywood's letters as indemnities and informed me that more than a year ago, in a meeting in Eric Yould's office, that John Haywood characterized the Tyee Wrap-up Program as being one of guaranteed cost --- to APA.

If the administration of the Tyee Wrap-up Program were changed from the Division Risk Management to the Power Authority, John Haywood would withdraw his letters. If this happened, Dave Carlson felt that major change in the insurance structure would be required. This because the referenced letters were the financial basis for the warranty policies and he did not know what Pac Mar would do concerning their policies should the security for their issuance be withdrawn.

All of this is understandable for the following reasons:

- Construction contracts have been issued indicating a $5000 deductible in the builders risk insurance. A withdrawal of John Haywood's letters would require that APA assume the difference in deductibles, i.e. between $5000. and the policy deductibles of $250,000 for Earthquake and Flood and $100,000 for all other perils; or the contracts would require amendment, to transfer the deductibles to the accounts of the contractors. This latter option would be most difficult to effect.

- The Pac Mar program may be modified, presumably per terms of its policies, retro agreement and filings. Should this occur, APA would be subject to the terms of the retro agreement which provides a maximum premium of the basic premium plus incurred losses. Presumably Pac Mar could ask for cancellation of their agreement with APCOP which provides for it, Pac Mar, to assume claims liabilities at a date following completion of the Project.

  These changes would have dramatic effect on the Power Authority. Also the APA would be responsible for the difference in liability insurance protection afforded under the subscription policy and the limits of liability promised in the construction contracts for Phases I and II.

  It appears that John Haywood may be unable to withdraw his letters despite a change in the administration of the wrap-up program.

The following should be required of APCOP with evidence of the corrections given to APA.

- The subscription liability policy should be amended to reflect the limit of liability provided, i.e. to bring it into conformance with the schedule of insurance. This will show a limit of $55,000,000 provided by the participating carriers.

  Endorsement 110A should be either deleted or affirmed that a $35,000,000 limit per occurrence is provided or that a $55,000,000 limit per occurrence is provided. Currently the subscription policy, on its declaration page, indicates a limit of $35,000,000 for Bodily Liability and a $35,000,000 limit for Property Damage Liability.

  The ocean marine policy should have all the blanks in the endorsements attached to be completed.

  The builders risk policy should be endorsed to indicate the total limit of protection afforded for all insureds. This in order to bring it into conformance with the schedule of insurance.

The Pac Mar policy amendment providing a change in the basic premium from $150,000 to $100,000 should be provided.

APCOP should provide APA with copies of the quarterly reporting required in section 8 under its contract with the Power Authority.

A schedule of actual deductibles or self insured retentions for all policies should be provided to APA.

The excess liability should be amended to bring it into conformance with the primary Pac Mar policy, particularly as respects the maritime coverage and a clear identification of the application of any aggregate limits of liability provided.

The following recommendations are made as respects other insurance provided the Power Authority.

Since the Division of Risk Management provides various insurances for APA, the Power Authority should be included among the insureds in all policies as is the University of Alaska shown as an insured.

The State's property insurance policies should be endorsed to automatically pick up all APA completed projects. The methodology used for establishing APA's responsibility for deductibles or self insured retentions should be clearly explained to APA for each area of insurance protection afforded through the services of the Division of Risk Management.

Alaska State Legislature

Advisory Council Members
Senator Kerttula, Chairman
Senator Bennett
Senator Vic Fischer
Senator Fahrenkamp

Pouch V
State Capital
Juneau, Alaska 99811
Phone: (907) 465-3114

SENATE ADVISORY COUNCIL

MEMORANDUM

TO: All Senators

FROM: Kurt S. Dzinich KSD

DATE: March 7, 1983

RE: APA Energy Rates

Over the past year, it has become increasingly obvious that the Energy Program for Alaska would require some fine tuning if it is to achieve the legislatively mandated goal of lowest reasonably costed energy. During the past few months, I have consulted with various interested parties and explored reasons for the problem as well as alternative solutions.

The attached HB9 Power Cost Study was prepared by APA for their February 28, 1983 Board meeting and will be addressed again at the next meeting now planned for March 14, 1983, in Juneau. The study is an excellent summary of how we got into the current predicament and some potential solutions.

The direct cause of the predicament appears to be our earlier expectations that the State grants derived from large oil revenues would be used to construct the projects thereby resulting in low rates which would only have to cover the cost of operations and maintenance. Contributing factors were overly optimistic cost estimates on early projects, the capital intensive nature of hydropower projects, and the growing pains associated with initiating such a large program.

While many lessons have been learned and the system substantially improved, there are still problems which must be solved in order to allow the program to succeed. Most importantly, the ongoing projects must be finished using debt financing in order to insure that the benefits are realized - and there is not doubt that in the long run the benefits will be substantial and that the projects will prove their economic feasibility.

I would be happy to discuss details of the report or the proposed solutions.

MEMORANDUM State of Alaska

TO: Eric P. Yould
Executive Director

DATE: December 28, 1982

FILE NO:

TELEPHONE NO:

FROM: Myles C. Yerkes
Director of Systems &
Planning Operations

SUBJECT: Marketing of Project Power Under the Energy Program for Alaska.

In discussing revisions to Power Sales Agreements required by House Bill #9 with concerned utilities, major problems with the Energy Program for Alaska surfaced. The Alaska Power Authority must consider modifications to this program or other actions necessary to secure power sales agreements with related utilities. Problems primarily relate to the inability of the current program to establish a reasonable and predictable energy rate for power customers under the program. Utilities voiced concern with current program language which allows the debt service for a particular project to be increased by the Legislature or the Power Authority without control by the utility. Utilities are understandably resistive to signing such "Take or Pay" agreements since the economic impact to related communities could be devastating.

The first major concern is the estimated initial cost of project power. Projected wholesale power rates by the financial group indicate Tyee at 18¢ per kilowatt hour in the initial years of operation with a very slow tapering following that period. Since existing utilities in the area (Wrangell and Petersburg) are currently generating power from diesel plants at a cost of approximately 10¢ per kilowatt hour, it is difficult, if not impossible, to market the project energy at this rate. This problem is not exclusive to the Tyee project, but will in all probability arise for most projects in the program. Program debt service must be reduced to in turn reduce the initial wholesale power rate. Since the Power Authority has no means to generate such revenue, it appears that our only option is to request the State of Alaska to appropriate additional funds to program construction to reduce future debt service. Unless debt service is reduced to allow marketing of project power at or slightly above the present cost of utility diesel generation, I sincerely doubt utilities will complete or abide by the terms of existing or proposed power sales agreements.

The second major concern is the inability of utilities to predict future wholesale power rates due to current program language which allows debt service to be increased by the Legislature through approval of additional projects to the program or implementation of the "Susitna Blackmail Clause". "Take or pay" wholesale power agreements with utilities are required to secure revenue bond financing of project costs above that appropriated by the State. For utilities to assume such a financial responsibility, they must see a predicable and reasonable wholesale power rate throughout the life of the contract.

Current legislation does not meet this criteria since costs can be unilaterally increased to the utilities by the Power Authority Board or the Legislature without consideration of alternatives to the utility. In summary, if we are to be successful in marketing Power Sales Agreements required for project revenue bonding, current program legislation must be amended to restrict the State from unreasonably increasing debt service to a project or causing rates to rise above reasonable alternatives.

The third concern is the ability of the Power Authority to provide stable wholesale power rates to the purchasing consumer. This problem arises primarily from two areas. First is the ability of the Legislature or the Power Authority Board to allow new projects under the program and assess increased debt service to existing utilities without specific regard to price stabilization to the ultimate consuming public. Second is program language which implies that wholesale power rates must be based upon estimated operation and maintenance expense for the upcoming year. If we are to provide reasonably stable wholesale power rates and proper price signaling to the general public, then current program legislation must be modified or interpreted to allow the Power Authority to ammortize annual operation and maintenance cost over a reasonable period to allow for reasonable price adjustment on a year by year basis and avoid the appearance of budget or fiscal irresponsibility. Such a policy would accommodate program language requiring purchasers pay the ongoing cost of project operations, maintenance, and debt service but would allow the Power Authority to ammortize operation and maintenance cost over a period of several years if required to provide reasonable and uniform wholesale power rates.

The final problem is the ability of Utilities to set power rates for different classes of customers in accordance with cost of service principles generally recognized by the State and Federal Regulatory Commissions. Current program language requires that a purchaser of project energy maintain power rates for industrial class customers equal to or above that provided to a residential class customer. Utilities have indicated concern that this may restrict their ability to market power on a reasonable cost basis to industrial customers and would hinder economic growth and expanded utilization of the hydroelectric projects. Utilities have suggested that current program language be changed to delete this requirement and allow a utility to set rates for all classes of customers in accordance with cost of service principals generally acceptable or approved by the FERC and the Alaska Public Utilities Commission.

The problem areas discussed must be dealt with during this legislative period if we are to successfully market the power from projects under the Energy Program for Alaska and reduce the incentive for a utility to default on an existing agreement. Your support and participation will be critical.

Sincerely,

Myles C. Yerkes
Director of Systems
Planning & Operations

MCY:ch

cc: Raymond J. Benish, APA, Anchorage

Mailed 12/28/82

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ALASKA POWER AUTHORITY

HB 9 POWER COST STUDY

1 - INTRODUCTION

At its inception in 1979/80 Alaska's hydroelectric program was provisionally based on the estimates that hydro units would come on at a period when thermal energy costs had continued to rise and the units would be substantially financed by the State of Alaska. This program, like many other energy programs elsewhere, now needs to be reviewed in the light of the currently prevailing circumstances under which some of the projects are expected to be substantially debt financed and may come on stream at a period when there has been a significant weakening in thermal energy prices.

This poses a number of problems which need to be addressed in the context of the HB 9 legislation which effectively interlocks the power rates of all projects in the system. The paper first describes the essentials of the HB 9 legislation and then considers the present status of the first four authorized projects (Swan Lake, Tyee Lake, Solomon Gulch and Terror Lake) in the light of this legislation. It then puts forward a number of possible solutions to the problems posed by this legislation for consideration by the Board before further development proposals are presented to the legislature.

This presentation focuses on the rate setting formula and presents four alternatives to attain a wholesale power rate comparable to the projected thermal rates. This approach may inadvertantly create the impression that HB 9 is itself a problem. However, the Power Authority does not in any way take issue with the legislation and believes that HB 9 is an equitable and workable rate setting mechanism.

2 - DESCRIPTION OF HOUSE BILL 9

2.1 - History

During the last session of the Legislature, HB 9 (subsequently enacted as Chapter 233, SLA 1982) was adopted to amend the Energy Program for Alaska.

The major and most detailed change introduced by HB 9 was to establish a system related but project-specific wholesale power rate rather than a single system-wide wholesale power rate. Under the previous legislation, the single wholesale power rate was calculated by totaling the operation and maintenance costs, inspection fees, and debt service costs for all projects in the system, then dividing by total sales to arrive at a cents-per-kilowatt hour rate, which would be applied to all project sales. The new and somewhat complex power rate system is outlined below.

2.2 - Wholesale Power Rates Under HB 9

Under the new HB 9 legislation a project's power rate will be based on the following three components: (1) it's own operation and maintenance costs, (2) it's own inspection fees, and (3) a portion of the total system debt service.

The O/M and inspection fee portion of the power rate is simply the actually incurred costs divided by project sales.

The debt service portion of any individual project's power rate is the most significant aspect of the legislation and is most easily described by the following formula. The debt service component is

$$\left(\frac{x - \frac{xp}{y}}{y - p} \right) z$$

where

x = the state's total investment in the particular project
y = the state's total investment in all projects within the energy program for Alaska
z = total debt service including coverage for all projects for the year in question
p = the amount of principal repaid as at the date of the calculation

This formula, however for our present purposes, simplifies to:

$$\frac{x}{y} \text{ times } z$$

Thus total system debt service z is allocated to individual projects on the basis of the project's share (x/y) in the total investment by the state. This formula holds, regardless of whether a project itself has incurred any debt service.

In essence, this formula therefore allocates debt service so that each project pays the same amount of debt service relative to project cost as all other projects. Thus the benefits of state grants, directed towards specific projects, will be shared by all.

This methodology is complicated by subsection (c) (h) of the legislation which places a "cap" on the level to which the debt service component of the wholesale rate can increase in any one year. The "cap" rate each year is equal to the average system debt service rate (total system debt service divided by total sales) times a factor which increases by four percent per annum from one in 1983. If any projects have the debt service portion of their rates capped then the other projects, whose rates are still less than the cap rate, will have their rates adjusted upwards (to a maximum of the cap rate) so that sufficient revenues are collected to meet debt service obligations of the entire system. This allocation of the remaining debt service is again based on project cost.

?

This "cap" provision applies only to Swan, Tyee, Terror and Solomon Gulch. In consequence, any new projects will have to carry a correspondingly higher burden of debt service.

The final wholesale power rate then is the sum of the operating cost rate and the debt service rate. Further details of the methodology for power rate calculations is contained in Appendix C.

3 - WHOLESALE POWER RATE FORECASTS FOR; SWAN LAKE, TYEE LAKE, SOLOMON GULCH AND TERROR LAKE

In this section the effect of the HB 9 legislation on wholesale power rates for the Swan Lake, Tyee Lake, Solomon Gulch, and Terror Lake projects are examined to the year 2001. Power rate calculations under HB 9 depend not only on the usual parameters such as project cost [1], sales and financing, and economic variables such as inflation and interest rates, but also on which projects are included in the calculations. For example, Solomon Gulch, with a current wholesale rate of 3¢/kwh, would see its rate increase substantially when the Swan Lake and Tyee Lake projects are brought on-line and into the calculations in FY 1985.

3.1 - Forecast Assumptions

The forecasts presented are based on the assumptions detailed in Appendix B. A detailed description of the forecast methodology and model are provided in Appendix C.

3.2 - Wholesale Power Rates

Table 1 gives the wholesale power rates for each of the four authorized projects under the existing HB 9 legislation. The table is essentially for record and does not compare the results with the cost of thermal power. This is considered in the fuller context of the analysis of Section 4.

TABLE 1

WHOLESALE POWER RATES UNDER HB 9 (¢/kwh) IN THEN CURRENT DOLLARS

% Debt/% Equity	Swan 26/74	Tyee 36/64	Solomon 0/100	Terror 58/42
1985	11.4	12.1	9.7	N/A
1986	15.0	15.8	10.1	12.3
1987	15.1	16.1	10.1	11.7
1988	15.2	16.3	10.2	11.1
1989	15.2	16.6	10.4	10.6
1990	14.7	16.9	10.7	10.2
1991	14.3	17.4	11.0	10.1

Project Summary *

Project	Total Project Cost ($ millions)	Installed Capacity	On-line Date FY	Utilities Served
Swan Lake	93.50	22.5 MW	1985	Ketchikan
Tyee Lake	124.60	20 MW	1985	Petersburg/ Wrangell
Solomon Gulch	53.00	12 MW	1983	Copper Valley
Terror Lake	189.40	20 MW	1986	Kodiak
Total	460.50			

* See Appendixes [illegible] and B for further details

3.3 - Retail Power Rates Under the Power Assistance Program

The impact of the hydro projects on retail rates for the regions served are materially reduced at the retail level by the Power Cost Assistance Program. This in outline provides (with some limitations) for 95 percent of the cost of power in excess of 15 cents per kwh in 1985 to be covered by State grants to the utility. This reference level of 15 cents in 1985, however, increases by one (1) cent each year. The effect of this in mitigating the early year cost of the hydro projects is shown in Table 2 in the context of the retail power rates to which the Power Cost Assistance Program provisions apply.

It is seen from this that after the power assistance grants, the average net retail cost (after the Power Cost Assistance is applied) of the hydro power to consumers is competitive with that of thermal for all projects in 1985.

The effect of Terror Lake coming on in 1986 is to introduce a jump in the cost of power for the whole system. This occurs as a result of the debt/equity ratio for Terror Lake which is substantially below the system average. This, as also shown in Table 2, results in Tyee Lake having a cost of power nine percent higher than thermal.

TABLE 2

AVERAGE NET RETAIL POWER RATE
UNDER POWER ASSISTANCE PROGRAM

Power Assistance Level		Swan ¢/KWH		Tyee ¢/KWH		Solomon ¢/KWH		Terror ¢/KWH	
		Hydro	Thermal	Hydro	Thermal	Hydro	Thermal	Hydro	Thermal
1985	15.0	14.4	16.1	16.1	16.4	14.3	20.2	N/A	N/A
1986	16.0	17.1	17.2	19.1	17.5	15.1	21.6	17.8	18.3
1987	17.0	17.8	18.4	19.8	18.8	15.5	23.2	17.9	19.6
1988	18.0	18.5	19.6	20.6	20.0	16.0	24.7	18.1	20.9
1989	19.0	19.1	20.8	21.4	21.3	16.6	26.3	18.1	22.3
1990	20.0	19.0	22.1	22.2	22.7	17.3	28.1	18.3	23.8
1991	21.0	18.8	23.5	23.1	24.1	18.1	30.0	18.7	25.4

1. See Appendix A for project descriptions

It is possible that these temporary differentials, in net cost, will be lower and that they will be acceptable to the local utilities as a small price for the major long term benefits conferred by having large resources of low cost hydro power indefinitely. The Power Authority planning must, however, prepare for the contingency that this is not the case since, short term, it depends both on the unpredictable short term cost of fuel oil and on the continuance of the Power Cost Assistance Program. It is also possible that the utilities will wish to negotiate the power rate, while ignoring the Power Cost Assistance Program.

The following section, therefore, reviews the HB 9 legislation and the competitive position of the hydro development at the wholesale power rate level excluding the mitigation effect of the Assistance Program.

4 - THE EARLY YEAR POWER COST, SYSTEM INCREMENT AND UNIFORM RATE PROBLEMS UNDER HB 9

4.1 - The Problems

The wholesale power rates as they stem from existing legislation (and as shown in Table 1) need to be considered in the context of the estimated cost of thermal power generation from existing capacity in the areas served. Here the economics of the Swan, Tyee and Terror Lake projects are each seen to be materially affected by three interrelated problems arising from their basic economics and the impact of the HB 9 legislation. The problems are:

The Early Year Power Cost Problem

This is the problem of the recent weakening of oil prices which may result in making the early year cost of power from the hydro projects being higher than the early year cost of the diesel operation which they displace.

The System Increment Problem

This is the problem of all power rates on the system being increased through the HB 9 mechanism when a new project is introduced to the system and the project has a higher proportion of debt finance than the average of the existing system as a whole. The Terror Lake project is more heavily debt financed than the existing projects (58 percent compared with 26 percent). When this project comes on stream in FY 1986 the effect of HB 9 is to share this increased cost of debt service among all four projects and so further increase the cost of power for Swan Lake, Tyee Lake and Solomon Gulch.

The Uniform Rate Problem

The HB 9 legislation requires that a single-power rate be established for each project. As noted in Section 5, this creates underutilization and consequently higher unit costs by precluding the Power Authority from offering lower priced power to secure industrial and home heating loads.

The effect of the early year power cost problem alone is shown in Table 3 on the assumption that diesel oil costs increase by only the rate of inflation between the end of 1983 and the first year of service (FY 1985). On this assumption, in 1985 all projects show power rates less than local thermal generation cost.

However, a problem occurs when Terror Lake is brought into the calculations in 1986. This is the System Increment problem - the effect of HB 9 when a higher than system average debt financed project is added to the system. When this occurs it is seen from Table 3 to have the effect of:

(i) increasing the cost of power of Swan and Tyee over their 1985 level by 32 percent and 31 percent, respectively (even with the "cap" in place);
(ii) making the cost of power of Tyee Lake 15.8 ¢/kwh compared with 13.4 ¢/kwh for diesel generation.

Terror Lake itself, with its higher debt service, would come in at approximately the same cost as thermal. On the inflationary assumptions given, it would take four years to close the net cost gap between thermal and hydro for Tyee Lake.

EARLY YEAR COST OF POWER & SYST[illegible]REMENT P[illegible]LEM
WHOLESALE RATE (¢/kwh)

	Swan			Tyee			Solomon			Terror	
% Debt/Equity	26/74			36/64			0/100			58/42	
	Thermal[1]	Hydro Without Terror	Hydro With Terror	Thermal[1]	Hydro Without Terror	Hydro With Terror	Thermal[1]	Hydro Without Terror	Hydro With Terror	Thermal[1]	Hydro
1985	14.1	11.4	11.4	12.5	12.1	12.1	18.1	9.7	9.7	N/A	N/A
1986	15.2	11.8	15.0	13.4	12.7	15.8	19.5	9.3	10.1	13.0	12.3
1987	16.3	12.0	15.1	14.4	13.0	16.1	20.9	8.9	10.1	14.0	11.7
1988	17.4	12.2	15.2	15.4	13.4	16.3	22.4	8.5	10.2	15.0	11.1
1989	18.6	11.9	15.2	16.5	13.8	16.6	24.0	8.6	10.4	16.0	10.6
1990	20.0	11.5	14.7	17.6	14.1	16.9	25.6	8.8	10.7	17.1	10.2
1991	21.4	11.1	14.3	18.9	14.5	17.4	27.5	9.1	11.0	18.4	10.1

[1] Source: Based on 1981/1982 utility accounts for; Ketchikan, Wrangell, Petersburg, Copper Valley and Kodiak.

Diesel oil price assume constant until 1984 and increasing thereafter in line with inflation (as given in Appendix B). Units o/a costs assumed to increase with inflation from 1981.

4.2 - Solution to the Early Year Power Cost and System Increment Problem

Possible Solutions

It is seen from the preceding analysis that the Early Year Power Cost problem alone is not unduly severe. The System Increment problem, however, is of considerably great seriousness first, because it compounds the Early Year Power Cos problem by increasing the cost of power whenever heavily-debt financed projects are added to the system. Second, and of more importance, it places the utilities in a position of appreciable uncertainty as to the future burden of power costs which they might be obliged to assume through the HB 9 mechanism.

It is true that the HB 9 mechanism does provide a "cap" for the existing four projects on the rate of increase of individual project power rates resulting from new increments to the system. But this does not rectify the basic fact that over the long term, utilities coming into the system are exposed to what might appear an open-ended liability to meet their share of whatever the debt service cost is of additional increments to the system. This was not a material issue while expectations were that the hydro power, even in the early years, would be less expensive than the highly escalating cost of the thermal option and there was the general expectation that the hydro additions would, in very large measure, be financed by equity contributions from the State. With the weakening of both these expectations, a concern on the part of utilities joining the system as to the extent of escalation in future hydro power costs is understandable. It is also possible that this combined with the Early Year Cost of Power problem (which it exacerbates) will result in difficulties in negotiating contracts with the local utilities.

This problem has no easy solution. A range of possible solutions have been considered and are as outlined below.

4.2.1 - Stand Alone Legislation

The first option to be considered is that of amending HB 9 such that future projects had a calculated cost of power which was on a stand-alone basis, that is, the "new" projects were exempt from the HB 9 debt service sharing provision. This would indeed shelter the existing projects from any high debt service component of new projects, but would have the obvious serious disadvantage of leaving these new projects disadvantaged relative to the projects which preceded them under the HB 9 legislation.

At a practical level it would also appear to be unacceptable since, for example, in the case of Terror Lake it would imply a wholesale cost of power in the first year (1986) of 15.4 cents and 25 percent higher than under HB 9. Rather than meet this cost of power (estimated to be some 25 percent higher than that of the thermal option) the local utilities might feel obliged to forego the very substantial long-term advantage which would be conferred by the fact that the cost of the hydro power would be virtually fixed in money terms.

In summary, the "stand-alone" solution would involve the probability of foregoing the long-term falling real cost of power which the present hydroelectric program is designed to achieve.

4.2.2 - Higher State Equity Contributions

Higher State Equity Contributions than those which form the basis of the forecast power rate of Table 1 would have the overall effect of reducing power rates and so helping to resolve the Early Power Cost and System Increment problems. The major difficulty with this solution, however, is that the HB 9 legislation effectively shares the benefits of any larger state equity in any particular project between all the projects in the system thus reducing all power rates. In consequence, higher State Equity contributions to reduce the cost of power, in the case of Lake Tyee for example, would have the effect of reducing not only the Lake Tyee power rate, but also the power rates of Swan Lake, Terror Lake, and Solomon Gulch, although the last would already have a power rate 50 percent less than the cost of thermal under the existing proposed financing. Moreover, this sharing of the benefits of greater state equity of necessity, means that much larger state equity is required to reduce the power rate of any given project. The numerical effect of this is shown in Table 4.

TABLE 4

WHOLESALE POWER RATES RESULTING FROM ADDITIONAL STATE EQUITY CONTRIBUTIONS

	Swan	Tyee	Solomon Gulch	Terror
Thermal Rate				
1985	14.1	12.5	18.1	N/A
1986	15.2	13.4	19.5	13.0
1987	16.3	14.4	20.9	14.0
HB 9 Rate Under Base Financing Assumption [1]				
1985	11.4	12.1	9.7	N/A
1986	15.0	15.8	10.1	12.3
1987	15.1	16.1	10.1	11.7
HB 9 Rate After Additional State Grants of $40 million				
1985	11.4	12.1	9.7	N/A
1986	12.5	13.4	8.6	9.9
1987	12.7	13.7	8.8	9.6

[1] See Appendix B Total state contributions assumed to be $281 million (approximately 60% of total financing)

This estimates the total additional equity contribution which will be required to ensure that all the power rates from the authorized projects are below the cost of the best thermal option. As seen from Table 4, Lake Tyee presents the most serious problem with a cost of power 2.4 cents higher than the thermal cost in 1986. Consequently, the equity contribution would be determined by whatever was required to achieve this objective. It would, however, require $40 million of equity. As can be seen from the table, this makes Lake Tyee equal in power rate to the cost of thermal by reducing the cost by 2.4 cents. But it also reduces the cost of power for Swan, Solomon Gulch, and Terror Lake by 2.5, 1.5, and 2.4 cents respectively in 1986, thus bringing their cost well below the cost of thermal power in their areas. This is again because the high equity contribution to Lake Tyee has the effect, through the operation of HB 9, of reducing all other power rates. It is because HB 9, effectively makes it necessary to reduce all power rates in order to reduce any one of them by greater equity, that the magnitude of the equity contribution at $40 million is so large.

4.2.3 - Low Interest Rate Loans

The Early Year Power Cost and System Increment problems could also be reduced by the state providing financing in the form of low interest rate loans. The larger the amount of such loans and the lower the interest rate, the lower the burden of debt service which HB 9 would require to be shared among all the projects on the system.

This solution, however, has much the same disadvantages as the higher state equity proposal considered above. Again the whole of the benefit of this low cost form of financing would be shared among all projects on the system irrespective of their power rate so that the problem of sharing applies here as in the equity financing case.

Moreover, in terms of the total level of appropriations required, this proposal would require very much higher appropriations than in the greater state equity case. This is because it would require $2.4 million of (say) five percent interest rate money to reduce power cost by as much as $1 million of state equity since the latter involves no burden of interest or repayment. Hence the low interest loans will have all the adverse affects of greater state equity and the addition would require appropriations 140 percent higher to achieve the same impact on the power rates.

4.2.4 - Equalization Grants as an HB 9 Over-ride

It is clear from the options considered above that any state assistance in meeting the Early Power Cost and System Increment problems through state financing assistance is made very costly by the effect of HB 9 sharing the benefits among all the projects on the system, irrespective of their existing power rates. Economical and effective state assistance, therefore, needs to be in a form which was not treated in this way by the HB 9 division and so could be directed at the particular projects which have the Early Year Cost of Power and System Increment problems.

This could be achieved by a system of annual "Equalization Grants" directed towards making the cost of power from the hydro station equal to that of thermal alternative, until such time as the increase in fuel costs on the thermal alternative brought its costs up to that of hydro and thus made further Equalization Grants unnecessary. To ensure that such grants were not swept up by the HB 9 legislation and the benefits shared among all projects irrespective of need, it will be necessary to legislate that the Equalization Grants were not to be taken into account in the application of HB 9.

Specifically, the legislation might take the following form. It would apply to areas where the cost of power from the hydro source was higher than the existing thermal power option. The program would then undertake for, say, a five to six year period, a special "Equalization Grant". This grant would meet the whole of the estimated difference between the cost of the hydro power and the cost of the thermal power as estimated each year based upon the price of diesel oil.

In the case of Tyee Lake, where the early year cost problem has been seen to be most material under HB 9, the cost of this (on the assumption of diesel oil prices increasing at the rate of inflation from 1984) would be approximately $1.8 million in then current dollars (approximately $1.4 million in 1983 dollars). The year-by-year costs of the Equalization Grant are shown in Table 5 in then current dollars. On the inflation assumptions assumed, the Tyee Lake power rate would be competitive with that of thermal at the end of four years so that the Equalization Grant could be terminated. Thereafter, as already noted, the cost of the hydro power would be falling progressively in terms of constant dollars as inflation progresses.

TABLE 5

COST OF EQUALIZATION GRANTS ($ millions)

	Swan	Tyee	Solomon	Terror	Total
1985	0	0	0	N/A	0
1986	0	0.8	0	0	0.8
1987	0	0.6	0	0	0.6
1988	0	0.3	0	0	0.3
1989	0	0.1	0	0	0.1
1990	0	0	0	0	0
1991	0	0	0	0	0
TOTAL	0.0	1.8	0	0	1.8

Similar Equalization Grants might need to be extended to other projects. The total cost in the latter case, however, is likely to be relatively small given that with this solution to the system increment cost problem, their cost of power would become competitive with thermal within a very short period.

The Equalization Grant provisions could be written into the power contracts of the utilities with the Power Authority, thus giving the assurance of their continuation over the appropriate period.

4.2.5 - Equalization Loans

An alternative to the Equalization Grants would be Equalization Loans. These would be simply the grants made repayable at a date when the hydro power was competitive with the thermal alternative. Under this proposal the grants would be carried as an unsecured loan for a given period - [illegible]mple, eight years from the commencement of the grant. By this [illegible]e, the hydro power should be strongly competitive with the thermal [illegible]tion. In consequence, by this time it should be possible for the [illegible]ty to accept an increase in the power rate, which would be suffi[illegible] support long-term commercial borrowing with the proceeds of the [illegible]ng going to repay the outstanding loan accounted for by the Equalization Grant.

This proposal would involve some technical problems in the debt financing. It would, for example, be necessary to secure the prior consent of the existing bond holders for this additional subsequent borrowing, and the terms on which the borrowing would take place would need to be precisely and legally specified if the existing bond holder interests were to be protected. These problems, however, would have to be overcome without undue difficulty if this particular proposal won the consent and cooperation of the utilities concerned.

There might remain the problem for the utilities that they would be subject to uncertainty as to whether or not the Equalization Grant would apply to later increments to the system or whether, after their own Equalization Grants had run out, they were to be subject to the effect of the System Increment problem as other projects with relatively high debt service were added to the system and were not in receipt of Equalization Grants. This potential exposure, however, might be acceptable to the utilities given they had the shelter provided by the Equalization Grants over the first five years and the then highly competitive economics of their own sources of hydro.

Turning to the economics of the Equalization Grant system from the stand point of the State of Alaska, it is seen from Table 5 to involve only $1.8 million in total ($1.4 million in 1983 dollars). Against this must be set the major long term economic advantages of reduced future costs from the hydro program.

4.2.6 - Standardized State Financing Until System Maturity

It has been seen that the System Increment addition problem essentially arises where the increment to the system has higher debt service costs than the then existing units in the system. This particularly arises with Terror Lake where it is 58 percent financed by debt compared with 26 percent for the system as a whole. A means of substantially eliminating the System Increment problem would therefore be to ensure that for an interim period at least (for, say seven years) additions to the system were financed with the same proportion of debt as the existing system - that is only 26 percent with the balance being funded from state equity.

This would be needed for only an interim period until the system was established and like other "mature" power systems, begin to reap the benefits of decreasing cost of power in constant dollars from the substantial amount of capacity acquired in the past. This measure would realistically address the fundamental problem which all newly established power systems pose, namely that they have no backlog of cheap capacity acquired at the lower prices prevailing in earlier years. In consequence they have an inherent problem introducing into the system new units of capacity, the current costs which, in an inflationary world, inevitably involve higher costs than units purchased at the substantially lower prices prevailing in earlier years. If this problem is not addressed and resolved it would result in the system being permanently locked into whatever types of capacity have the lowest early year costs irrespective of the long term economics.

The Standardized Financing Option would be a solution which, within existing legislation, would create a "mature" system such that the power rates resulting from this option would all rapidly become competitive with the existing thermal option so that within a few years other units could be introduced into the system without causing excessively large increases in power rates.

The evident major problem with this option is that it would involve additional equity of approximately $60 million to be appropriated in FY 1984 and 1985 and as such may be deemed unacceptable.

5 - MARKETING AND DEVELOPMENT SOLUTIONS

The preceding sections have addressed the immediate problems in a legislative context since these need detailed and lengthy consideration prior to legislation. The Power Authority is, however, actively pursuing the marketing and development activities which will help improve the economic competitiveness of the projects under construction or authorization. This includes:

(1) Transmission interconnections to serve adjacent communities or interties;
(2) Securing home heating markets and
(3) New industrial and commercial loads.

Very substantial potential increases in sales of power (and consequent reduction in unit costs) are possible given that the three projects have substantial underutilized in the early years and, in the case of Swan Lake, only about 40 percent.

The uniform rate imposed by HB 9 for all power from a given project is a serious obstacle to the greater utilization of capacity by securing home heating and industrial and commercial loads. These loads can only be secured on the basis of a price of power significantly lower than the single wholesale rates of Table 1.

On these grounds, it is recommended that HB 9 be modified to permit multiple tariffs whenever this is shown as likely to improve utilization and reduce unit costs overall.

6 - SUMMARY AND CONCLUSIONS

1. The report reviews the key elements in the Power Authority's hydroelectric program in the light of the issues posed by the recent weakening of alternative energy prices, the present stage of development of the projects, and the impact of the HB 9 legislation.

2. The HB 9 legislation is designed to share the debt service cost of all projects on the system between all projects, irrespective of the actual level of debt service which they have incurred individually. The allocation of the system debt service between individual projects is in proportion to the percentage which the state investment for each project represent of the total state investment for all projects. If, for example, the investment in a particular project represented 20 percent of all such investment it would have to carry 20 percent of all the debt service on the system. This means that the power rates of individual projects are not fixed but will increase if new projects with heavy debt financing are added to the system. This is referred to below as the System Increment problem.

3. This legislation and the weakening in diesel oil prices has created three separate but inter-related problems. These are:

   The Early Year Power Cost Problem - the problem that a weakening in the cost of diesel oil can make a new and substantially debt financed hydro project uncompetitive with the thermal alternative it displaces in the early years.

   The System Increment Problem - the phenomenon of additional, largely debt financed project increasing the power rates on all the existing projects.

   The Uniform Rate Problem - the problem that HB 9 calls for each project to have single uniform wholesale power rate.

4. These three problems represent significant difficulties in the marketing of hydro-electric power and the realization of the long term economic benefits of this renewable power source. Utilities may be reluctant to take the hydro-electric power where it involves higher early year power costs and may also be reluctant to enter into long term contracts given that the System Increment problem presents them with an indeterminate future cost of power. The Uniform Rate problem also makes it difficult to resolve the problems by securing greater sale since it precludes offering lower tariffs to secure "low cost" loads such as those offered by industrial demand and the home heating market.

5. These problems are illustrated by an analysis of the Terror Lake, Swan Lake, Tyee Lake and Solomon Gulch project.

   - Prior to the introduction into the system of Terror Lake, Swan Lake, Tyee Lake, and Solomon Gulch are all competitive with the cost of the thermal power which they displaced.

   - Adding Terror Lake (with its 58 percent debt financing) to the system in 1985 highlights the increments to system problem. Through the HB 9 mechanism this increment to a system has the effect of increasing the power rates of all the projects on the system and in particular making Tyee Lake 2.4 cents more costly than the cost of thermal power.

6. While these problems are inherent in the HB 9 legislation their numerical magnitude results from the small size and recent establishment of the system. This means that any new project can be relatively large compared with the rest of the system, and because the system is relatively new it does not have a large base of old assets acquired at the much lower prices obtained years earlier into which to easily assimilate any new high cost source of power.

7. A wide range of possible solutions to these problems were considered in Section 4 including greater state equity contributions, lower interest rate loans, etc. The problem, however, is to find a solution to these problems that is economical in terms of the magnitude of the state contribution required. The HB 9 legislation makes the additional state equity solution very costly since this legislation would share the benefits of such contributions between all projects in the system thus reducing all power rates irrespective of the extent of which they were already competitive with thermal.

8. In the light of this analysis it is concluded that the most economical and effective means of resolving the problems indicated in paragraph 4.2.4 would be that of "Equalization Grants". These would be special state grants designed to reduce the cost of the hydro power in the early years into equality with the cost of the thermal power which it displaces. On present forecasts, grants would only be required for Tyee Lake for a period of four years. The total cost (in 1983 dollars) would be $1.4 million compared with approximately $37 million in the case of the additional state equity.

9. It is expected that the Equalization Grants might be necessary for a number of projects until the system achieves the "maturity" and competitiveness inherent in the low escalation rate of hydro and thus becomes able to absorb new high cost additions to the system without unacceptably high increases in power rates.

10. Turning to the Uniform Rate problem, it is concluded that this is a material obstacle to greater utilization of the hydro projects and prevents the system obtaining lower unit costs by supplying the industrial and heating markets. It is recommended, therefore, that consideration be given to changing the legislation to permit the Power Authority to establish multi-rate tariffs wherever this appears likely to secure larger markets and hence lower unit costs. Given such legislation the Power Authority would expect to be able to significantly improve the competitiveness of the hydro power projects.

11. In summary, the HB 9 legislation as it now stands poses significant problems for the hydro-electric development program at its current relatively immature stage of development and in the context of the weakening in thermal fuel prices. Legislation along the lines indicated in paragraph eight and paragraph ten of this section would, however, resolve these problems and enable the program to realize its ultimate objective of long term low cost power for most Alaskans.

APPENDIX A

A.1 I. SWAN LAKE HYDROELECTRIC PROJECT HISTORY AND DESCRIPTION

The City of Ketchikan, having made the decision to discontinue its reliance on the use of diesel electric generation to meet rising energy demands, authorized the engineering firm of R. W. Beck in September of 1977 to investigate the feasibility of developing, as a major hydroelectric generating resource, the Swan Lake Project which is located approximately 22 miles northeast of Ketchikan near the northern end of Carroll Inlet in the central portion of Revillagigedo Island.

In June of 1978, R. W. Beck issued a feasibility report indicating that a hydroelectric project which would demonstrate a benefit/cost ratio of 1.25 could be constructed at Swan Lake at a total investment cost of $80,924,000. Subsequently, the City of Ketchikan, Ketchikan Public Utilities (KPU) authorized R. W. Beck to proceed with preparation of final design of the project.

The 1980 Legislature through joint resolution authorized the Alaska Power Authority to issue bonds up to the maximum amount of $120,000,000 for financing the construction of the Swan Lake Project.

Construction was initiated by KPU in November of 1980. Funding for project design and initial construction was secured primarily through the proceeds of loans from the Power Authority's Power Project Revolving Loan Fund.

On May 28, 1981, the Power Authority loaned KPU $35,000,000 for construction from funds which had been raised through the sale of General Obligation Bonds.

On May 21, 1982, the Power Authority and KPU executed an acquisition agreement under which, in return for providing funds to complete project construction, the Power Authority will receive title to the project and as operation of the project will provide sufficient power for the City of Ketchikan's needs via a Power Sales Agreement.

The Swan Lake Project consists of a dam, a power tunnel and a powerhouse situated at tidewater on Carroll Inlet, plus approximately 30 miles of transmission line from the site to Ketchikan.

The dam, which is essentially completed, is a double curvature concrete arch structure located about 0.75 mile downstream from the outlet of the existing Swan Lake. The dam has a maximum height of 174 feet above the base of the foundation excavation. The dam crest of elevation 344 above mean lower low water (MLLW) is 428.5 feet long. The dam has a crest thickness of 6 feet and has a base thickness of 16.5 feet.

A 100-foot wide ungated ogee service spillway section with the crest at elevation 330 is located in the central portion of the dam. Spillway

discharges will be flipped downstream from the toe of the dam to a plunge pool excavated in rock in the existing stream channel. The spillway is designed to pass a Probable Maximum Flood which is estimated to have a peak inflow of 37,150 cfs and a volume of 38,700 acre-feet.

A.2 I. TYEE LAKE HYDROELECTRIC PROJECT HISTORY AND DESCRIPTION

On December 19, 1979, the Alaska Power Authority submitted an application to the Federal Energy REgulatory Commission (FERC) for the construction of the Tyee Hydroelectric Project in the vicinity of Wrangell and Petersburg, Alaska. Our engineers, R. W. Retherford Associates/International Engineering Company (IECO), estimated the cost of the project at that time at $53,333,000.00, including an allowance for inflation at the rate of seven percent per year during the construction period.

Procurement of long-lead-time turbines began in July 1981, in anticipation of a FERC license. FERC issued a license August 5, 1981, and the award of several additional procurement and one construction contract followed almost immediately thereafter.

The power-on-line date is scheduled for January 1984. The current estimate of the total project cost is $124,000,000.00. Available funds include $82,000,000.00 in State grants and $50,000,000.00 in interim financing.

The powerhouse is located in the Tongass National Forest, approximately 40 miles eastsoutheast of Wrangell, Alaska. The project is designed to develop the energy potential of Tyee Lake--a natural lake at Elevation 1396---convert it to electricity, and transmit the energy to the communities of Wrangell and Petersburg for distribution. The project includes the following principal features:

1. A tunnel system between Tyee Lake and a powerhouse, which is located at sea level on the south side of the Bradfield River valley. The tunnels consist of approximately 4,770 feet of 10-foot diameter tunnel, 1,880 feet of 13-foot diameter tunnel, and 1,380 feet of 10-foot diameter vertical shaft, all nominally unlined. The tunnel will contain a rock-trap, tunnel plug, access gate, steel penstock, and manifold. The tunnels will be connected to Tyee Lake by the "Lake-Tap" method at a water depth of approximately 140 feet. A dam is not required.

2. A gate-shaft near the upstream end of the tunnel, consisting of approximately 420 feet of vertical, 12-foot diameter shaft, containing an intake gate, stoplog, and fine trashrack.

3. A powerhouse containing two, 10-MW hydro-generating units with provision for a future third unit. There will be an adjacent outdoor switchyard.

4. A 1200-foot long tailrace for discharging water from the powerhouse to an existing slough.

5. A 138-kv transmission system, 81-miles long. Approximately 60 miles will be overhead line and 12 miles will be underwater in four separate crossing.

costs of the utility, and hence its customers, would be less. The State and CVEA signed an Acquisition Agreement in 1981 whereby the State assumed the project and all costs and debt associated with the project. Agreements were also signed specifying the conditions under which the project would be operated by CVEA for the State and under which the entire output of the project would be sold to CVEA.

Construction of the project and the transmission line was completed in January, 1982, and commercial operation of the project began on March 31, 1982. The FERC license for the project was transferred to the Power Authority on May 28, 1982, and the Power Authority assumed full ownership of the project in July, 1982. Since that time, the project has been operated by CVEA for the Power Authority with sale being made to CVEA of the usable output of the project.

A.4 I. TERROR LAKE HYDROELECTRIC PROJECT HISTORY AND DESCRIPTION

The Terror Lake Hydroelectric Project was initiated by the Kodiak Electric Association (KEA) in the mid-1960's to provide lower cost electrical power to its customers. Tippetts, Abbett, McCarthy and Stratton and Robert W. Retherford and Associates were retained to prepare a feasibility study which indicated the the project was not economically feasible at that time. The rapid rise in the cost of diesel fuel in the mid-seventies resulted in KEA retaining Robert W. Retherford and Associates and International Engineering Company to upgrade the previous feasibility study, apply for a Federal Energy Regulatory License and to accomplish the project design. The application for a license was submitted to the Federal Energy Regulatory Commission (FERC) in December 1978, and their initial review indicated that more environmental data was required. The additional data was acquired during 1979 and was submitted to FERC in February, 1980. The Department of the Interior, the Alaska Department of Fish and Game, the Legal Defense Fund of the Sierra Club, the Audubon Society and the Northwest Wildlife Federation were granted interventions by FERC. By letter of July 28, 1981, KEA transmitted an Agreement between KEA and the interveners in which the interveners agree to withdraw their objections in return for certain additional stipulations. The FERC License was issued to KEA October 5, 1981, and transferred to the Alaska Power Authority on May 1982.

The Terror Lake Hydroelectric Project is located on Kodiak Island as shown in and is about twenty-five miles southwest of the City of Kodiak.

The principal components of the project consist of the following:

- The natural storage of Terror Lake will be increased by 108,000 acre-feet by building a dam across the lake's natural outlet. This dam will raise the water surface level from the present elevation of 1,250 feet to a maximum elevation of 1,420 feet.

- The dam will be a compacted rockfill structure with an upstream concrete face. It will have a maximum structural height of 193 feet and an effective crest elevation of 1,420 feet. A sidechannel spillway will be excavated in the rock of the right abutment. It will be ungated and unlined, and it will have an inlet crest 625 feet long. A reinforced-concrete outlet conduit will pass through the base of the dam, and will be used to make controlled releases down the Terror River for maintenance of the fish spawning beds.

- A power tunnel will leave Terror Lake from an intake structure on the eastern shore and head northeast for 26,300 feet to an outlet portal on the slopes of the Kizhuyak Valley. It will have an 11-foot-diameter section, and will be unlined, with only nominal lengths of concrete lining and other supports as required.

  Runoff from the 15.1 square miles of the natural catchment area of Terror Lake will be supplemented by diversion from 8.6 square miles of adjacent catchment areas. These areas are Shotgun Creek, Falls Creek, Rolling Rock Creek, and Mount Glotoff Glacier. The diversions will be accomplished by small diversion dams, open

power tunnel. One of these shafts (of Rolling Rock Creek) will also function as a surge shaft. Provisions have been made in the design for the future diversion of the runoff from 4.0 square miles of the Upper Hidden Basin Creek catchment area and the 5.1 square miles of the Upper Uganik catchment area.

- A single, inclined, steel, penstock, 3,100 feet long, will extend from the tunnel outlet portal, down the side of the Kizhuyak Valley, to an above ground powerhouse located on the valley floor. The powerhouse will contain two vertical-axis, 18,336hp Pelton-type, 6 nozzle impulse turbines, each connected to a 10-MW electrical generator. Thus, the total initial installed capacity will be 20 MW. The turbines, which will be set at Elevation 103.5, will operate at an average net head of 1,207 feet. Provisions will be made for a future third generating unit in the powerhouse, and the power tunnel and penstock have been designed to accommodate the additional flow, without modification.

- Transmission of the electric power to Kodiak will be via a single circuit, 138-KV, 19 mile long transmission line, using a combination of steel and wooden pole structures and AACSR conductor.

ASSUMPTIONS FOR FINANCIAL FORECASTS

°Project Costs and Financing

Projects Included	Total Cost (Millions $)	State Appropriations (Millions $)	Debt Financed (Millions $)	On-Line Date FY
Swan Lake	93.50	69.09	24.41	1985
Tyee Lake	124.60	79.48	45.12	1985
Solomon Gulch	53.00	53.00	0.00	1983
Terror Lake	189.40	79.26	110.14	1986
	410.50	280.83	179.67	

Notes

1. Costs are the total projected costs including escalations.
2. Debt is assumed to be 35-year bonds with a 10 percent interest rate.
3. Bond coverage was assumed to be 1.10 (i.e. 10 percent in excess of debt service costs).
4. Debt amounts exclude any Reserve Funds.

Calender Year	General Inflation (Percent) 1.	Interest Rate for Bonds (Percent
1983	6.8	10.0
1984	6.5	10.0
1985	7.4	10.0
1986	7.4	10.0
1987	6.9	10.0
1988	7.0	10.0
1989	7.1	10.0
1990	7.1	10.0
1991	6.8	10.0
1992	6.6	10.0
1993	6.5	10.0
1994	6.4	10.0
1995	6.4	10.0
1996	6.4	10.0
1997	6.4	10.0
1998	6.4	10.0
1999	6.4	10.0
2000	6.4	10.0
2001	6.4	10.0

NOTES

1. Source: Data Resources Incorporated, July 1982.

2. All costs shown in forecasts represent a January 1 or mid-fiscal year b

B-2 °OPERATION AND MAINTENANCE COSTS

Project	Annual O/M Costs (Millions $)	Year
Swan Lake	1.028	1985
Lake Tyee	1.32	1985
Solomon Gulch	1.27	1985
Terror Lake	1.08	1986

NOTES

1. Source: Alaska Power Authority

2. No real escalation in O/M costs was assumed, inflationary increases only DRI Indices.

B-3 °AGGREGATE PROJECT FIRM SALES:

FISCAL YEAR	SWAN LAKE	(KWH in thousands) TYEE LAKE	SOLOMON GULCH	TERROR LAKE
1985	32,000	33,620	41,000	-0-
1986	33,600	34,460	41,000	88,200
1987	35,280	35,320	41,000	91,954
1988	37,044	36,210	41,000	95,867
1989	38,896	37,110	41,000	99,947
1990	40,841	38,040	41,000	104,200
1991	42,883	38,990	41,000	106,294
1992	45,027	39,960	41,000	108,430
1993	47,279	40,960	41,000	110,609
1994	49,643	41,990	41,000	112,832
1995	52,125	43,040	41,000	115,100
2000	66,526	48,690	41,000	125,800
2001	69,850	49,910	41,000	128,060

Source: Alaska Power Authority

APPENDIX "C"

C.1 DESCRIPTION OF FINANCIAL MODEL
(refer to Table C.1)

1.	Year:	Fiscal years ending June 30.
2.	Energy GWH:	Total firm sales for all projects included in forecast.
3.	Real Price &/KWH:	Price ¢/KWH ÷ inflation index.
4.	Inflation Index:	Mid-year FY 1983 (January 1, 1983) = 100.
5.	Price ¢/KWH:	Wholesale Power Rate calculated under HB9. When more than one project is included in the forecast the rate shown is the average cost of power (Revenue ÷ Energy) for all projects.
6.	Revenue:	Sum of the revenues for all projects included in the forecast. Revenues are based on project sales and the power rate calculated under HB 9 Legislation.
7.	Less Oper. Costs:	Sum of operating costs for all projects included. The calculation for each project is: Operating Costs = (Generation KWH) X variable O/M costs ($/KWH)). plus (fixed O/M costs ($/KW) X KW). plus administration costs. plus insurance costs.
8.	Operating Income:	6 - 7
9.	Add Interest Earned on Funds:	Interest Rate X Reserve and Contingency Fund (previous year balance) (see 25 below)
10.	Less Interest on Long-Term Debt:	Interest Rate X Outstanding Short-Term Debt (previous year balance) (see 16 below)
11.	Less Interest on Long-Term Debt:	Annual interest costs for long-term debt (bonds and state loans)
12.	Net Earnings from Operations:	(8 + 9) - (10 + 11)

13.	Cash Income from Operations:	12
14.	State Grants:	Annual state grants
15.	Long-Term Debt Drawdowns:	Long-term debt drawn (including state loans and capitalized interest)
16.	Workcap Debt Drawdowns:	Short-term debt drawn for working capital (see 25 and 26 below)
17.	Total Sources of Fund:	13 + 14 + 15 + 16
18.	Less Capital Expenditures:	Annual capital expenditures, including capitalization interest and annual provision for renewals and replacements (0.3 percent of project construction cost per annum, no real escalation)
19.	Less Workcap and Funds:	Increase in, working capital and reserve and contingency fund (See 25 and 26 below)
20.	Less Debt Repayment:	Allowance for special payments to the state (not currently used)
21.	Less Payment to State:	Allowance for special payments to the state (not currently used)
22.	Cash Surplus (Deficit):	Surplus or shortfall of funds. For projects which receive more revenue under HB9 than is required to meet obligations (including debt service) the surplus is paid to the general state fund. For projects which do not receive sufficient revenues under HB9 to meet obligations, the deficit is met by a transfer from the general fund. This deficit will only occur for single projects. On a combined basis, a deficit can never occur under HB9 Legislation.
23.	Recovery from HB9:	Transfer of funds under HB9 to projects which show a deficit (see 22)
24.	Cash Recovered:	Cash retained by the project. This will always be zero as all excess funds are sent to the general state fund.

25.	Reserve and Contingency Fund:	Reserve fund is equal each year to 100 percent of provisions for renewals and replacements plus 100 percent of operating costs.
26.	Other Working Capital:	Annual working capital is equal each year to 15 percent of operating costs plus 10 percent of revenues.
27.	Cumulative Capital Expenditure:	Cumulative 18.
28.	Capital Employed:	25 + 26 + 27.
29.	State Contribution:	Cumulative 14.
30.	Recovery from HB9:	Cumulative 23.
31.	Retained Earnings from Operations:	Cumulative (net earnings from operations - cash surplus paid our).
32.	Debt Outstanding Short-term:	Cumulative 16.
33.	Debt Outstanding Long-term:	Outstanding long-term debt (bonds and State loans) after principal repayments.
34.	Debt Service Cover:	(12 + 11) · (11 + 20).
35.	Annual Borrowing $ 1983:	15 · 4.
36.	Cumulative Borrowing $ 1983:	Cumulative 35.
37.	Annual State Grants $ 1983:	14 : 4
38.	Cumulative State Grants $ 1983:	Cumulative 37.
39.	Total Annual Financing $1983:	35 + 37.
40.	Total Cumulative Financing $ 1983:	Cumulative 39.

Table C.1

Alaska Power Authority Financial Forecast for Fiscal Years ending June 30.

($ MILLIONS)

		1982	1983	1984	1985	1986
1.	YEAR					
2.	ENERGY GWH	--	--	--	--	--
3.	REAL PRICE	--	--	--	--	--
4.	INFLATION INDEX	--	--	--	--	--
5.	PRICE - ¢/KWH	--	--	--	--	--
	----------INCOME----------					
6.	REVENUE	--	--	--	--	--
7.	LESS OPERATING COSTS	--	--	--	--	--
8.	OPERATING INCOME	--	--	--	--	--
9.	ADD INTEREST EARNED ON FUNDS	--	--	--	--	--
10.	LESS INT. ON SHORT-TERM DEBT	--	--	--	--	--
11.	LESS INT. ON LONG-TERM DEBT	--	--	--	--	--
12.	NET EARNINGS FROM OPERATIONS	--	--	--	--	--
	----------CASH SOURCE AND USE----------					
13.	CASH INCOME FROM OPERATIONS	--	--	--	--	--
14.	STATE GRANTS	--	--	--	--	--
15.	LONG-TERM DEBT DRAWDOWNS	--	--	--	--	--
16.	WORKCAP DEBT DRAWDOWNS	--	--	--	--	--
17.	TOTAL SOURCES OF FUNDS	--	--	--	--	--
18.	LESS CAPITAL EXPENDITURES	--	--	--	--	--
19.	LESS WORKCAP AND FUND	--	--	--	--	--
20.	LESS DEBT REPAYMENTS	--	--	--	--	--
21.	LESS PAYMENT TO STATE	--	--	--	--	--
22.	CASH SURPLUS (DEFICIT)	--	--	--	--	--
23.	RECOVERY FROM HB 9	--	--	--	--	--
24.	CASH RECOVERED	--	--	--	--	--
	----------BALANCE SHEET----------					
25.	RESERVE AND CONT. FUND	--	--	--	--	--
26.	OTHER WORKING CAPITAL	--	--	--	--	--
27.	CUM. CAPITAL EXPENDITURE	--	--	--	--	--
28.	CAPITAL EMPLOYED	--	--	--	--	--
29.	STATE CONTRIBUTION	--	--	--	--	--
30.	RECOVERY FROM HB 9	--	--	--	--	--
31.	RETAINED EARNINGS FROM OPS.	--	--	--	--	--
32.	DEBT OUTSTANDING SHORT-TERM	--	--	--	--	--
33.	DEBT OUTSTANDING LONG-TERM	--	--	--	--	--
34.	DEBT SERVICE COVERAGE	--	--	--	--	--
35.	ANNUAL BORROWING $ 1983	--	--	--	--	--

36.	CUM. BORROWING $ 1983	--	--	--	--	--
37.	ANNUAL STATE GRANTS $ 1983	--	--	--	--	--
38.	CUM. STATE GRANTS $ 1983	--	--	--	--	--
39.	TOTAL ANNUAL FINANCING $ 1983	--	--	--	--	--
40.	TOTAL CUM. FINANCING $ 1983	--	--	--	--	--

C.2

METHODOLOGY USED FOR CALCULATION OF POWER RATES IN FINANCIAL MODEL

I. Operation and Maintenance Portion of Power Rates

This rate is calculated independent of other projects.

Components of Rate

A. Operation and Maintenance Costs. (see C.1 - 7).

B. Net short-term interest costs (interest on short-term debt - interest earned on reserve funds).[1] (See C.1 - 9 and 10).

C. Annual provision for renewals and replacements.[2] (see C.1 - 18).

O/M portion of the Power Rate = (A + B + C)/Project Sales.

II. Debt Service Portion of Power Rate

Components Used in Rate Calculation

A. Total System Debt Service (see C.1 - 11 and 20).

B. Bond Coverage (ten percent).

C. Period (year-1983).

D. State's Investment in each Project (equal to project cost for this analysis).

E. Project Sales (see C.1 - 2).

NOTES

1. A provision for working capital has been included in this analysis as well as a general reserve and contingency fund. Working capital is assumed to be met by short-term debt, with an annual interest rate of ten percent. The reserve and contingency fund earns interest at ten percent per annum, (on the previous year's ending balance).

2. The annual provision for renewals and replacements (0.3 percent of project construction costs (excluding IDC) per annum) is assumed to be funded with bond coverage where possible. If this coverage proves to be insufficient, then revenues (and rates) are increased so that this shortfall is just met.

Methodology Used to Calculate Debt Service Portion of Wholesale Power Rates

1. Calculate Average System Debt Service Rate (R1)

   R1 = (Total System Debt Service + Coverage)/Total Sales for all Projects.

   R1 = (A + B)/SUM(E).

2. Determine System Cap Rate (R2) (see Subsection 44.83.398(2)(h)).

   R2 = System Debt Service Average x (1 + .04 (year-1983)).

   R2 = R1 x (1 + .04 x C).

3. Calculate each project's initial, proportionate share of total debt services and Without Cap Rate (R3).

   R3 = (Total System Debt System Service + Coverage x (State's Investment in the Project/State's Investment in all Power Projects))/Project Sales.

   R3 = ((A + B) x (D/SUM(D))/E

4. Determine whether the Without Cap Rate for each Project exceeds the System Cap Rate and if it does, set that Project's Debt Service Rate (R4) equal to the System Cap Rate.

   If R3 greater than R2 then R4 = R2

5. If any projects are capped then using these rates would result in a shortfall of funds to meet debt service obligation. In order to correct this, the debt service share (and thus power rates) for projects whose debt service rates are still below the cap rate, are adjusted upwards (to a maximum of the System Cap Rate). This adjustment (R5) is again based on the State's Investment in the project.

   R5 = (State's Investment in the Project/Total State Investment in all projects whose rates are less than the System Cap Rate) x Shortfall.

   If a project's rate should exceed the System Cap Rate under this reallocation of the shortfall, its rate is also capped and the above procedure is repeated for the remaining projects whose rates are still less than the System Cap Rate.

6. The final debt service portion of the power rate for each project is equal to Project's share of Total System Debt Service Costs after application of limits/Project Sales.

   R4 = (R2 or (R3 x R5))/E

APPENDIX "D"

EFFECT OF "BLACKMAIL" CLAUSE ON POWER RATES

Section 44.83 383 (b) (2) states that if the general state fund does not stand at $5 billion by July 1, 1986, the power rate for each project will be set at the greater of

(a) the standard HB9 rate,

(b) a rate which will return 10 percent annually on the amount invested in the project, including loans and grants made by the state.

A comparison of power rates under standard HB9 calculations and those under the "Blackmail" clause starting in FY 1987 is presented in Table F.1. These results are also summarized for 1987 and 1991 in Table F.2. These calculations assume bond coverage of 1.10.

Results

The "Blackmail" clause, if invoked in 1987, would result in power rates increasing by more than 75 percent for Swan Lake, Tyee Lake, and Terror Lake. The rate for Solomon Gulch would increase by approximately 30 percent. These levels of rate increases would generate additional revenues in 1987 ranging from $1.2 million for Solomon Gulch to $9.0 million for Terror Lake. Total additional revenues for 1987 would be $21.2 million. These results are itemized in Table F2.

The difference between the standard HB9 rate and the "Blackmail" clause rate is seen to decline over time. Since the revenue generated under the "Blackmail" clause is fixed (at 10 percent of project cost) the "Blackmail" clause rates will decline as sales continue to increase. For the standard HB9 rates there is a decline in rates over time for most projects but this is much less since operating costs are increasing with inflation.

Table F.2

SUMMARY COMPARISON OF STANDARD HB9 AND "BLACKMAIL" CLAUSE RATES

	Standard HB9 Rate (¢/KWH)	"Blackmail" Clause Rate (¢/KWH)	Percent Difference	Additional Revenues Generated ($Millions)
Swan Lake				
1987	15.5	27.8	79	4.4
1991	14.1	22.9	62	3.8
Tyee Lake				
1987	16.4	34.8	112	6.6
1991	15.8	25.6	62	4.8
Solomon Gulch				
1987	10.0	12.9	29	1.2
1991	10.6	12.9	22	1.0
Terror Lake				
1987	12.2	22.0	80	9.0
1991	10.1	19.1	89	9.5

Table F.1

COST OF POWER SUMMARY FOR AUTHORISED PROJECTS USING STANDARD HR9 BASIS (EXCLUDING BLACKMAIL CLAUSE)*

YEAR	SWAN LAKE COST ICL IDC $MILL	SWAN LAKE SALES GWH	SWAN LAKE C.O.P CAPPED C/KWH	SWAN LAKE C.O.P W/O CAP C/KWH	LAKE TYEE COST ICL IDC $MILL	LAKE TYEE SALES GWH	LAKE TYEE C.O.P CAPPED C/KWH	LAKE TYEE C.O.P W/O CAP C/KWH	SOLOMON GULCH COST ICL IDC $MILL	SOLOMON GULCH SALES GWH	SOLOMON GULCH C.O.P CAPPED C/KWH	SOLOMON GULCH C.O.P W/O CAP C/KWH	TERROR LAKE COST ICL IDC $MILL	TERROR LAKE SALES GWH	TERROR LAKE C.O.P CAPPED C/KWH	TERROR LAKE C.O.P W/O CAP C/KWH
	PROJECTS															
1983	83.0	0.0	0.0	0.0	87.9	0.0	0.0	0.0	53.0	41.0	3.0	3.0	108.1	0.0	0.0	0.0
1984	98.2	0.0	0.0	0.0	125.3	0.0	0.0	0.0	53.0	41.0	3.3	3.3	193.4	0.0	0.0	0.0
1985	98.2	32.0	11.6	12.1	125.3	30.4	12.8	16.3	53.0	41.0	7.9	6.9	202.5	0.0	0.0	0.0
1986	98.2	33.6	15.5	16.3	125.3	33.1	16.5	21.1	53.0	41.0	10.0	9.1	202.5	88.2	13.0	11.3
1987	98.2	35.3	15.5	15.8	125.3	36.0	16.4	19.7	53.0	41.0	10.0	9.3	202.5	92.0	12.2	11.1
1988	98.2	37.0	15.5	15.3	125.3	39.2	16.2	18.4	53.0	41.0	10.0	9.6	202.5	95.9	11.4	10.7
1989	98.2	38.9	15.2	14.9	125.3	42.7	16.1	17.3	53.0	41.0	10.1	9.9	202.5	99.9	10.7	10.4
1990	98.2	40.8	14.5	14.5	125.3	46.5	16.0	16.2	53.0	41.0	10.3	10.2	202.5	104.2	10.2	10.2
1991	98.2	42.9	14.1	14.1	125.3	48.9	15.8	15.8	53.0	41.0	10.6	10.6	202.5	106.3	10.1	10.1

* COST OF POWER CALCULATION BASED ON THE INCLUSION OF THE FOLLOWING PROJECTS:
SWAN LAKE LAKE TYEE SOLOMON GULCH TERROR LAKE

COST OF POWER INCLUDES O/M PORTION

COST OF POWER SUMMARY FOR AUTHORISED PROJECTS UNDER BLACKMAIL CLAUSE*

YEAR	SWAN LAKE COST ICL IDC $MILL	SWAN LAKE SALES GWH	SWAN LAKE C.O.P C/KWH	SWAN LAKE ADD REV GEN $MILL	LAKE TYEE COST ICL IDC $MILL	LAKE TYEE SALES GWH	LAKE TYEE C.O.P C/KWH	LAKE TYEE ADD REV GEN $MILL	SOLOMON GULCH COST ICL IDC $MILL	SOLOMON GULCH SALES GWH	SOLOMON GULCH C.O.P C/KWH	SOLOMON GULCH ADD REV GEN $MILL	TERROR LAKE COST ICL IDC $MILL	TERROR LAKE SALES GWH	TERROR LAKE C.O.P C/KWH	TERROR LAKE ADD REV GEN $MILL
	PROJECTS															
1983	83.0	0.0	0.0	0.0	87.9	0.0	0.0	0.0	53.0	41.0	3.0	0.0	108.1	0.0	0.0	0.0
1984	98.2	0.0	0.0	0.0	125.3	0.0	0.0	0.0	53.0	41.0	3.3	0.0	193.4	0.0	0.0	0.0
1985	98.2	32.0	11.6	0.0	125.3	30.4	12.8	0.0	53.0	41.0	9.9	0.0	202.5	0.0	0.0	0.0
1986	98.2	33.6	15.5	0.0	125.3	33.1	16.5	0.0	53.0	41.0	10.0	0.0	202.5	88.2	13.0	0.0
1987	98.2	35.3	27.8	4.4	125.3	36.0	31.8	6.6	53.0	41.0	12.9	1.2	202.5	92.0	23.0	9.0
1988	98.2	37.0	26.5	4.1	125.3	39.2	32.0	6.2	53.0	41.0	12.9	1.2	202.5	95.9	21.1	9.3
1989	98.2	38.9	25.3	3.9	125.3	42.7	29.4	5.7	53.0	41.0	12.9	1.2	202.5	99.9	20.3	9.5
1990	98.2	40.8	24.1	3.9	125.3	46.5	27.0	5.1	53.0	41.0	12.7	1.1	202.5	104.2	19.4	9.6
1991	98.2	42.9	22.9	3.8	125.3	48.9	25.6	4.8	53.0	41.0	12.7	1.0	202.5	106.3	19.1	9.5

* COST OF POWER CALCULATION BASED ON THE INCLUSION OF THE FOLLOWING PROJECTS:
SWAN LAKE LAKE TYEE SOLOMON GULCH TERROR LAKE

COST OF POWER CALCULATED USING BLACKMAIL CLAUSE I.E. THE GREATER OF:
THE STANDARD UNCAPPED HR9 RATE OR 10% OF THE AUTHORITYS INVESTMENT IN EACH PROJECT

A SPECIAL REVIEW OF THE ALASKA POWER AUTHORITY INSURANCE PROGRAMS ADMINISTERED THROUGH THE ALASKA POWER AUTHORITY AND THE DEPARTMENT OF ADMINISTRATION DIVISION OF RISK MANAGEMENT

June 29, 1982

Chairman, Alaska Power Authority	Chuck Conway
Commissioner, Department of Administration	Carole J. Burger

STATE OF ALASKA

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

JUNEAU, ALASKA 99811

June 29, 1982

Members of the
Legislative Budget and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review:

A SPECIAL REVIEW OF THE
ALASKA POWER AUTHORITY
INSURANCE PROGRAMS
ADMINISTERED THROUGH THE
ALASKA POWER AUTHORITY AND THE
DEPARTMENT OF ADMINISTRATION
DIVISION OF RISK MANAGEMENT

June 29, 1982

Gerald L. Wilkerson

Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit

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PURPOSE OF THE REVIEW

In accordance with the provisions of Title 24 of the Alaska Statutes and a special request of the Legislative Budget and Audit Committee, we have reviewed certain issues relating to an insurance "wrap-up" program for Alaska Power Authority construction projects. Our review encompassed activities of the Alaska Power Authority (APA) and the Department of Administration, Division of Risk Management, as well as those of insurance brokers and agents handling APA accounts.

In the Spring of 1981, legislation was enacted that broadened the scope of APA's authority and responsibility for administering Alaska's energy program. APA became directly involved in the construction and acquisition of power projects throughout the State.

The first construction project to come on line was the Tyee Lake hydroelectric project. This project, located approximately 40 miles southeast of Wrangell, was to be constructed in three phases. Bids for Phase I were solicited in early June 1981, with construction scheduled to begin the following October.

The Request for Proposal (RFP) for Tyee Lake contained generally standard wording in which the burden for purchasing and maintaining adequate insurance was placed on the contractor. Simultaneous to the Tyee Lake bid process, APA also sought advice from the Division of Risk Management about the insurance requirements and liability ramifications of APA contracts in general. The Division of Risk Management in turn consulted with the State's major insurance broker, Marsh & McLennan Inc. During July 1981, a series of discussions and correspondence ensued among APA, Risk Management, Marsh & McLennan Inc. and various consultants, which ultimately resulted in a decision to substitute an owner provided insurance program for contractor provided insurance on the Tyee Lake project. That is, rather than requiring the contractor to purchase insurance and to see that his sub-contractors do likewise, the owner (APA) would "wrap-up" all parties and exposures into a comprehensive safety and insurance program.

Correspondence between Marsh & McLennan Inc. and APA indicates that the decision to employ a wrap-up program for Tyee Lake was reached during the latter part of July. Bid openings were scheduled for August 11, 1981. Given the time constraints, APA elected to have contractors submit bids with insurance costs included, as specified by the RFP. Upon the award, APA would then determine whether the contractor would agree to an owner provided insurance program and, if so, would negotiate an amount to back out of his bid.

Bids were opened as scheduled on August 11, 1981. Proposals were evaluated and the contract eventually awarded on September 25 to the joint venture of Southeast Drilling Co., Inc. - Harrison Western Corp. (SE-HW) for a bid of $44,952,000. SE-HW subsequently agreed to owner provided insurance, and a change order was signed October 20 reducing the contract amount by $1,798,867.

On October 28, 1981, subscription policies effective October 1 for Phase I of the Tyee Lake project were issued by the two firms that handle the State's master insurance policies: Marsh & McLennan Inc. and Corroon & Black/Dawson & Co., Inc. During November and December, the brokers and the Division of Risk Management worked out details on how to structure and administer the wrap-up program. This involved arranging for claims adjusting, safety consulting, actuarial and related services, as well as negotiating with underwriters for insurance placements. In addition, the two brokerage firms worked out internal agreements on how to jointly handle the APA account.

The contract between APA and the brokers to provide the above services was not finalized until December 22, 1981. This contract, backdated to October 1, 1981, provides for APA to use Risk Management as a consultant for risk management services, and for Marsh & McLennan Inc. and Corroon & Black/Dawson & Co., Inc., to provide for specified services necessary to administer the Alaska Power Construction Program (APCOP). Contract terms are stated in general language, but the appendix on consideration clearly limits the contractual agreement to the SE-HW portion of the Tyee Lake project. Consideration for this contract was to be $1,790,000, but a premium discount of $100,000 was subsequently applied. First payment on the contract in the amount of $540,000 was made December 23, 1981.

ISSUES AND ALLEGATIONS

During the Spring of 1982, several issues and allegations were raised about the series of events outlined in the preceding paragraphs. Various members of the Legislature, representatives from interested professional groups, and State administrators questioned whether owner "wrap-up" was an appropriate or allowable insurance method for State agencies. Specific allegations surfaced regarding the procedures for bidding and awarding the Tyee Lake construction and insurance contracts, and the brokers' and Division of Risk Management's administration of the APA insurance programs.

We have not included in this report a general discussion of the pros and cons of wrap-up insurance. This issue was the subject of considerable debate during the last session of the Legislature and resulted in the passage of SB 831, which prohibited State agencies from providing insurance to contractors awarded State construction projects. SB 831 was vetoed by the Governor because he did "not find this prohibition in the best interests of the State". Whether or not this legislation is pursued is a matter of legislative and executive decision during the next session.

We have, however, examined the various allegations and legal issues that have been raised. A discussion of each issue and our findings thereon follow:

A. Contractual Procedures - Tyee Lake Construction Contract

No allegations have been raised and we found no improprieties on the bidding and preliminary award of the Tyee Lake - Phase I contract to SE-HW. Allegations have been raised, however, that SE-HW failed to provide proof of adequate insurance as required by RFP, and that as a result a change order was issued wherein APA would provide insurance instead.

We found that the insurance provided by SE-HW was inadequate, but that this was due to misunderstanding rather than the fact that SE-HW was uninsurable. The chronology of events is outlined below:

09/10/81 APA Board approves contract award to SE-HW.

09/11/-- Negotiations begin between SE-HW and Division of Risk Management on amount of bid attributable to insurance. Dates uncertain, but no indication that negotiations pre-date Board approval. APA copied on at least one related letter dated 09/21/81.

09/15/81 Contract award challenged by Pacific Ventures, a lower bidder rejected because proposal did not conform to RFP. Temporary restraining order placed.

09/25/81 Temporary restraining order lifted. Notice of Award sent to SE-HW, subject to certain requirements including proof of adequate insurance. This letter signed by same APA individual involved in earlier insurance discussions with Marsh & McLennan Inc. and Risk Management, and copied on 09/21/81 letter regarding cost of contractor insurance.

10/08/81 SE-HW responds to Notice of Award, signs contract, and supplies performance bonds and certificates of insurance.

10/16/81 APA acknowledges receipt of signed contract but notifies SE-HW that performance bonds deficient and insurance inadequate. Letter to SE-HW states: "Pursuant to advice of the State Division of Risk Management, the Alaska Power Authority proposes to provide a wrap-up insurance program . . . . A change order has been prepared to effect these modifications . . . ." SE-HW given option of agreeing to change order or supplying evidence of adequate insurance.

10/20/81 Change Order No. 1 substituting owner provided insurance for contractor provided insurance and decreasing contract by $1,798,867 signed.

10/20/81 Notice to Proceed issued.

From discussions we have held with involved parties, it appears that by the time SE-HW responded to the 09/25/81 tentative Notice of Award, an understanding had been reached that APA would be providing insurance coverage and thus little attention was given to evidences of insurance. There is no indication that SE-HW was uninsurable.

There is some question as to whether Risk Management exceeded its authority by dealing directly with the contractor without APA's knowledge and before APA had officially proposed the idea of owner provided insurance. We have received conflicting information about this. Most likely, this was a case of bad communication both within APA and between APA and Risk Management.

B. Contractual Procedures - APA Brokerage Contracts

To date, all APA insurance reviews or brokerage services have been performed by Marsh & McLennan Inc. and Corroon & Black/Dawson & Co., Inc. (A schedule of APA contracts with and payments to the brokers is presented in Appendix A). This has generated considerable controversy, with specific questions raised about:

- Meetings of Risk Management, APA, and Marsh & McLennan Inc. prior to Tyee Lake brokerage contract.
- Awarding of Tyee Lake contract to Marsh & McLennan Inc. and Corroon & Black/Dawson & Co., Inc. without competitive bid.
- Expectations by brokers that Tyee Lake contract would be expanded to future APA construction projects.
- Expansion of broker's involvement to cover completed or acquired projects.
- Awarding of APA insurance review contract to brokers without competitive bid.

Each of these areas is discussed below.

Pre-contract meetings: It is unclear when wrap-up discussions first took place and who it was that first proposed the concept. Our review indicates, however, that wrap-up on Tyee Lake was not explicitly agreed to until late July, when representatives from APA, Risk Management, and Marsh & McLennan Inc. met in Marsh & McLennan's Seattle offices. There is no evidence to suggest that there was anything conspiratorial about this meeting, or that the decision by APA and Risk Management to utilize owner provided insurance was anything more than an attempt to explore economical insurance alternatives. Undoubtedly, Marsh & McLennan Inc. wished to secure the State's business, but as a profit making firm this is only normal.

Awarding of Tyee Lake contract without competition: In our July 1980, performance review of the Division of Risk Management, we criticized the Division for not utilizing competitive procedures in its selection of brokers. During FY'81, the Division went through an extensive broker selection process, and in May 1981, Marsh & McLennan Inc. and Corroon & Black/Dawson & Co., Inc., were contracted with to provide risk management and insurance programs for the State. When APA sought advice from Risk Management about the insurance ramifications of its newly expanded role, then, it was reasonable that Risk Management in turn sought advice from its primary consultant, Marsh & McLennan Inc.

The question is whether it was also reasonable to contract with Marsh & McLennan Inc. for the Tyee Lake wrap-up. In the first place, if a consultant believes he will be awarded the contract for any services he recommends, then he is more likely to recommend that those services are necessary. Secondly, it is State policy to utilize competitive selection procedures, and no attempt was made to do so in this case.

It is our belief that APA and Risk Management tried to objectively evaluate the wrap-up option, and decided that it was in the best economic interests of the State. The fact that the time frame for Tyee Lake was too short to go through a broker selection process was not considered a major problem. This had just been done for the State's other coverages, and it was reasoned that that selection process would satisfy similar requirements for Tyee Lake. Therefore, it was decided to utilize the State's current brokers.

While we do not question APA or Risk Management's motives behind this decision, we do think they acted in haste. If there was insufficient time to go through a broker selection for Tyee Lake or to look into the legal questions raised later in this report, then it would perhaps have been better to utilize contractor provided insurance on Tyee Lake and reconsider wrap-up for future projects instead.

Expectations of future APA wrap-up contracts: Marsh & McLennan Inc. correspondence indicates that the firm was vying for and in fact expected to provide brokerage services on future APA wrap-up programs. In addition, the contract between APA and the brokers was worded in such a way that future projects could simply be appended to it. However, the contract as signed December 22, 1981, is clearly limited to Tyee Lake - Phase I (with the implicit understanding that Phases II and III would be added), and APA and Risk Management memos demonstrate that the insurance alternatives for other APA construction projects would be decided on a case-by-case basis. This intention is also evidenced by testimony of APA staff at the October 2, 1981, APA Board meeting.

We cannot verify whether APA and Risk Management would in fact have gone through a broker selection process on future projects, since the APA Board opted that contractor provided insurance be used on the only other construction project to date, Terror Lake. Certainly no procedures for broker selection were begun prior to the Board's April 15, 1982, Terror Lake decision, though this may be attributable to the controversy and questionable future of State agency wrap-ups at that point in time.

Expansion to cover completed or acquired projects: The issue of whether or not to use owner provided insurance applies only to construction projects. Another issue is how best to insure completed or acquired projects, the immediate cases in point being Solomon Gulch and Swan Lake.

The Division of Risk Management has taken the stand that, as State owned property, completed projects such as Solomon Gulch automatically become a Risk Management responsibility. As is done for other State owned property, Risk Management would negotiate the cost and conditions of coverage and bill APA accordingly. Furthermore, it is Risk Management's responsibility to determine whether coverage in place on acquisitions such as Swan Lake adequately protects the State, and, if not, to cover exposures. In both of the above instances, the method for providing insurance has been to fold the projects into the State's master insurance programs which are brokered through Marsh & McLennan Inc. and Corroon & Black/Dawson & Co., Inc. The brokers have adopted the acronym "APOP" for these projects, which stands for Alaska Power Operations Program.

Vague allegations have been raised about the nature and extent of APOP, and that it is being thrust upon the entities from which projects are being acquired. We found no substance to these allegations, and to our knowledge APOP is no more than as described above. In addition, until or unless a separate risk management program is developed for APA, we concur with the Division of Risk Management's judgment on how to handle completed or acquired projects.

Awarding of insurance review contract: APA also contracted with Marsh & McLennan Inc. and Corroon & Black/Dawson & Co., Inc., to perform an insurance review of all APA contracts. This agreement, signed the same day as the APCOP - Tyee Lake contract, involved an evaluation of contract insurance language and evidences of insurance, establishment of on-going contract review procedures, and other related services. Contract consideration was to be for services rendered, not to exceed $40,000.

Results of this contract demonstrate that APA contracts generally did not have adequate insurance language and that APA's exposures were greater than intended. However, the fact that there was evidently a legitimate need for this contract does not justify its being awarded without competitive bids. Nor was there any particular time pressure, as there was with the APCOP - Tyee Lake contract, that would preclude normal competitive bid procedures.

C. Administration of APCOP - Tyee Lake Contract

Several questions have also been raised about the administration of the APCOP - Tyee Lake contract; that is, how the brokers and the Division of Risk Management are performing those services they were contracted with to provide. These questions are discussed below.

One question is whether the Workers' Compensation (WC) reserve established for State employees is commingled with or has in fact been used for Tyee Lake employees. The APCOP - Tyee Lake and State WC reserves are not commingled, and as of July 1, 1982, they will also be handled by different adjusters. Prior to the establishment of an APCOP reserve account, however, a Tyee Lake employee was injured and $9,417 was paid out of the State WC reserve to cover related claims. The State's reserve was subsequently reimbursed upon establishment of the APCOP WC reserve account in January 1982.

Another question has to do with whether the brokers and/or Risk Management have conducted business using "secret" bank accounts. We have found references to three bank accounts. The first was established with First Interstate Bank in Seattle, and was used by the brokers for paying all bills related to their APCOP account. This account was subsequently closed and replaced with an account with the National Bank of Alaska. A third account, also with the National Bank of Alaska, is a depository account used by Northern Adjusters for paying APCOP Workers' Compensation claims. All three of these accounts are utilized internally by the brokers or their sub-contractors to perform services necessary to fulfilling the APCOP contract. Risk Management neither deposits nor withdraws funds from these accounts. Therefore, these accounts are not subject to the requirement that as State accounts they be reported to the Department of Revenue.

Questions have also been raised about the propriety of payments from the APCOP bank accounts, particularly for such things as lunches, dinners, or drinks. We think these questions are moot. Marsh & McLennan Inc. and Corroon & Black/Dawson & Co., Inc., are being paid a fixed sum, a portion of which is attributable to brokerage fees. In general, it is not within our control to dictate to the brokers and their respective managements how those fees may be used.

Another issue is whether State competitive bid procedures have been bypassed by contracting with brokers who then in turn sub-contract with other firms to perform certain services. Particular questions have been raised about the sub-contracts for claims adjusting. We think

that while State procedures may be bypassed, there is very little incentive on the brokers' part for not employing competitive procedures of their own. As noted before, the brokers are being paid a fixed sum to perform certain services. It is certainly not in their best interests to over-pay sub-contractors. As far as the claims adjusting sub-contract is concerned, State competitive procedures were not bypassed. The contract RFP and award process was administered through the Division of Risk Management along with the claims adjustment contracts for other State accounts, and met standards for objective and competitive review.

Two final questions, which underlie all the above, are what APA is buying in its APCOP - Tyee Lake contract, and whether it is less expensive than contractor provided insurance would have been. A budget for all phases of the Tyee Lake wrap-up program is being prepared but has not been finalized. Once the budget is established, the Division of Risk Management has informed us that in its capacity as risk management consultant for APA, it will arrange for audits of APCOP expenses and actuarial reviews of loss reserves.

It is also too early to determine if wrap-up for Tyee Lake will be cost effective. Tyee Lake - Phase I was bid with insurance, with $1,798,867 subsequently backed out. The APCOP Phase I insurance contract cost, after premium discount, $1,690,000. Therefore, there is an immediate apparent cost savings of $198,867. Since the other Tyee Lake contracts were bid net of insurance, no easy "upfront" numbers are available, and it is beyond the scope of this report to project them. A schedule of claims as of May 31, 1982, is presented in Appendix B, but the total insurance costs of Tyee Lake will not be known for several years.

D. Legal Issues

In addition to the legal issues implied in the matters already discussed, several specific legal questions have been raised. These include:

- Is the State insured on Tyee Lake and has it been from the start?
- Do wrap-ups by State agencies violate existing law?
- Is the State self-insuring Workers' Compensation for Tyee Lake, and if so, is this in compliance with law?

Each question is discussed below.

Is the State insured on Tyee Lake and has it been from the start? The basis for this question is two-fold. First, while work on the Tyee Lake project began in November 1981, the insurance contract between APA and the broker was not signed until December 22, 1981. Second, while APA was provided with "subscription policies" by the brokers in October 1981, these policies were not agreed to by underwriters until, in some cases, months later.

From our review of legal opinions and documents, it appears that the State is and has been covered on Tyee Lake, if for no other reason than that it has clear recourse against the brokers themselves. This is established through letters of intent and brokerage warranties in which the brokers certify that they have placed insurance as specified in the "subscription policies." Marsh & McLennan Inc. and Corroon & Black/ Dawson & Co., Inc., it should be noted, have assets valued far in excess of dollars being insured under the APCOP - Tyee Lake contract. In addition, the State's master insurance contract is broadly worded and would include Tyee Lake exposures.

Do wrap-ups by State agencies violate existing law? We have reviewed several legal opinions and discussed this question with representatives of the Attorney General's Office. To our knowledge there is no Alaska law or body of laws that generally prohibit wrap-up insurance programs by private or public entities.

Is the State self-insuring Workers' Compensation for Tyee Lake, and if so, is this in compliance with law? This is the primary legal question on the owner provided insurance program that is in place for Tyee Lake, and to date it is unresolved. Through our discussions with the two agencies who have jurisdiction over Workers' Compensation - the Division of Workers' Compensation and the Division of Insurance - we have identified the key issues to be:

1. All employers must provide Workers' Compensation coverage for their employees. This may be done one of two ways: The employer may purchase a WC policy through an insurer approved by the Division of Insurance, or may be granted a self-insurance certificate by the Workers' Compensation Board.

2. The WC coverage for Tyee Lake contractors and their employees is provided under a policy by an approved insurer, but is, in the end, self-insured by the State. This is illustrated as follows:

   - APA contracts with brokers for APCOP services.
   - Brokers contract with Pacific Marine Insurance Co., an approved Alaska insurer.
   - Pacific Marine issues policy, makes necessary filings with Division of Insurance, WC Board.
   - Pacific Marine, in effect, reinsures total liability back through APCOP brokers.
   - Brokers establish loss reserve fund from which Tyee Lake WC claims, up to $300,000 per occurrence, are paid (insurance purchased for excess coverage); amount of fund comes out of lump sums paid by APA to brokers. The final amount to be set aside for WC reserves is still being negotiated.
   - Brokers receive assurance from Division of Risk Management that if actual losses exceed loss reserves, "the State loss reserve fund would be made available to pay losses after exhaustion of the APCOP loss reserves."

3. The question now becomes, by what authority can the State self-insure Tyee Lake employees? The State of Alaska has been granted a self-insurance certificate and self-insures Workers' Compensation for State employees. According to the Workers' Compensation Board, however, this certificate does not allow the State to insure non-State employees, such as the contractors and their employees on Tyee Lake.

4. A related question is whether the State is, in effect, acting as an insurance company.

5. Finally, a significant question exists as to where the funds would come from if the WC loss reserves established for Tyee Lake claims prove to be inadequate. This question has not been adequately considered, let alone answered.

   One scenario is that these excess losses would be covered under the State's aggregate of excess coverage. Under this insurance, virtually all State losses above a given aggregate are covered. For the year ended May 15, 1981, the aggregate base was $7,500,000; for the current period, the base is reduced to $7,000,000. Actuarial estimates indicate that State losses will exceed the aggregate for the year just ended, and the trend of losses has been to increase each year.

A second scenario is that State losses will not exceed the aggregate, and therefore the excess losses on Tyee Lake will have to be absorbed elsewhere. It is unclear how this would be done.

A third scenario is that losses on Tyee Lake will be less than the reserves. In this event, funds would be returned to APA.

CONCLUSIONS AND RECOMMENDATIONS

In general, we found the allegations that APA, Risk Management, or brokers/agents acted improperly to be unsubstantiated. We do believe, however, that APA, relying heavily on the advice of Risk Management, acted hastily in its decision to employ owner provided insurance for Tyee Lake, even though delay would have precluded this option. By so doing, they did not adequately consider the legal ramifications or impact of wrap-up as viewed by other State insurance agencies, and entered into a major contract without utilizing competitive procedures. In any event, while time constraints may arguably support the Tyee Lake sole source contract, they do not justify the awarding of a separate $40,000 contract by APA to the brokers without competitive bid.

In conjunction with the Tyee Lake wrap-up program and in anticipation of this concept being applied to future APA projects, we make the following recommendations:

1. The Divisions of Risk Management, Insurance, and Workers' Compensation should discuss, in a formal setting if necessary, the Workers' Compensation and other insurance questions that have been raised. Using a State-funded loss reserve for non-State employees is clearly a divisive and unresolved issue. It is incumbent on these agencies to clarify what is a very gray area.

2. APA and Risk Management should monitor and evaluate the Tyee Lake wrap-up program in order that some comparative data be available for future projects. This would entail audits and actuarial reviews of payments and loss reserves, as well as an independent evaluation of owner vs. contractor provided insurance.

3. APA should decide whether or not to utilize owner provided insurance far enough in advance to incorporate this into the contractor RFP. For example, contractors could submit bids with insurance, without insurance, or both with and without insurance and then be measured against some pre-determined criteria.

   In addition, sufficient time should be allowed to go through a broker selection process on construction projects where APA opts for owner provided insurance.

4. APA and Risk Management should clarify their respective responsibilities over APA projects, whether under construction or completed. In December 1981, the two agencies signed a memorandum of understanding outlining the role each played in providing risk management

services for APA. However, this "understanding" has become somewhat strained. For example, brokers have been given conflicting signals over certain coverages, and APA is even considering employing its own risk manager.

We would hope that APA's decision will be based on economics and need, and will consider all those issues inherent in wrap-up regardless of who administers it. In any event, until and unless APA establishes its own risk management program, the existing memorandum of understanding should be followed to ensure comprehensive and continuous coverage on APA projects.

APPENDIX A

SCHEDULE OF APA CONTRACTS WITH AND PAYMENTS TO BROKERS
As of June 15, 1982

Contract Encumbrance Number	Description	Contract Amount	Payments at 06/15/82
CC082307	Alaska Power Construction Program (APCOP) - Tyee Lake, Phase I[1]	$1,790,000	$540,000[2]
CC082304	APA Contract Insurance Review	$ 40,000	$ 20,000

1 To date, no provisions for Tyee Lake - Phases II-III have been appended to the APCOP contract. These phases were bid net of insurance, but how and through whom APA will provide insurance has not been finalized.

2 Scheduled payments are:

10/01/81	$ 640,000	
Less Premium Discount	(100,000)	
		$ 540,000
08/01/82		580,000
02/01/83		570,000
		$1,690,000

APPENDIX B

TYEE LAKE LOSSES AND PAYMENTS
As of May 31, 1982

Loss Type	Estimated Loss Incurred	Loss Payments
Workers' Compensation[1]	$111,846	$33,108
Property	20,000	-0-
	$131,846	$33,108

1 As of May 31, 1982, 14 Workers' Compensation claims had been submitted for adjustment. Largest estimated loss for a single claim was $25,000.

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF ADMINISTRATION
OFFICE OF THE COMMISSIONER

POUCH C
JUNEAU, ALASKA 99811

August 2, 1982

Mr. Gerald Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit
Legislative Budget and Audit Committee
Pouch W
Juneau, AK 99811

Re: Response to a Special Review of the Alaska Power Authority Insurance Programs Administered Through the Alaska Power Authority and the Department of Administration, Division of Risk Management, Dated June 29, 1982

The decision to recommend the Wrap-up program to the Alaska Power Authority (APA) was completely the responsibility of the Division of Risk Management. Wrap-up insurance has been the normal way to cover large construction projects for the last 30 years. This is not to imply that wrap-ups are not controversial because they are. This controversy, however, does not deter from the cost effective nature of wrap-ups. There are three valid reasons for not considering wrap-up insurance:

1. The construction project is not large enough (50 million or greater);

2. The Risk Management Program of the owner or contractor is not sophisticated enough to adequately coordinate the required services.

3. The political considerations which have resulted in several states passing restrictive legislation prohibiting wrap-ups.

Prior to recommending wrap-up to the APA, meetings were held between Risk Management and the Division of Insurance. Even though wrap-ups are acceptable in Alaska, the Division of Insurance is responsible for setting up guidelines and if required, adopting regulations. After reviewing the guidelines and discussing Risk Management's program, the Division of Insurance decided to not adopt regulations. Most of the questions regarding wrap-ups had been answered

several years ago when Alyeska Pipeline Co. was given approval to provide an owner wrap-up for the Taps Construction.

Before answering the individual recommendations, we would like to make two observations: First, the atmosphere surrounding the initiation of this audit was inflammatory in that there were a considerable number of rancorous accusations made against the Division of Risk Management, APA and the APCOP brokers. We believe that the auditors were able to cut through the periphery issues and produce a professional report which is notable for its objectivity.

Second, many of the legal issues on closer examination did not have substance. In order to completely counteract the questions, we had legal research done on several of these legal questions and they were not found to be meritorious.

The conclusion that there were no improprieties are concurred with. The decision to use the State's recently appointed brokers for the first wrap-up program is justified from a Risk Management standpoint and the brokers who participated in the RFP understood it to be for Risk Management services over a three to five year period.

The $40,000 contract review program has received more publicity than it warrants. This contract review had two facets: 1. To determine what existing liabilities were outstanding, and to provide coverage if needed. Since the State's brokers were responsible for providing the coverage ex commission, there was no logical way to select another contractor. Also, there was a sense of urgency due to the pending acquisition of the Solomon Gulch and Swan Lake projects and the need to become immediately involved in the contract negotiations between the APA and the project attorneys.

Recommendations

1. The Divisions of Risk Management, Insurance, and Workers' Compensation should discuss, in a formal setting if necessary, the Workers' Compensation and other insurance questions that have been raised. Using a State-funded loss reserve for non-State employees is clearly a divisive and unresolved issue. It is incumbent on these agencies to clarify what is a very gray area.

   Agreed. Attached is a memo (Appendix I) which has been sent to both the Division of Insurance and the Workers' Compensation Board which should resolve the problem. If not, we are prepared to meet with appropriate personnel to answer any questions.

2. APA and Risk Management should monitor and evaluate the Tyee Lake wrap-up program in order that some comparative data be available for future

projects. This would entail audits and actuarial reviews of payments and loss reserves, as well as an independent evaluation of owner vs. contractor provided insurance.

Agreed. This recommendation is an excellent one and one in which Risk Management is quite interested in pursuing. We believe that the Tyee Program will prove to be extremely cost effective and will also have a considerably better safety record than similar projects of this type. In addition, we believe that we are using a maximum of Alaska Risk Management contractors on the Program and that we are making it available for the smaller Alaska contractor to participate by furnishing raw coverage insurance that the smaller contractor might not be able to purchase on its own. See Appendix II and III for allocation of costs.

3. APA should decide whether or not to utilize owner provided insurance far enough in advance to incorporate this into the contractor RFP. For example, contractors could submit bids with insurance, without insurance, or both with and without insurance and then be measured against some pre-determined criteria.

   In addition, sufficient time should be allowed to go through a broker selection process on construction projects where APA opts for owner provided insurance.

   Agreed. Risk Management was limited by the decision process that the APA and its board of directors were operating under. There is no question but that the insurance language should be incorporated prior to the bids being put out. In addition, we would recommend that all insurance specifications include the owner wrap-up language and that after the bid is let that the contractor's firm be given the option of proposing its price to write the coverage. In this way a direct comparison of advantages of owner or contractor wrap-up could be made and a decision made at that time.

4. APA and Risk Management should clarify their respective responsibilities over APA projects, whether under construction or completed. In December, 1981, the two agencies signed a memorandum of understanding outlining the role each played in providing risk management services for APA. However, this "understanding" has become somewhat strained. For example, brokers have been given conflicting signals over certain coverages, and APA is even considering employing its own risk manager.

   We would hope that APA's decision will be based on economics and need, and will consider all those issues inherent to wrap-up regardless of who

administers it. In any event, until and unless APA establishes its own risk management program, the existing memorandum of understanding should be followed to ensure comprehensive and continuous coverage on APA projects.

Agreed. There have been meetings with the APA and Risk Management since the pressure of the legislative activity has been reduced. The result of the last meeting was that Risk Management would take over the administration of the contract between the APA and the APCOP brokers. In this way the APA would not be responsible for understanding and administering a Risk Management Program but instead, will pass this responsibility to Risk Management pending any decision to set up their own program. In this regard there is presently a Request for Proposal (RFP) for a Risk Management consultant to study the whole wrap-up insurance question for the APA.

Although it is difficult to quantify the exact savings to the State, a Federal government study has verified savings of 30-40 percent of conventional insurance costs. This relates to two percent of construction costs. In addition, since the State holds on to the loss reserves, an additional one per cent of costs is realized through investment earnings. If the present construction schedule of the APA is realized, the savings would amount to $192,600,000.

It is important that the controversy surrounding this program not obscure the potential savings to the State, which would be lost if the program were terminated.

Sincerely,

Carole J. Burger

Carole J. Burger
Commissioner

CB/JH/jbh
3/0802-02/RM2

MEMORANDUM State of Alaska

TO: Ms. Jackie McClintock
Director
Division of Workers' Compensation
Department of Labor

DATE: August 2, 1982

FILE NO:

TELEPHONE NO: 465-2180

FROM: John Haywood
Director
Division of Risk Management
Department of Administration

SUBJECT: Tyee Lake Wrap-up Program Insurance

There have been several questions raised as to the details of the Workers' Compensation Insurance for the Tyee Lake Wrap-up Program. There are many ways in which large accounts structure their workers' compensation programs and some are more controversial than others.

Due to the unusual level of interest in this program, it was Risk Management's decision with the concurrence of Marsh and McLennan and Pacific Marine Insurance Company to provide one of the conventional forms of coverage.

Consequently, we have negotiated a Retrospective Rating Plan "D" combined Workers' Compensation and General Liability. This is an incurred loss retro program which puts it in the mainstream of insurance programs.

JH/je
5/0802-06/RM1

APPENDIX II
TYEE PREMIUM ALLOCATION

TOTALS	I - Tunnel & Powerhouse	=	$1,690,000
	II - Submarine Cable	=	598,000
	III - Transmission Line	=	1,496,602
	TOTAL		$3,784,602

PHASE I - Powerhouse & Tunnel Contract - $1,690,000 - Total Premium

1.	General Liability & Workers' Compensation - 2 yrs	=	974,000
2.	Inland & Marine Cargo	=	303,000
3.	Non-owned Aviation	=	61,000
4.	C.O.C. - Builders Risk	=	181,000
5.	Excess Insurance	=	171,000
			$1,690,000

PHASE II - Submarine Cable Contract - $598,000 - Total Premium

1.	General Liability & Workers' Compensation	=	179,400
2.	Non-owned Aviations	=	32,500
3.	C.O.C. - Builders Risk	=	29,900
4.	Excess Insurance	=	63,980
5.	Marine Insurance	=	292,220
			$ 598,000

PHASE III - Transmission Line Contract - $1,496,602 - Total Premium

1.	General Liability & Workers' Compensation	=	1,174,327
2.	C.O.C. - Builders Risk	=	162,100
3.	Excess Insurance	=	160,130
			$1,496,602

APPENDIX III
TYEE WRAP-UP BUDGET
August 22, 1982

PHASE	I	-	1,690,000
	II	-	598,000
	III	-	1,496,602
TOTAL		-	3,784,602

PREMIUM	1,242,000
RETENTION	1,894,000
ADMIN. EXP.	82,000
BROKER FEE	119,000
EXTRAORDINARY TRAVEL/LEGAL	40,000
SAFETY	78,000
CLAIMS ADJ	60,000
ATTORNEYS	15,000
CONTINGENCY	207,602
PRESS RELEASE	5,000
INSURANCE LIASON	20,000
CPA/ACTUARIAL	10,000
CLAIMS MANAGEMENT	12,000
TOTAL	3,784,602

3/0802-02/RM2

ALASKA POWER AUTHORITY

334 WEST 5th AVENUE - ANCHORAGE, ALASKA 99501

Phone: (907) 277-7641
(907) 276-0001

August 5, 1982

Mr. Gerald Wilkerson, CPA
Budget and Audit Committee
Legislative Auditor
Division of Legislative Audit
Pouch W
State Office Building
Juneau, Alaska 99811

Subject: Response to Preliminary Audit Report
Alaska Power Authority Insurance Programs

Dear Mr. Wilkerson:

Attached is our response to the Preliminary Audit of June 29, 1982. Mr. Conway requested that I respond to you directly. The Alaska Power Authority has expressed its agreement with each of the Audit Report Recommendations and has initiated action to implement the recommendations.

The Power Authority is currently selecting an Insurance Consultant to provide professional services on insurance matters. This action will increase our expertise and management of insurance related issues and thereby mitigate the administrative concerns addressed in the Legislative audit.

Sincerely,

Eric P. Yould
Executive Director

Attachment: as stated

RECOMMENDATION ONE:

1. The Divisions of Risk Management, Insurance, and Workers' Compensation should discuss, in a formal setting if necessary, the Workers' Compensation and other insurance questions that have been raised. Using a State-funded loss reserve for non-State employees is clearly a divisive and unresolved issue. It is incumbent on these agencies what is a very gray area.

POWER AUTHORITY RESPONSE:

This recommendation is not addressed to the Alaska Power Authority.

RECOMMENDATION TWO:

2. Power Authority and Risk Management should monitor and evaluate the Tyee Lake wrap-up program in order that some comparative data be available for future projects. This would entail audits and acturial reviews of payments and loss reserves, as well as an independent evaluation of owner vs. contractor provided insurance.

POWER AUTHORITY RESPONSE:

The first part of this recommendation addresses the monitoring and evaluation of the Tyee Lake wrap-up program and refers to an audit program. The Power Authority agrees that this is a necessary and beneficial action since the Tyee wrap-up program is the Power Authority's first owner's provided insurance program.

In order to implement this recommendation, the Power Authority has issued an RFP for an Insurance Consultant. An evaluation of the Tyee wrap-up will be a primary task of the Consultant.

The Insurance Consultant will, if appropriate, define an audit scope and follow through with an audit program.

Secondly, the Power Authority Insurance Consultant will conduct an independent evaluation of owner vs. contractor provided insurance.

RECOMMENDATION THREE:

3. Power Authority should decide whether or not to utilize owner provided insurance far enough in advance to incorporate this into the contractor RFP. For example,

contractors could submit bids with insurance, without insurance, or both with and without insurance and then be measured against some pre-determined criteria.

In addition, sufficient time should be allowed to go through a broker selection process on construction projects where Power Authority opts for owner provided insurance.

POWER AUTHORITY RESPONSE:

Power Authority agrees that should the review of the Insurance Consultant indicate that owner-provided insurance is cost effective and in the best interest of the Power Authority and provided that the Power Authority staff concur with the Consultant's opinion, any owner-provided insurance programs will be incorporated in the contract issuance process.

Power Authority will take steps to insure that sufficient time is allowed to properly select a qualified broker.

RECOMMENDATION FOUR:

4. Power Authority and Risk Management should clarify their respective responsibilities over Power Authority projects, whether under construction or completed. In December, 1981, the two agencies signed a memorandum of understanding outlining the role each played in providing risk management services for Power Authority. However, this "understanding" has become somewhat strained. For example, brokers have been given conflicting signals over certain coverages, and Power Authority is even considering employing its own risk manager.

   We would hope that Power Authority's decision will be based on economics and need, and will consider all those issues inherent to wrap-up regardless of who administers it. In any event, until and unless Power Authority establishes its own risk management program, the existing memorandum of understanding should be followed to ensure comprehensive and continuous cverage on Power Authority projects.

POWER AUTHORITY RESPONSE:

The Power Authority agrees with this recommendation and as such the Power Authority and the Division of Risk Management have mutually agreed that the day-to-day administration and monitoring of Tyee "wrap-up" insurance program should be the responsibility of Risk Management. The Power Authority Tyee insurance contracts are in the process of being assumed by Risk Management. The Power Authority believes that the existing memorandum of understanding has been clarified for both parties.

The Power Authority will approve insurance premium payments prior to Risk Management making payment. Payment will be made on the basis of insurance premium invoiced cost and in accordance with the terms specified by the Power Authority's transmitted RSA.

The existing memorandum of understanding applies only to the Tyee "wrap-up" insurance program. The Power Authority will rely on the advise of its Insurance Consultant in evaluating future project insurance requirements.