



Expo

**Exposition Metro Line
Construction Authority**


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DATE: OCTOBER 5, 2006

TO: BOARD OF DIRECTORS

FROM: RICHARD D. THORPE 
CHIEF EXECUTIVE OFFICER

**ACTION: AUTHORIZE THE CEO TO REMOVE EARTHQUAKE
INSURANCE COVERAGE DURING CONSTRUCTION**

RECOMMENDATION

Authorize the CEO to remove Earthquake coverage from the Builder's Risk portion of the Contractor Controlled Insurance Program approved by the Board in September 2006.

SUMMARY

The insurance program for the Expo Light Rail Project was approved by the Board last month with a not-to-exceed amount of \$15,565,960, which included earthquake coverage as a sub-limit to the Builder's Risk policy. As negotiations between the Authority and the Contractor continued on final coverage and associated premiums, the idea of eliminating earthquake coverage from the Builder's Risk portion of the policy was discussed. Because of the high cost of earthquake insurance and the relatively low limits of coverage, eliminating earthquake coverage would result in substantial cost savings to the Authority. However, if earthquake coverage were removed, any damage sustained by an earthquake, would be solely the Authority's responsibility.

DISCUSSION

Earthquake premiums have greatly increased in price because of casualty losses resulting from the 2005 hurricane season. Dropping this coverage would save approximately \$1.4 million in premiums, but would expose the Authority to unlimited costs associated with any earthquake event. However, Metro, the City,

the County, LAWA and other municipalities have recently declined earthquake coverage for existing property, except for those properties that must have earthquake coverage based on bonding requirements.

Property under the course of construction often includes coverage. Metro's Eastside project and the just-completed Orange Line included earthquake insurance. However, the City of Los Angeles generally excludes earthquake coverage for property under construction. The County of Los Angeles determines the need for earthquake coverage on a case-by-case basis.

Earthquake insurance is included as a sub-limit in the Builder's Risk portion of the insurance program. Builder's Risk insurance is for coverage of property losses associated with the construction of the Expo Line. Builder's Risk insurance includes fire and theft coverage, flood insurance, terrorism coverage as well as earthquake coverage. These coverages all have different limits and all have separate premiums. The Authority removes earthquake coverage from the Builder's Risk policy and all other coverages mentioned above would still be in place.

The premium for earthquake damage protection is approximately \$1.4 million and includes a loss limit of \$25 million and has a deductible of 5%, and is subject to a minimum deductible of \$250K per claim. The total premium quoted for Builder's Risk coverage was \$2.1 million and is distributed as follows: \$582K for All Other Perils (AOP); \$107K for Flood, \$53K for Terrorism and approximately \$1.4 million for Earthquake. If the Authority decided to remove the earthquake coverage, the remaining premium for the Builder's Risk component would be roughly \$700K. The remaining \$1.4 million would be savings to the Authority that could be used for other project expenses.

In the case of the Expo project, if the earthquake coverage remains as part of the insurance program, then the contractor would be responsible for the deductible. The insurance carrier would pay all losses to property or equipment up to \$25 million attributable to earthquake damage. Any losses above \$25 million would be the Authority's responsibility. So the \$1.4 million for the earthquake premium covers up to \$25 million in damage.

If the Authority decides to forego coverage, the biggest risk would be to the aerial structures and underground segment during construction. If there was an earthquake that damaged these structures or caused any damage to the project during construction and the Authority declined coverage, the Authority would be responsible for all losses resulting from any earthquake damage.

ALTERNATIVES

Defer a decision on earthquake coverage until the start of major construction and closer to the time when substantial structures would be under construction. This

deferral may reduce the cost of the earthquake premium as the coverage would be in place for a shorter period of time and the premium would cover three years (or less) of construction as opposed to four years if the insurance was purchased now. However, the risk in waiting to procure earthquake insurance is that the price may be higher than it is today or it may be more difficult to procure or unavailable entirely.

FINANCIAL IMPACT

The cost of earthquake coverage is included in the not-to-exceed amount of \$15.65 million already approved by the Board and is part of the \$640 million project budget. Any savings from the removal of earthquake coverage from the overall insurance program would be used for other project line items.

NEXT STEPS

None

ATTACHMENT(S)

None