



OFFICE OF THE
City Auditor

South LRT Insurance and Damage Claims Process Review

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The Office of the City Auditor conducted
this project in accordance with the
*International Standards for the
Professional Practice of Internal Auditing*

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1. Introduction

During and following the construction of the South LRT extension (SLRT) a number of homeowners filed property damage claims they associated with construction activity. News media reported that a number of claimants expressed dissatisfaction with the settlement process. With the ongoing expansion of the LRT system and potential for future claims the Office of the City Auditor (OCA) included an audit of the SLRT insurance and claims process as part of its *2012 Annual Work Plan*.

2. Background

The SLRT is part of a comprehensive public transportation system that supports a sustainable, livable city. In December 2000, the City took out an insurance policy and included conditions in contractor agreements that transferred the financial risk for potential damage claims to an insurance company (insurer) and the contractors working on the project. The policy was taken out to cover SLRT construction activity for the period December 31, 2000 to December 31, 2010.

We originally intended to determine if damage claims were managed in a fair and consistent manner. This required that the insurer provide us with information on their claim settlement process and settlement results. The response we received clearly stated they were unwilling to provide the OCA with the information required to assess the fairness of the claims process. Therefore, we focused our review on the City's role in managing the SLRT claim process. The City's role included three major activities: communications with residents living near the construction site, acquisition of insurance, and monitoring of the claims process.

3. Objectives

The objectives of this review were to determine whether:

1. The claims handling process was transparent and clearly communicated to residents of affected communities,
2. The City demonstrated responsible ownership in its management of the insurance and claims processes to minimize the financial and reputational risks, and
3. There are opportunities to improve the process for future major construction projects.

4. Scope and Methodology

This review was limited to an assessment of the City's management of the insurance and claims processes associated with the wrap-up liability insurance policy which covers damage claims made by third parties such as those reported by the media. We did not undertake the review of individual claims and settlements.

Two overarching principles used in our review are:

- Responsible ownership – As the owner of the SLRT extension project the City needs to demonstrate it managed all processes associated with the project. This includes leading key processes and providing oversight of processes delegated or transferred to private service providers. Responsible ownership allows the City to demonstrate that needs were adequately defined; services were delivered effectively, efficiently and in a cost effective manner; and that desired outcomes were achieved.
- Openness and transparency – The City's reputation and citizens' trust can only be maintained by operating in open and transparent ways. Citizens need to know the City is using tax dollars responsibly. They expect the City's decisions and actions to be transparent.

We interviewed City staff from the Law Branch and LRT Design and Construction Branch and reviewed documentation to determine the rationale and process adopted for insuring and managing SLRT insurance claims.

5. Observations and Analysis

The damage claims process applied for the SLRT project demonstrates strong support for protecting the City's financial interest. However, our observations show that the insurance claims practices applied for the SLRT were not formally communicated to residents in the affected communities. The Administration needs to ensure processes and practices are open and transparent to protect the City's reputation and maintain public trust.

We identified three areas of improvement:

1. Communications with Community Residents
 - Responsibility for communications resides jointly with the LRT Design and Construction Branch and Corporate Communications.
2. Acquisition of Insurance
 - The Risk Management Office, Law Branch is responsible for defining the City's insurance needs and communicating expectations to the insurer.
3. Oversight of the Claims Process
 - Oversight to ensure the claims process is applied in a consistent and fair manner resides with the Risk Management Office, Law Branch.

- The Administration transferred the responsibility for assessing and settling claims to the insurer along with the financial risk when it took out the insurance.

We noted that the Administration made a number of changes to their processes prior to this review, and made additional enhancements during this review to address issues they experienced on the SLRT project. The changes are highlighted in sections 5.2 and 5.3.

5.1. Communications with Community Residents

We looked at the communications of claims process information conveyed to residents living near the SLRT construction site. Specifically we were looking for information that residents could use to prepare themselves in the event they needed to file a claim.

Pre-construction Communications

Prior to construction an engineering firm was hired by the LRT Design and Construction Branch to identify the properties that would be exposed to the greatest risk of damage and to complete a pre-inspection of the identified properties. Generally, the properties identified were adjoining the construction site.

The inspection reports prepared by the engineering firm covered the exterior of the building and when permitted by the property owner the interior. These reports were maintained in the LRT Design and Construction Office. Some inspection reports show that the property owners refused this service.

We were advised that copies of the reports were sent to the property owners. If a claim was made by the property owner, a copy of the pre-inspection report was sent to the Risk Management Office and the insurance adjuster acting for the insurer.

We compared the listing of properties identified as at risk with the list of claims maintained by the Risk Management Office. In total, we were able to compare 47 properties where full addresses were provided. Twelve of the claims were on the list of properties considered exposed to the greatest risk. The remaining 35 properties were not listed as at risk, many not being adjacent to the construction site.

The only formal communications were to residents who received pre-inspection reports. There was no formal communication with other residents living near the construction site suggesting they take similar actions to document the condition of their property prior to construction. For the 35 properties not listed as at risk this would mean they may not have had the condition of their property documented prior to SLRT construction activity making it difficult to support a damage claim.

There is no legal obligation for the City to provide residents with information on how to prepare themselves in the event they will need to file a claim. We noted that on July 1, 2012 changes to the Alberta Insurance Act will come into effect. The changes are intended to strengthen consumer protection. Providing residents with information to prepare themselves in the event they need to file a claim strengthens their position and aligns with the intent of the new Act.

Ongoing Communications

An extensive communication strategy was in place to keep residents informed on construction activities and overall project progress. The strategy included construction bulletins, quarterly newsletters, and a website that provided current information on the project. These channels provided residents with an email address and phone number (voice mail) to call if they had any questions. However, the communications did not provide information to prepare residents in the event they needed to file a damage claim.

Effective communication on the claims process is necessary to minimized negative perceptions because:

- Vibration damage claims stem from construction undertaken for the City.
- The insurer is fully responsible for evaluating vibration damage claims.
- Vibration damage claims are difficult to evaluate given various factors such as ground conditions and the age of homes.

News reports portrayed the City's claims process as confusing, adversarial, unfair and stacked against claimants. We believe negative publicity generated by the media can impact the City's reputation and erode public trust.

To increase awareness of the claims process and reduce the risk of negative publicity the City should include the following information in its communication with residents:

- Advice on how to prepare for construction activity (i.e., photographs to document pre-construction condition) and the criteria normally used to assess damage claims,
- The phone number(s) of City staff who should be contacted if excessive vibrations are noticed to allow prompt action to be taken to minimize the potential for damage, and
- Easy access to information on how and when to file a claim.

Recommendation 1 – Enhanced Communications

The OCA recommends that the Manager of LRT Design and Construction, in conjunction with the Director of Risk Management and Corporate Communications, enhance the LRT communications strategy to provide residents with access to information on the claims process, including:

- Preparing information that would assist them in the event a claim is required,
- Contact information to minimize the potential for damage during construction, and
- How and when to file a claim.

Management Response and Action Plan**Accepted**

Action Plan: The City of Edmonton is committed to communicating effectively with residents and stakeholders on all projects and programs. Building on the recommendations of the City Auditor, the Administration is developing a comprehensive project communications strategy that will expand the scope of current practices to include updating project websites and other communications with affected stakeholders.

Planned Implementation Date: June 2012

Responsible Party: Manager of LRT Design and Construction, in conjunction with Corporate Communications and the Law Branch

Recommendation 2 – Access to Claims Process Information

The OCA recommends that the Director of Risk Management enhance the City's website to provide easy access to information that informs residents on the damage claims process and criteria that may be used to assess a claim.

Management Response and Action Plan**Accepted**

Action Plan: The City's website and the 311 contact centre are integral to the City's communication with residents and stakeholders. The Administration will review and update the protocols for the website and 311 contact centre to ensure that the insurance claims process is accessible for citizens. Administration will also determine if general guidelines for construction related claims can be added to the City's claims access channels.

Planned Implementation Date: June 2012

Responsible Party: Director of Risk Management

5.2. Acquisition of Insurance

Standardization of Coverage

Wrap-up liability insurance for the SLRT project was acquired in December 2000. This insurance is part of “project specific insurance” purchased by the City to cover contractors, consultants and other professionals working on major construction projects. This coverage replaces insurance policies that would have to be taken out by individual contractors and consultants if the City did not provide the coverage. The benefits identified for project specific insurance include:

- Standardization of coverage for all contractors, consultants, and other professionals working on the project. This eliminates the risk of one or more contractors acquiring inadequate insurance.
- A lower overall cost of insurance as an overhead to manage insurance is not added to individual contracts.
- The claims process is simplified, requiring claimants to deal with only one insurer. This eliminates the risk of arguments on who is responsible for the damage and which insurer is responsible for settling a claim.

The SLRT project manual and tender documents issued to potential contractors states “The City will provide project insurance ...” For the SLRT project, the tender for the project specific insurance was issued by the managing consultant and the managing consultant’s address is listed on the insurance policy. We were advised that the Director of Risk Management and LRT Design and Construction management were part of a team assembled to define project risk and procure appropriate insurance for the SLRT project. In our opinion participating on a team is not the same as being responsible for the insurance acquisition process.

Table 1 shows changes the Administration made for the insurance acquisition process for the NAIT LRT construction project based on their experience. We are not making a recommendation as the changes demonstrate responsible ownership of the insurance acquisition process.

**Table 1
Comparison of the SLRT & NAIT LRT Insurance Acquisition Process**

	SLRT	NAIT LRT
Acquisition of Insurance	The managing consultant/ construction administrator tendered and appointed the insurance broker/companies with participation from the City.	The City defined its requirements and acquired project specific insurance through the City’s insurance broker as a normal course of business.

	SLRT	NAIT LRT
Deductible	<p>The deductible for each claim was \$5,000.</p> <p>The City recovered the deductible from the contractor/sub-contractor responsible for the damage.</p>	<p>The deductible for each claim increased to \$50,000.</p> <p>The contractor managing the construction is responsible for the deductible for all claims.</p>

Cost of Insurance

To minimize the cost of liability insurance on the SLRT project, the Administration acquired wrap-up liability insurance for the SLRT project directly. The premium for the SLRT wrap-up liability insurance was approximately \$880,000. The Administration estimates that the cost of insurance would have been double this amount if contractors had provided their own insurance. However, comparative data is not available for the SLRT as contractors were not required to include the cost in their bid.

A change to the tender process was introduced in 2011 that requires contractors to identify the cost of insurance in their bids. This change allows the Administration to compare the cost of insurance procurement options and demonstrate cost savings. The Director of Risk Management provided an analysis for a current construction project that shows the cost of wrap-up liability insurance would have been more than double if the City had chosen to let the contractors provide their own insurance rather than the City taking out project specific insurance. The analysis suggests that a 50% savings for SLRT insurance is a reasonable assumption.

5.3. Oversight of the Damage Claims Processes

The third benefit of project specific insurance identified in section 5.2 is a simplified claims process that requires claimants to deal with only one insurer. To fulfil their oversight role, the Risk Management Office set up “companion claim” files to monitor claim problems which arose between claimants and the insurer. They advised us they used the files to track specific claims and issues claimants had with the claims process in general. We were also advised that the City’s claims files are incomplete as the City did not have access to the insurer’s assessment of claims.

The City’s role in the damage claims process was limited to receiving and forwarding claims to the insurer, paying the deductible on settled claims and recovering the deductible from the responsible contractor. Once a claim was filed, communication on individual claims was between the claimant, and the insurer and the insurance adjuster. We were advised that the City would also act as a liaison when a complaint was received from a citizen to ensure the complaint was acted on. However, the final decision on the settlement of claims remained solely with the insurer.

In September 2011 the insurer advised the Law Branch they processed 75 claims for property damage and personal injury. A report produced by Risk Management listed 79 claims. These claims included residential property damage, vehicle accidents and job

site damage. We were unable to reconcile these numbers as the insurer records were not available. We were advised that one of the reasons for the difference may be due to there being no standard definition of a claim. For example, a claim that reported damage to two properties could be listed as one claim by the insurer and two claims by the City.

The Administration believes that all claims received were processed by the insurer and that claims were settled fairly and in a consistent manner for the SLRT project. However, in our opinion the absence of a standard definition for a claims file and incomplete files prevents effective monitoring or analysis of claims or actions taken to address concerns and issues.

Table 2 shows changes the Administration made to the claims management process for the NAIT LRT construction project based on their experience. The recommendations in section 5.1 address the need for enhanced communication. We are not making further recommendations as the changes listed in table 2 demonstrate the Administration’s desire to effectively monitor claims activities to ensure processes are applied in a fair and consistent manner.

**Table 2
Comparison of the SLRT & NAIT LRT Claims Management Process**

	SLRT	NAIT LRT
Information for Claimants	No published information was available.	311 has been provided general information on how a citizen can file a damage claim.
Managing the Claims Process	The City did not have complete files or an effective way to monitor claims as there was limited information being shared by the insurer.	The following oversight activities have been documented. <ul style="list-style-type: none"> • Performance standards/timelines have been defined. • A copy of all claims documentation will be maintained by Risk Management office. • Quarterly meetings will be held with the Construction Manager and the City’s insurance broker to discuss trends and issues. • The number of claims recorded by the City and insurer will be reconciled quarterly.

	SLRT	NAIT LRT
Settlement of Claims	The insurer controlled the entire process.	<p>The construction manager can settle minor claims without involving the insurer.</p> <p>The City will review the claims adjuster report prior to it being sent to the insurer.</p> <p>Quarterly meetings will be held with the Construction Manager and the City’s insurance broker to discuss difficult claim situations.</p>

5.4. Property Value Claims – MGA Section 534

Some media coverage noted that the property value claims notification resulted in some residents confusing the damage claims process and the property value claims process documented in section 534 of the Municipal Government Act (MGA).

The MGA required that the City send notices to owners of property abutting public works construction sites notifying them of their right to file a claim for a permanent reduction in the appraised value of land resulting from the public work.

The letter sent out for the SLRT project only stated it was being sent out as it was a requirement under section 534 of the MGA. This section of the act was attached to the letter for the recipients’ review. It should be noted the MGA contains language such as “injurious affection”¹ which may not be understood by the general population.

The Law Branch recently revised the letter clarifying the language on the purpose of the letter and adding a statement on claims for physical damage to property or injury.

The changes made by the Law Branch clarify the difference between damage claims and property valuation claims. If confusion persists, they could consider including generic examples for the two types of claims.

6. Conclusion

The SLRT communication strategy to keep citizens informed on construction activities did not provide information to prepare them in the event they needed to file a claim for damage to their property. We made two recommendations to enhance communications that will increase the transparency of the claims process and demonstrate that the City

¹ “injurious affection” means, in respect of land, the permanent reduction in the appraised value of land as a result of the existence, but not the construction, erection or use, of a public work or structure ...

is committed to the fair treatment of its citizens. The recommendations also align with changes to the Alberta Insurance Act that strengthen consumer protection.

Table 3 summarizes the actions taken by the Administration to enhance its processes for the NAIT LRT construction project.

**Table 3
Insurance/Claims Management Process Enhancements**

	NAIT LRT
Acquisition of Insurance	The City defined its requirements and acquired project specific insurance through the City’s insurance broker as a normal course of business.
Deductible	The deductible for each claim increased to \$50,000. The North Link Partnership managing the construction is responsible for the deductible for all claims.
Information for Claimants	311 has been provided general information on how a citizen can file a damage claim.
Managing the Claims Process	Performance standards/timelines have been defined. A copy of all claims documentation will be maintained by Risk Management office. Quarterly meetings will be held with the Construction Manager and the City’s insurance broker to discuss trends and issues. The number of claims recorded by the City and insurer will be reconciled quarterly.
Settlement of Claims	The construction manager can settle minor claims without involving the insurer. The City will review the claims adjuster report prior to it being sent to the insurer. Quarterly meetings will be held with the Construction Manager and the City’s insurance broker to discuss difficult claim situations.

These changes strengthen the oversight of the acquisition of insurance and processing claims and should provide the information required to effectively manage the processes for future major construction projects.

The OCA thanks the management and staff of the LRT Design and Construction Branch and the Law Branch for their cooperation and support throughout our review.