Bumpy Road for OCIPs?
How the Texas Legislature Could Drive the Use of Owner Controlled Insurance Policies Out of Texas

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Imagine you commute to work down a neighborhood road marred by potholes. You beg your local government to fix them, but your local government ignores you, claiming that it’s not in the budget to fix potholes. So you convince your friendly Neighborhood Association to raise money to fill the potholes with dirt. Problem solved! Your commute is smoother and everyone in your neighborhood is happy to solve the Pothole Problem.

While you’re perfectly satisfied driving on your pothole-free road, the State comes in and determines that it never intended for Neighborhood Associations to fix road problems; after all, that is a TxDOT or county problem, not the Neighborhood Association’s! “But State, I went to my local government first, and they didn’t have the money to help with my Pothole Problem,” you plea, “all I want is to be rid of the Pothole Problem and get on my way to work.” Deaf to your plea, the State decides that Neighborhood Associations are no longer allowed to fund road problems. Now, Neighborhood Associations are out the business of fixing potholes.

Oversimplified as it may be, this is the long-and-short of the problems facing consolidated insurance programs in Texas. Wrap-up insurance policies, often known as owner-controlled insurance programs (OCIPs), are the construction industry’s answer to the Pothole Problem.

On the Road of Construction Insurance Reform
The road was bumpy for the construction industry in the 1990’s—an era when construction defect litigation was at an all-time high. As insurers began sustaining catastrophic losses under commercial general liability policies, or “CGL’s,” the carrier pool willing to provide insurance to large-scale and/or risky construction projects shrank. Premiums skyrocketed, which meant that a good portion of the subcontractor workforce could not afford basic workers’ compensation policies. This left many workers uncovered. As worksites became more dangerous, those unfortunate enough to get hurt had no choice but to sue. And if workers’ injuries were not bad enough or if they were at fault? “Too bad,” said the system, “no ‘Day in Court’ for you.”

To fix this Pothole Problem, (i.e., too many gaps in coverage resulting from overly-expensive CGLs), the construction industry looked to the project owner as its “Neighborhood Association”—an umbrella entity who could organize and manage coverage to ensure that every worker was covered, and that the project remained insured even after the subcontractors left the worksite. Instead of requiring insurance provision
from the bottom-up, project-specific OCIPs could be written for blanket CGL coverage, workers’ compensation coverage—whatever the owner required.

The advent of OCIPs meant that general contractors and subcontractors no longer had to worry about qualifying for the right type and limit of coverage. If a project had an OCIP, smaller contractors could remain competitive because they were free from the burden of carrying their own policies. Workers could be confident they’d be covered if they got hurt. And the owner could save the frictional cost of ensuring that all of their contractors retained separate conventional CGL policies.

Retention of control at the top of the pyramid also meant that there would be fewer hiccups in the project’s overall risk management program—a bonus that would also decrease CGL premiums. Plus, due to economies of scale, the owner saved even more money by purchasing more policies at a cheaper price than would otherwise be expended for the same type and limit if the coverage was part of the general contractor’s original bid.

In Texas, OCIPs have typically been written for workers’ compensation coverage, as was the case in *Entergy Gulf States v. Summers*, the seminal Texas Supreme Court case on OCIPs as they relate to workers’ compensation. Entergy required that all contractors working in any capacity at its various facilities enroll its OCIP, which ensured workers’ compensation coverage for all workers. John Summers, an employee of one of Entergy’s subcontractors, International Maintenance Corporation (IMC), was injured at Entergy’s plant. Summers collected his workers’ compensation benefits under Entergy’s OCIP, then sued Entergy for negligence.

Entergy fought back, claiming that since it had provided Summers workers’ compensation coverage to IMC’s employees under its OCIP, it was entitled to statutory immunity from tort claims as Summers’ “statutory employer.” No, claimed Summers, Entergy was not the general contractor; it was the premises owner. Premises owners are not entitled immunity as a statutory employer, no matter how much insurance they purchase; therefore, argued Summers, he was entitled to bring negligence claims against Entergy.

**Texas Supreme Court in the Driver’s Seat**

The issue that went up on appeal was whether Entergy, as the premises owner, could also be the general contractor, since Summers claimed the statute only allowed general contractors to qualify for immunity as statutory employers. In terms of the Pothole Problem, the question was whether the Neighborhood Association could take care of both the neighborhood and the roads. Arguing in Summers’ vein, Summers’ answer to the

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1 282 S.W.3d 433 (Tex. 2009)
2 TEX. LAB. CODE § 406.123(e) (immunity rule)
3 TEX. LAB. CODE § 406.121(1) (defining “general contractor”)
Pothole Problem would have been that only the government can take care of roads, and since the Neighborhood Association is not the government, the Neighborhood Association is out of the road management business.

The Texas Supreme Court did not buy Summers’ argument, and instead, held that Entergy could be both the premises owner and the general contractor. This decision enraged a handful of Texas Legislators, who claimed that, in all the years of implementing workers’ compensation policy, they had never intended for premises owners to qualify for immunity. “Judicial activism,” charged the Legislature, claiming that the Court is not at liberty to pass on policy decisions and, instead, is bound by the Legislature’s intent.

On the same day the Supreme Court decided Entergy, it also issued HCBeck v. Rice—a workers’ compensation case that further defined the rules of the immunity game. Unlike Entergy, the issue was not whether HCBeck could qualify as a general contractor because HCBeck was the general contractor. HCBeck operated under a workers’ compensation policy that was part of an OCIP purchased by a different premises owner, FMR Texas, Ltd. Thus, when HCBeck hired other subcontractors, all of those subs had to enroll in FMR’s OCIP.

After the worker of one of HCBeck’s subcontractors was injured, he collected his workers’ compensation under the OCIP, then sued HCBeck for negligence. In this case, HCBeck was only “providing” its subcontractors an OCIP that was purchased by a different property owner, FMR. But HCBeck wasn’t “paying” for anything, unlike Entergy, who had actually purchased the OCIP in its name. The Supreme Court didn’t see the difference, and therefore, held that HCBeck, like Entergy, was a statutory employer.

Why does it make a difference that HCBeck qualified as a statutory employer in the same manner as Entergy? Because the Supreme Court said that as long as the parties contract correctly, and everyone remains contractually bound to purchase workers’ compensation or its equivalent if the OCIP terminates, then everyone “provides” the policy as a general contractor and therefore obtains the statutory immunity protection against tort claims. In effect, it is the HCBeck opinion that truly immunizes contractors up and down the chain from exposure to tort lawsuits by injured workers. If the contracts and risk policies are appropriately authored—as was the case in HCBeck—then a worker is limited to an “exclusive remedy” of workers’ compensation coverage under the OCIP.

And this “exclusive remedy” scheme would be fine, assuming, of course, that workers’ compensation recovery was adequate. But if it is true that workers are not made whole

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4 284 S.W.3d 349 (Tex. 2009)
5 TEX. LAB. CODE § 408.001(a).
by their “exclusive remedy” of workers’ compensation, then the real problem for the Legislature is not whether the premises owner should qualify as a general contractor, but whether the workers’ compensation system in Texas is adequate at all. In short, HCBeck essentially punted the entire mess to the Texas Legislature.

The State at the Wheel: Can the Legislature Fix the Entergy Problem?
What followed was a Legislative battle during the 81st Session of the Texas Legislature, which was in session when the opinions were released in April of 2009. Proponents of legislation that would fix the “Entergy Problem” (Entergy-type legislation) wanted to add words into the definition of “general contractor” so that a premises owner could never be both a general contractor and a premises owner.\(^6\) Thus, since immunity was only given to general contractors, premises owners would never be immune from tort suits. On the other hand, opponents of Entergy-type legislation in favor of the Court’s ruling argued that this fix would be like a band-aid on a gunshot wound. They encouraged the Legislature to wait until the interim to correct the inefficient Texas workers’ compensation scheme in its entirety.

The problem before the Legislature is similar to the Neighborhood Association’s dilemma with the potholes: if local government did have sufficient funds to fix the roads, then the Neighborhood Association would not need to fill the potholes in the first place. Likewise, if workers’ compensation is enough for injured workers, then the worker would not need to sue in tort. But just like the local government’s budget forced you to enlist the Neighborhood Association to fix your road’s potholes, so too, does the inadequacy of the workers’ compensation system force the injured worker to sue to fix his economic gap.

Here’s where the hypothetical diverges from the reality: The Neighborhood Association fills in the potholes to combat the problem of a lack of government road funding. It assumes that there is not adequate road funding. In contrast, the insurance and construction industries created OCIPs to combat the problem of expensive CGLs and gaps in coverage. But what they didn’t assume was that there is not an adequate workers’ compensation system. In fact, the efficacy of the OCIP assumes, as it must, that the State favors blanket workers’ compensation coverage for all workers. As Justice Hecht wrote in the Entergy concurrence:

Workmen’s compensation laws have become part of our public policy. The object of the laws was to do away with the issues of negligence, unavoidable accident, assumed risk, contributory negligence, and other like issues, and to fix the amount recoverable free of any uncertainty. The old system of settling disputes was unsatisfactory, and modern business methods demanded that compensation for injuries to employees be not

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\(^6\) Tex. H.B. 1657, 81st Leg., R.S. (2009)
controlled by the fault or negligence of the employee, but should rest upon broader, more humane, and more certain rules.\(^7\)

When workers’ compensation laws made their debut, the most important issue on the Legislature’s agenda was ensuring that workers retained benefits without regard to fault, and that the cost of litigation would not be such a high barrier to entry that it would prevent the worker from recovering anything at all. Now, advocates for the Entergy-type legislation want to have it both ways: they want premises owners on the hook for tort litigation while ensuring that all workers retain the ability to recover on workers’ compensation claims. The result is double recovery for the worker, double coverage for the premises owner—who’s providing both the worker’s compensation policy and the CGL policy, and increased premiums for everyone.

But advocates for Entergy-type legislation forget that tort exposure will send shock waves of consequences throughout the industry. In addition to the most obvious consequence, (i.e., more tort litigation equals higher premiums across the board), Entergy-type legislation will practically wipe out the use OCIPs in Texas altogether. Thus, just as the State’s decision to remove Neighborhood Association from the road maintenance business would drive Neighborhood Associations out of the pothole filling business, so, too, would the State’s decision to remove premises owners from immunity protection drive premises owners out of the OCIP business.

Imagine the following: If the Entergy-type legislation passes, general contractors must contract to perform work “for the benefit of another,” essentially encompassing a three-party system like that of HCBeck—premises owner, general contractor, subcontractor.\(^8\) But then the definition of “statutory employer” allows only a general contractor statutory immunity.\(^9\) The premises owner will always be exposed to tort claims, no matter what kind of insurance he provides, and thus, his CGL policy is bound to rise with the increased cost of litigation. Even if this is passed to the general contractor through indemnity agreements or contractual adjustments, the result is the same: increased CGL premiums across the board.

Indeed, the original benefit of OCIPs was that it cost less to obtain policies for everyone, instead of forcing everyone to obtain policies and then true up the higher cost in the bidding process. If CGL costs are going to increase with increased litigation no matter what the scenario, the gap between the cost of policies under an OCIP and the cost under the traditional system disappears along with the incentive to purchase an OCIP.

Of course, with the disappearance of OCIPs comes the revival of the problems inherent under a traditional insurance model: lack of widespread and secure coverage, higher

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\(^7\) 282 S.W.3d at 455 (Hecht, J. concurring) (quoting Woolsey v. Panhandle Ref. Co., 116 S.W.2d 675, 676 (1938))

\(^8\) Tex. H.B. 1657, 81st Leg., R.S. (2009)

\(^9\) TEX. LAB. CODE § 406.123(e).
barrier to entry for contractors, fewer industry players, less certainty in the risk management process. If the Legislature adds these costs back into the scenario while simultaneously failing to revitalize the workers’ compensation system, it will not only be the industry that suffers: it will be the workers.

**Back Seat Driving: What Would Happen if You were in Charge?**

No everyone can agree on whether OCIPs are a good or bad thing for Texas. Advocates for Entergy-type legislation argue that this three-party scenario whereby the premises owner never has immunity will ensure that the owners always maintain a safe worksite. They forget that the premiums are underwritten based upon risk, and that an unsafe worksite translates into a higher risk rating, which equates to a higher premium. Therefore, opponents of the Entergy-type legislation argue that the industry polices worksite safety more efficiently—in a way that can balance safety concerns while maintaining the viability of wrap-up OCIP-type policies.

The veritable “ace of spades” for Entergy-type legislation is that workers’ compensation, today does not adequately compensate injured workers. On that point, nobody disagrees. The point of contention, however, is whether the Entergy-type legislation will actually remedy the system. As explained above, removing OCIPs from the industry’s toolbox will probably do little to improve the system, absent some reform to the Texas workers’ compensation system.

One idea debated during the interim hearings at the Senate Committee on State Affairs and the House Joint Committee on Judiciary and Civil Jurisprudence/Business and Industries is introducing a definition for Broad Statutory Employer into the statutory framework. This employer would be like Entergy or FMR—one that contracts with multiple other employers whose contractors perform simultaneously at a given worksite. The BSE statute would also include a mechanism to incorporate Hazard Pay Benefits, wherein common injuries typically sustained on a hazardous worksite would be categorized and assigned Hazard Pay Ratings. Workers would receive increased compensation based upon the degree of their injury and the height of the risk.

The idea behind the BSE/HPB system is that the savings an owner would enjoy from tort immunity as a Broad Statutory Employer could be poured into the Hazard Pay Benefit system, which would create more resources for those severely injured on the job. Since owners would either manage their HPB risk internally or add additional riders to their workers’ compensation policies, the risk factor would vary depending on workplace safety. The fact that hazardous worksite injuries will impact the risk factor will incentivize owners to ensure that workplace safety is maintained.

**Conclusion**

While it is unclear precisely what the Legislature will do in response to the industry in the post-Entergy era, it is certain that the issue will arise during the upcoming 82nd
Legislative Session in January of 2011. In fact, workers’ compensation is under a microscope, as the Workers’ Compensation Commission is up for Sunset Review—which is Texas’s effort to revamp state agencies every so often in order to maintain efficiency.

Other issues remain as to the outcome of the benefit adequacy debate, Entergy’s effect on subrogation, and a possible gross negligence exception to the current law. If your business depends on the viability of OCIPs in Texas, or if you are worried about the potential of skyrocketing CGL policies in the construction insurance market, then jumping on the Road to Comp Reform may be your best bet—even if it is covered in potholes.