

Contract Works

Biting off more than you can chew!

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In this article we discuss unfamiliar project risks and the potential for construction losses as Small to Medium Enterprise (SME) contractors expand into new and more complex projects in the Australian construction sector, which may in fact be beyond their expertise and capability.

Whilst such expansion into new territory comes with great opportunity, it may also be accompanied by higher risk and it is questionable as to whether Insurers should come along for the ride in respect to such matters when things go wrong. This article looks at the following two key risk items in such scenarios.

1. Increased contractual risk
2. Increased technical risk

We also detail how CTA operates to manage such matters to the benefit of all involved, as such increased risks can lead to complexities in any associated Insurance claims.



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Urban Renewal

The construction industry on the east coast of Australia is experiencing unprecedented levels of activity with respect to transport infrastructure and residential urban infill projects. State governments and local authorities throughout Australia are increasingly favouring urban activation and renewal projects as a method of leveraging existing transport infrastructure and public utilities due to;

- The limited availability of greenfield sites for new residential land development projects;
- A preference for closer proximity of accommodation to city and town centres that allows access to employment opportunities and essential services;
- The need for higher density accommodation to cater for population growth in major urban centres; and
- Increased Environmental restrictions imposed by statutory authorities.

This has intensified construction activity around existing transport infrastructure in a bid to increase housing density and bring people closer to city centres, public transport, and employment opportunities. SME construction contractors are growing their businesses to leverage new opportunities, and this poses some unique challenges and associated risks.

Ironically during times of heightened construction activity, SME contractors often fall foul of events which can lead to receivership etc. Simply put, a large project can expose a smaller SME to a large and unexpected loss which can severely hurt the bottom line in the event Insurance is not triggered.



Contracting risk

As contractors expand they invariably compete to win larger and more complex projects. This often exposes technical deficiencies as elements of the project are misunderstood during the tender phase which can erode profit margins when errors or omissions are discovered during construction. Contractors may attempt to recapture lost revenues from oversights made in a tender submission via contract variations during the construction phase.

Indeed in the context of the above an insured peril event such as a storm to the project site may be perceived as an 'opportunity' to add items during the repair that might ultimately be included in an insurance claim. The construction loss adjuster is required to have a detailed understanding of the original Works Under Contract (WUC) and to identify any elements incorporated within a claim that pertain to betterment or additional cost items which did not form part of the original project scope.

This sounds simple enough to determine but the adjuster often has to piece together the detail of the original scope and determine the construction status that was enjoyed prior to the peril. In our consideration of such matters it is not uncommon to request and review the following:

- Original contracts and associated scopes of work
- Internal progress reports and construction program Gantt charts
- Progressive photographic records of the construction
- Site diaries and so on

If any of the above information is absent, this can lead to a somewhat unsatisfactory situation where Insurers are left to formulate the pre-loss situation with the assistance of consultants such as quantity surveyors. Left with such options it is possible for some claims to end up in dispute because the hypothetical scenario may not reflect the expectation or the position of the contractor, albeit that the contractor cannot support their position well. CTA is well versed in managing such situations and looks to its industry specific construction adjusters to ease the claims to conclusion with minimal angst.

Example 1 - Poor data management and recording

An example of the above is when an Insured is part way through a large construction project where progress and recording of the same is complex and not well defined pertaining to earthworks. In the event of a large rainfall event to their incomplete earthworks it can be difficult to ascertain the exact pre-loss status via documentation and photographs. These situations can often leave Insurers trying to model the status through the use of consultants that specialise in quantity surveying or project scheduling. Often the politics of internal 'progress' can interfere with or intermingle into insurance claims and it is up to the adjuster to sort out the wood from the chaff.



SME contractors simply may not have the resource or 'know how' to ensure appropriate project recording systems are in place to prove what has been done pre-loss. Thus poor contracting methods, record keeping and scheduling know-how can be very detrimental to the success in supporting a valid claim.

Technical Risk

Larger and more complex construction projects often require contractors to purchase and operate technically complex machinery in order to fulfil contractual obligations. Trenchless technology incorporating vertical and horizontal boring, and specialised foundation equipment are increasingly being added to the suite of services offered by contractors. The successful operation of such equipment relies heavily upon suitably qualified operators, and detailed preparation prior to breaking ground. Operation of such equipment has the potential to cause extensive damage to underground services and utilities necessitating expensive repairs and potentially exposing employees to serious health and safety consequences. Often these events occur due to a lack of experience by the contractor and Insurers need to be diligent when considering underwriting such risks.

Construction loss adjusters require a detailed understanding of reinstatement methodologies to mitigate losses being incurred by the contractor following damage to public utilities and underground services. To this end CTA holds degree qualified civil / structural engineers on staff to assist in the root cause and reinstatement review such that the right answer is identified to determine policy response and ultimately to audit the claim should indemnity be granted.



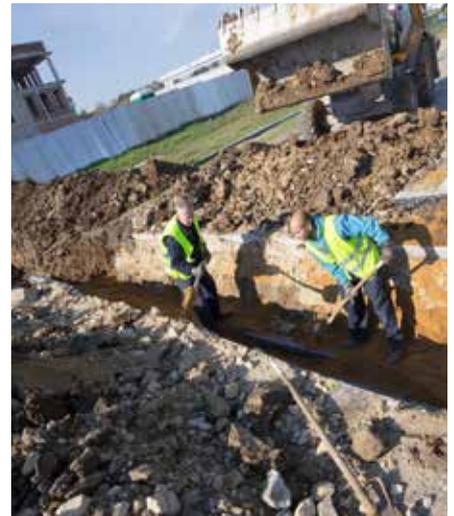
Example 2 – Rectifying the initial defect as part of the reinstatement

An example of the above is where a contractor attempts to undertake work which either fails or causes damage to contract works. Often rework is required which must include betterment such that the completed works perform as originally intended. The Adjuster will be called upon to identify any defects, what is insured damage and what constitutes betterment? Not always a straight forward discussion as some contractors will be economic with the truth when it comes to their short-comings in execution or design of the project.

Example 3 - Consequential Loss

Program delays and ensuing contractual penalties are another potential consequence stemming from construction losses. Contractors will therefore be keen to return to a pre-loss position as quickly as possible to achieve practical completion on the date nominated in the contract and avoid incurring penalties in the event of delayed completion. Loss adjusters must be mindful of construction program pressures on the contractors desire to mitigate lost time and reinstate damage quickly. Interpreting construction programs critical path will be vital to ensure a claim does not incorporate cost elements associated with accelerating the construction program or altering the scope of work under contract to facilitate early completion or 'catch-up' of the works program. There is also the regular issue of 'standby' time for labour and equipment finding its way into claims. This can be substantial and is normally excluded, much to the 'surprise' of the inexperienced contractor!

Aside from the direct project impacts there can also be issues for neighbours to the project. Contractors working in close proximity to existing structures on a project site may require the use of shoring and propping equipment or ground stabilisation techniques to provide adequate stability during excavation activities. This potentially exposes contractors to a slew of issues stemming from damage to existing property resulting from subsidence, settlement and vibration. The adjuster will need to pay particular attention to the Policy and determine if cover extends to these elements when considering an Insureds claim. Hopefully any third party liability cover is adequate and this could be an issue if a contractor were piling for example next to a high rise building that leads to damage of the same.



CTA Claims Management Benefit

The initial site visit and inspection is vital for the adjuster to understand the cause of and extent of resultant damage. At this very early stage there is likely to be a necessity to engage the right expert(s) dependent upon the anticipated cost and complexity to reinstate. A detailed review of the Insureds incident report and witness statements will help establish the pertinent facts with sufficient clarity to provide Insurers a preliminary report detailing findings.

The adjuster must also ensure that detailed photographic records are collected during this initial site visit and it may be appropriate to discuss preliminary planning in relation to potential reinstatement and repair methodologies. If the loss has resulted from a weather or fire event, there may be debris necessitating removal from the project site, and the adjuster should discuss how the contractor proposes to deal with debris removal as this will likely determine how soon reinstatement can commence following works to make the site safe.

Contingent upon the complexity of the loss, the initial site visit may enable the adjuster to consider third parties who have contributed to the loss and against whom recovery rights might exist for Insurers. Whilst the issue of recovery is unlikely to be resolved definitively at this early stage, adjusters should be mindful of the need to preserve witness statements and other evidence which may be relied upon later in the course of investigating the incident. Adjusters should consider appropriate methods to provide temporary protection of the undamaged portion of the works, including the preservation of evidence and other facts which may be needed once the investigation is further progressed.

CTA construction loss adjusters are hired from the construction industry and have the ability to interpret construction drawings, and specifications in detail which adds significant value to the management of a contractors claim following a loss. Interrogation and analysis of construction documentation assists with program review and the sequence of critical path tasks required to achieve practical completion. The adjuster will also be able to determine any obvious errors, omissions, or defects of workmanship following review of the project specification and construction drawings.

CTA construction loss adjusters have experience in civil construction, civil design project management, and contract superintendency aspects of the industry and this adds significant value when reviewing documentation to assess whether damage to Contract Works falls for consideration under a Policy including;

- Assessment of Contract value (original contract sum, approved contract variations, and escalation provisions);
- Review of Contract duration (date for practical completion, approved Extensions of Time);
- Consideration of the applicable Policy deductible;
- Consideration of the Contractual Maintenance and Defect liability duration period and how this relates to Policy coverage;
- Confirmation the loss occurred within the Period of Insurance;
- Confirmation the Damage is Insured? What betterment might exist? Are there defects involved?
- Review of extensions, endorsements, and exclusions contained within the Policy;
- Consideration of the Basis of Settlement; and
- Provision of advice in respect of recovery against third parties.



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CTA are mindful that nobody appreciates surprises during the process of adjusting a construction loss. Insurers must be apprised of developments which may impact the magnitude of the loss including specific reasons impacting their estimated reserves. Brokers also need to be informed should anything materialise which may influence an Insurers determination to grant indemnity in respect of their Client's loss. For these reasons it is important to communicate timely and accurate updates to all stakeholders. Regular communication with the Insured throughout reinstatement enables transparency and this will assist to identify potential Policy response issues earlier in the adjustment process. CTA coordinate periodic updates and formal reports to Insurers summarising the pertinent facts and findings based upon our enquiries. As the series of written reports progress we aim to present new information and thus our reports track the matter from date of loss to the present position for consideration by the reader.

Conclusion

SME contractors are currently experiencing substantial growth in new business opportunities, and coupled with this is inherent risk which needs to be managed appropriately. Construction will always involve losses due to unavoidable nature of weather events and other unforeseen factors.

Adjusters with construction industry experience add substantial value through liaison with stakeholders from the initial instruction and site meeting, throughout the reinstatement process and ultimately in agreeing a final settlement. Applying our knowledge of various construction methodologies to construction losses, allows CTA adjusters to consider appropriate mitigation and reinstatement strategies in consultation with Insureds and Insurers alike.

About Us

Charles Taylor Adjusting (CTA) is one of the leading loss adjusting businesses in the market. We provide loss adjusting services across aviation, marine, natural resources, property, casualty, technical and special risks along with average adjusting services for ship owners. The business primarily focuses on larger and more complex commercial losses arising from major insured incidents and claims. CTA is a business of Charles Taylor Plc (www.ctplc.com) which is quoted on the London Stock Exchange (CTR). Charles Taylor plc is a leading provider of professional services to clients across the global insurance market. The Group has been providing services since 1884 and today employs over 2,000 staff in 76 offices spread across 29 countries in the UK, the Americas, Asia Pacific, Europe the Middle East and Africa. The Group offers services, principally on a fee-based model and operates through three businesses – Management, Adjusting and Insurance Support Services. It also owns insurers in run-off. Charles Taylor's vision is to become the professional services provider of choice to the global insurance market.

Charles Taylor Adjusting (CTA) Expertise

CTA has qualified engineers on staff throughout all Australian offices with diverse backgrounds ranging from “big picture” Project Engineering / Construction right through to detailed design work. Our Engineering Adjusters hold Adjusting qualifications and are members of the Australian Institute of Chartered Loss Adjusters (AILCA), the Australian & New Zealand Institute of Insurance and Finance (ANZIIF), or other UK-based professional bodies of equivalent or higher standards. We ensure outcomes are concisely reported to Insurers to match their requirements in documenting the circumstances of the loss in a clear and logical manner, allowing them to reach a conclusion in respect to policy response.

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