Construction Claims: The Importance of Claims Preparation

December 2018

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Introduction

Ease and speed of settling claims are important considerations when purchasing insurance to effectively transfer risk. Generally, 80% of the time, claims progress without major challenges. But when there are challenges or rejected claims, it can cost the insured significant amounts of time and money and even have adverse effects on the balance sheet. In these situations, employing the technical experience of a claims preparation service can help avoid claims rejection and recover a more favorable settlement amount. Additionally, it removes the burden of time spent preparing the claim, leaving more time to spend on other important business activities. Construction/erection losses are one of the most requested services of Aon, which make use of dedicated engineers with experience across tunneling, wet work, power, oil & gas, as well as operational infrastructure.

While many claims preparation services rely broadly on forensic accounting expertise, Aon´s claims team is staffed with engineers that provide added value with respect to highly technical aspects of construction losses, where the determination of the cause of loss and certain technical discussions on the extent of the damage can be very complicated. Careful on-site technical studies of the claim through an engineer's perspective can often make a significant difference in how construction losses are ultimately settled.

Claims preparation services benefit clients by:

- Removing the burden of managing the claim from the Insured, allowing the Insured to focus on other productive activities, such as customer and supplier services.
- Benefiting from industry leading technical support when it comes to discussing the application of specific insurance clauses (particularly in Construction/Erection policies).
- Effectuating quick, agile and effective liquidation of claims.
- Optimizing compensation in line with the policy coverage.
- Increasing rigor in working with insurance companies to meet their obligations and make partial payments as interim amounts.
- Seeking to limit legal proceedings to exceptional cases and provide clients with technical assistance in such legal proceedings.
- Seeking to obtain technical certification for the Insured on the compensation agreements reached.

Construction/erection loss scenarios that maximize claims preparation services

Difference between "Damage" and "Deterioration"
(see Case Study 1)
Insurance policies provide coverage for repair in case of "Damage," but exclude costs for rectification due to "Deterioration." Distinguishing between the two can be difficult, and there is a blurry line of distinction in many cases. Deteriorations or defective conditions not triggered by an accidental or sudden event are usually not covered by insurance policies (i.e. gradual corrosion, wear & tear, etc.). This issue can often arise when losses occur to operational infrastructure and power plants.

Cost of "Betterments"
Carriers frequently argue that insureds take advantage of the insurance policy's indemnities by reinstating damaged works with additional betterments. Betterment costs are not covered and are usually very difficult to assess because hypothetical reinstatement scenarios must be compared and quantified.

In any event, when a betterment is implemented, it can well happen that there are no additional costs associated with it, or the costs are actually lower than those corresponding to the original design / method of construction. As a construction client recently shared: "The current struggle in construction losses does not lie so much on the interpretation or application of the policy terms but in agreeing on the best solution to reinstate the damaged asset."

Cost of "Improvements" *(See Case Study 2)*
"Improvement" and "betterment" are different concepts. "Improvement" stands for rectification measures specifically applied when the cause of the loss is a defective design, material of workmanship affecting a portion of the project. It is related to the "Design Error" exclusion clause of the policy, for which there is a wide variety available in the market (LEG and DE wordings being the most common).

With LEG3 or DE5 clauses in the policy, discussions about the existence of improvements, and the cost of said improvements, are even tougher than those related to betterments. This is because the "defective portion" is not always evident, and the difference between the cost of a strict repair of damages and the cost of implementing an improvement can be negligible, despite what could be initially expected.

With LEG2 or DE3 clauses in the policy, discussions about what preventive measures would have avoided the loss are also tricky because the loss adjusters must deal with hypothetical scenarios where there is room for subjective considerations.

Difference between "Damage" and"Mere Defect"
(see Case Study 3)
Another contentious and frequent discussion related to Design Error clauses is about the thin red line between "defect" (whose mere existence does not constitute a loss event) and "damage." If different portions of the works containing the defects and the resulting damage are found, the solution can be self-evident, but there are clauses (e.g. LEG3) that grant coverage even for defective portions of the works, provided they are damaged as well. Thus, distinguishing between mere defects and damages consequent to said defect is of paramount importance.

The standard language designers frequently use is often confusing. Designers may unintentionally address "defective elements needing remediation" without an appreciation of the subtle differences of these terms in construction insurance policies. Consequently, loss adjusters often resort to the same terms argued by the insured to decline the claim.

It is therefore helpful, to engage a professional construction claims preparation team to produce and present the technical documents needed to explain the myriad circumstances.

The Cause of the Loss during Maintenance Period
(See Case Study 4)
During the maintenance period of the policy, the "all risk" concept generally does not apply any more. Only losses caused by specific circumstances are covered (depending on the maintenance clause provisions). Thus, the burden of proof is on the insured, and a root cause analysis is necessary from the beginning for the policy coverage to be triggered. During the construction period it would be the insurer's responsibility to demonstrate the application of a specific exclusion.

This different approach makes the claim presentation and negotiation more complicated, and the active contribution of an experienced Claims Preparation Team is helpful for clients.

DSU Claim: Effect to the Critical Path of the Project
Insureds will frequently claim for every delay in a project once a covered loss happens; and the loss adjuster will surely tend to find that there was a chance to avoid/minimize any delay, but for other uninsured contributing circumstances.

An effective means of solving the difficulties presented by these types of discussions is with a thorough analysis of the critical path of the project (the series of activities that, put in a row one after another, determine the duration of the total works), and of the alternative critical path that results from the impact of the loss event.

In our experience, we frequently find that the standard project program used by the contractor is not accurate enough to shed light on the critical aspects of the discussion. We can help to fine-tune it and explain the technical basis to the loss adjuster.

Increase in Cost of Working / Acceleration measures
(See Case Study 5)
Both the Insurer and the Insured share interest in minimizing the DSU, and that the policy provides fair coverage for all the extra efforts taken as long as they pay off.

Thus, a thorough analysis of the critical path is needed that includes alternative scenarios modelling and comparison. A robust presentation of the extra expenses that will be incurred, in comparison with the standard cost of the works, is also suggested.

The complexity of this analysis increases when considering that the extra expenses do not have to be exclusively related to shortening the duration of critical path activities. Some other project works that have float (some room for delay without affecting the project's critical path) can also be sped up, with a reasonable chance of negotiating coverage for the corresponding cost. It is so because it wouldn't be fair to leave the project vulnerable to future events regardless of whether they are insured or not when there is still a long way to go before the project completion. Additionally, if the policy includes an Additional Increase in Cost of Working clause, this can further aid a successful settlement.

Needless to say, the involvement of Engineers and Project Planning specialists in these technical discussions can prove beneficial.

CASE STUDY 1

"Damage" or "Deterioration"

Background
Two solar power plant owners faced two claims for damage due to leakage on heat exchangers valued between USD 6 to USD 8 million, plus Business Interruption amounting to an additional USD 10 to 15 million.

Approach
The insurer's representative initially assumed the case could be due solely to deterioration that had accelerated the consumption life of the heat exchangers, disregarding insured damage due to a lack of "sudden event." However, Aon collaborated with the original equipment manufacturer to identify the nature of the defects and found that operational errors (in one case) and design errors (in the other case) triggered the damages. The claims team clearly explained the red line between said design errors and further damages caused by them.

Results
In one case, the result was full indemnity in favor of the insured of USD 16 million, while in the second case, a report was put forward and defended, which is still awaiting resolution in arbitration court.

CASE STUDY 2

“Improvements”

Background

A contractor’s diaphragm wall for a subterranean garage started to tilt inwards before the excavation had finished. A set of remedial and preventive measures costing circa EUR 2 million was implemented urgently, including soil anchors that were not part of the original design.

Approach

Insurers initially considered most of these solutions as “improvements” of the project. Aon presented the case explaining that a) a correct design would not have needed the anchoring system, but a much cheaper solution; and b) the anchoring system only intended to sustain the walls during the construction phase, effectively protecting them once they would have started to move. The system had no further contribution once the project was finished because of the self-resistant nature of the final structure. The Mitigation Clause also provided for a more robust defense of the case.

Results

The result was the recognition of indemnity in favor of the insured for most of the remediation works carried out.

CASE STUDY 3

“Damage” or “Mere Defect”

Background

A contractor faced USD 3 million worth of defects which were identified following quality control tests on foundation piles of a subway station in South America.

Approach

The insurer’s representative initially understood the case as a mere construction defect, with no damage because nothing had “broken down.” The claims preparation team invested time completing document reviews and interviews to determine the nature of the defect and identified that the bentonite slurry used to drill the pile bores was defective and found that damage suffered by the pile’s fresh concrete was due to the collapse of the excavation walls.

Results

The result was full indemnity in favor of the insured of USD 3 million.

CASE STUDY 4

Damage during Maintenance Period

Background

The roadbed of a highway experienced major damages following torrential rains during the maintenance period of the policy.

Approach

The initial inspection found a defect in the design of the drainage system, which initially led to a lack of coverage under the policy, as the policy had no Guarantee Cover for maintenance. However, a thorough technical study proved that there was no causal link between that design error and the damages. The drainage system issue proved to be a consequence of a workmanship defect during the construction of the road which, unlike design errors, are usually covered under the CAR policies during the maintenance period.

Results

The result was full indemnity in favor of the insured of USD 2.5 million.

CASE STUDY 5

Increase in Cost of Working / Acceleration measures

Background

Following a once-in-200-year rain event, the construction site of a Liquified Natural Gas plant being erected in the Middle East was flooded. There was a substantial period of time before the completion date, and Aon was engaged by the Principal to support the claim for the extra expenses that the acceleration of the works would need, with the aim of avoiding/minimizing the Delay in Start Up (DSU).

Approach

Insurers initially considered that only acceleration costs related to critical path activities deserved coverage. Aon helped to explain what those costs were, by identifying each task and cost, and having them linked to the critical activities of the project. Aon also presented an argument in favor of recognizing coverage for extra expenses related to saving time in other non-critical activities, explaining that the floats in the project program were necessary to protect the correct timing when alternative critical activities should be carried out, from eventual unforeseen problems that might happen. The Additional Increase in Cost of Working clause helped to resolve the case.

Results

The result was the loss adjuster's agreement to settle the claim, including those time-saving efforts able to be proven by the insured. The loss settlement is still ongoing.

Aon has a global claims advocacy team of over 1,300 claims professionals from around the world bringing to bear technical knowledge, claims precedent, and multiple formal claims escalation agreements with insurers. Our team has secured 40% declination overturn and 28% financial uplift, helping to provide $4.5 billion in claims settlements to our clients over the last three years.

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About Aon

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