

**PROPERTY
CLAIMS
ASSOCIATION**

◆ *of the Pacific* ◆

San Francisco, California

November 2009

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Association News Network Associate Affiliate



The Present and The Future of PCAP

November Message from 2009
PCAP President Robert Fox



Bob Fox

Our October luncheon was a success due to the efforts of Craig Pusser and Ward Loveland. Their presentation sure made for an interesting session. So

did the location. It all came together at John's Grill with the "Maltese Falcon" watching over the proceedings. We have follow up information in answer to some of the questions posed to Craig and Ward. It is incorporated in this newsletter for your further enlightenment.

This was our last program for the year. We are scheduling 6 for the coming year to be held every other month

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Pardini to Present Annual Legal Review at January PCAP Luncheon Meeting

Join PCAP in kicking-off the New Year

**Thursday
January 21, 2010**

with guest speaker:

Julian J. Pardini

Lewis, Brisbois, Bisgaard & Smith, LLP

at

2200 Powell Street, Emeryville, CA 94608

**Earn Two (2) Hours CE credit offered by
DOI, RPA, CPCU and MCLE for the program.**



Julian J. Pardini

Julian J. Pardini serves as Vice-Chair of Lewis Brisbois' Insurance Coverage and Bad Faith department. Mr. Pardini's practice focuses primarily on insurance coverage and bad faith litigation, specializing in lawsuits arising from first party coverage disputes and suspicious losses. He also handles general liability and subrogation matters. His presentations are known for their lively nature, while providing pertinent and valuable information. Start your new year off right with PCAP and this first meeting of the year.

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FREE to members and just \$10.00 for non-members.

*A light lunch will be served. **Reservations are a must.**
No Show reservations will be charged \$10.*

Mail your check and reservation to:

Mike Diliberto, c/o RGL Forensic,

100 Bush Street, 20th Floor, San Francisco, CA 94104.

Call 415/593-1301 or email reply to mdiliberto@us.rgl.com.

President's Message

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starting in January 2010. The January program will again be offered by Jay Pardini and will cover case law that affected the P & C business in 2009. There are some interesting decisions that came down which will affect the way you do business so try to attend.

That leads to membership and continuing education credit. Our membership fee will still be \$40 for the year until March 1, 2010. Then it will increase to \$50. So sign up early and reap the benefit of a no charge meal and CE credit for each program you attend.

We will be renewing our provider status with the DOI for Independent Adjuster accredited programs. The same will be true with the State Bar. Attorneys will continue to receive MCLE credit by attendance at our sessions. Registered Professional Adjusters have approved our past programs and we anticipate they will do so in the future. For those required to acquire CE credit, PCAP offers a great deal for the price. That's reflected in our membership which is growing. So you'll want to be a part of PCAP!

Now a plug for VOLUNTEERS! We need a few good people to join our board to help with future programming; meal selection and delivery; locations for the programs; newsletter publishing; website updating; and guidance for the future of this association. Contact one of us if interested.

We are always looking for newsletter articles you can share with the association. If you have one, send it to me at rseefox@sbcglobal.net.

Thanks for your participation.

Bob Fox

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Builders' Risk - Quantifying the Soft Costs & Time Elements

By John A. Damico, CPA

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Introduction

While most construction projects are carefully planned, funded and include contingencies for the scheduled completion date and total costs, an unanticipated and extended delay in startup ("slippage") can be a devastating and potentially lethal economic blow if not properly insured under Builder's Risk coverage.

Builder's Risk ("BR") is a unique and often times complicated all-risk property insurance coverage generally intended for properties in the course of construction and/or under renovation that are intended to become a permanent part of a project. It is premised on the basis that an unanticipated event may occur during the construction phase that can cause physical damages, delays in completion/startup, lost profits and increased construction overhead costs and expenses. As expected, BR and property policy issues can be interrelated and overlapping.

Each BR coverage application must be carefully scrutinized by the Underwriter as it relates to the Reported Values and Maximum Potential Loss exposures specific to each project. Underwriting appropriate coverage limits, sub limit, coinsurance requirements and endorsements that properly position the BR coverage for the unexpected can be instrumental to the overall success of the project and provide that much needed safety net for the owners/developers.

Triggers and Concurrent Events

Examples of events and/or insurance perils that can potentially trigger a delay in completion may include:

- Industrial accidents and natural disasters
- Errors in design and defects in workmanship (while errors in design or defects in workmanship are usually excluded from the BR coverage, the ensuing losses may be covered)
- Contract disputes and change orders
- Contractor negligence
- Inspection or compliance delays
- Human error

In some instances, two or more events will take place simultaneously that cause a delay in the project's completion. When this occurs, it is important to evaluate each occurrence and distinguish between the covered v non-covered events that impact both the additional time and expense attributable to each concurrent event.

The Adjustment Team and Its Early Involvement

Typically, the adjustment team is comprised of an independent adjuster (the team leader), an experienced construction consultant, other necessary consultants (such as consultants capable of analyzing and measuring delay), coverage counsel and a forensic accountant. Having an experienced adjustment team that has "been there and done that" and can quickly get up to speed goes a long way toward evaluating the direct damages, the potential time delay and then sharing repair and rebuild suggestions as well as mitigation strategies with the insured. In some cases the adjustment team can make the insured aware of special industry resources that may expedite the potentially delayed completion of the construction project.

In my view, it is critical that the adjustment team be involved immediately to meet with the insured and its representatives, to discuss what has transpired, understand what physical damages occurred and identify respective areas of claim responsibility. Initially, the adjustment team needs to put their thumb on the pulse of the construction project at the time of loss to understand the most current version of the critical path and the likelihood of an on-time completion had no loss occurred. At these early meetings, the adjustment team can also help manage the expectations of the insured during this stressful time, create a regular dialogue for periodic updates to eliminate surprises and also discuss potential strategies to get the project back on track and on an expedited basis. Regardless of coverage, it is in everyone's best interest to minimize the delay and mitigate the potential economic damage to the project.

The lead adjuster will need to set a reserve shortly after the loss. This will involve interviews

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with the insured and its representatives as well as a preliminary request for key planning, operational and financial documents. The sooner those critical documents are collected and analyzed, the more effective the adjustment team will be in determining the estimated economic impact of a delayed opening due to covered perils.

Measuring the Delay in Completion

In all instances, appropriate construction consultants are required to sift through the construction data, correspondence, change orders, memos, plans, drawings, critical path schedules, etc., to assess the project and determine where it stood at the time of a covered event relative to its projected completion date. Whether there are loss or non-loss related factors, it is important for the consultants to determine what issues stand in the way of the scheduled completion date.

By relying on their training, experience, information provided and interviews with key contractors and vendors, the consultants will create a revised project schedule. Comparing the projected (pre-loss) to the estimated actual completion date determines the time associated with the project slippage solely attributable to the covered loss. This time delay is an essential factor in measuring the Soft Costs and Time Element losses in accordance with the Builder's Risk coverage.

Quantifying the Loss Resulting from the Delay

One of the most pressing questions from both the insured's and carrier's perspective is, "How much will this delay cost per day and what is the impact on the total cost of the project?" Irrespective of insurance coverage or a potential action perhaps against a negligent third party, getting your arms around the estimated daily exposure early on in the process goes a long way toward evaluating mitigation strategies and estimating the Soft Cost and Time Element claim exposures.

While each team member has specific responsibilities, some will - out of necessity - overlap to ensure that all of the bases are covered. The forensic accountant's primary focus relates to valuation and quantification issues involving Soft Cost, Time Element and Reported Values aspects of the coverage.

Having been properly instructed by the lead adjuster on coverage and adjustment matters and advised as to the time element scenarios by the construction consultants, the forensic accountant can begin the accounting analysis to either respond to the insured's claim and/or create an independent measurement of the economic impact on the construction project. Some of the initial discussions and information requests will typically center on the following topics and documents:

- Construction, operational and financial plans and budgets
- Critical path charts and most recent revisions
- Contracts, amendments and change orders
- Construction status reports, meeting minutes and periodic general contractor memos
- Loan packages submitted to lender for construction financing
- Estimated time for debugging and ramp-up to normal operating levels
- Actual start-up experiences with similar construction projects
- Actual monthly construction project level cost and expense reports
- Applications for advances, draws or progress payments against the contract
- Percentage of completion accounting

In each instance, the forensic accountant will carefully review

the entire body of information in conjunction with the other consultants to establish a framework to eventually measure the compensable losses under the Builder's Risk policy.

Soft Cost Coverage

This coverage is intended to reimburse the insured for additional expenses that occur because of a delay in the project's completion. The delay must be a result of direct physical loss or damage from a covered peril to covered property.

Whereas the Hard Costs are typically associated with the "sticks and bricks", the Soft Cost coverage is extended to a very specific list of construction overhead costs and expense categories selected by the insured at the time of insurance application. Soft Cost categories typically can include:

- Interest on construction financing & conversion to permanent loan
- Real estate taxes
- Marketing and leasing expenses
- Architect, consultant, engineering and developer fees
- Construction general conditions
- Bond and permit fees
- Testing and inspection fees
- Bank and letter of credit fees
- Administrative costs, licensing and permits
- Legal and accounting
- Commissions for renegotiations of leases
- Insurance premiums for: Builder's Risk; Workers Compensation; General Liability

Soft Costs: Accounting Issues

Concentrating on the covered Soft Cost expense categories, a full accounting analysis of the projected/budgeted and actual construction overhead accounts must be undertaken to identify potential increases. Naturally, not all increased overhead costs are loss driven. It is a common practice to review costs on a line-by-line basis with other members of the adjustment team and, eventually, the financial representatives of the insured.

It is important to drill down and look below the surface to determine the reason that costs may have increased. In so doing, it typically requires a further review of the critical planning, operational and financial documents including contracts and lease agreements and collaboration with the other consultants beyond the accounting ledgers, journals and financial reports.

Using interest on construction financing as an example, the increased interest expense can be a function of a change in the lending rate which would have been experienced had no loss occurred. However, if the construction financing was in place for a longer duration due to the loss, that would be a legitimate additional Soft Cost expense. It is also important to understand the insured's pre-loss plan to convert from construction to permanent financing and whether or not this was impacted by the loss. Additionally, while the construction financing falls under the Soft Cost category, the conversion to permanent financing would take place once the project is completed and would be considered part of the continuing expense of the business operations.

Finally, if the repairs can be completed on an expedited basis such that the anticipated project completion date is not seriously compromised, there may be no need to consider the Soft Costs calculation.

Time Element Coverages

Business Income or Rental Income coverage is not automatically included in the BR policy. It is separate coverage provided for the project owner (not additional insureds) and is subject to policy limits, sub-limits,

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deductibles, waiting periods, coinsurance et al.

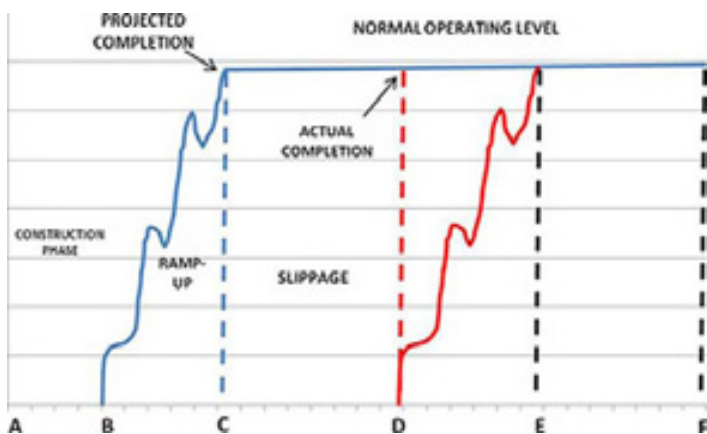
In most cases, the Business Income exposure is the sleeping giant lurking behind the BR loss, and its loss potential can be exponential. As such, it is critical that the actions of the BR carrier not contribute to the delay in startup.

When a limit of insurance for Business Income or Rental Income is shown, the policy will pay the actual loss sustained as the result of the project being delayed beyond the scheduled completion date. The delay must be directly caused by a covered cause of loss. Coverage for the Business Income or Rental Income loss is during the period of time between the date the project would have completed had no loss occurred and the actual date the project is completed with reasonable speed and similar quality. If the insured decides not to rebuild or repair the covered property, the policy will not pay for either the Business Income or Rental Income loss. In addition, expenses incurred for reducing the loss otherwise payable and extra expenses can be included in the coverage.

Time Element Coverages: Accounting Issues

There are certain accounting issues specific to the BR Time Element coverage which may differ from the standard property insurance policy. This is due to the fact that, instead of measuring the loss at a business which is up and running, you are confronted with a business or portion thereof that is in the course of construction and has not yet started up or begun to generate operating revenues.

In the more complex construction projects, full startup requires the



time necessary for debugging, trial runs and a gradual ramp-up to expected operating levels. When there is an extended startup, there can be a debate as to where to measure the business income loss along the revised time line caused by the construction delay. Naturally there are other market, operational and financial factors that would influence projections; however, there are at least two positions that can be taken if we use the following graph as an illustration.

Some take the position that the Actual Loss Sustained should be measured on the startup curve for the delay (B to C), while others believe it is more appropriate to determine the loss at normal operating levels and after the startup curve (C to D). Because the same period of time (B to C) should be required for the same startup process (D to E) - even though the actual completion occurs on a delayed basis - it is my view that what the insured really loses is the time they would have been at normal operating levels and actual profitability levels. During previous relatively stable economic times when the business climate was more predictable, it was often reasonable to consider the actual

operating results after the startup curve (E to F) as a proxy for what would have been experienced had no loss occurred. However, in today's uncertain economic environment, using that post-loss evaluation may not necessarily be valid and should only be considered in situations when business and economic circumstances are rather compatible.

The task of projecting likely business income had no loss occurred becomes even more challenging with a start-up operation that is delayed to the point of cancellation. However, unlike a standard property policy where there would be business income coverage for the theoretical time to rebuild or repair the project as it was at the date of loss, there will be no coverage for Business Income or Rental Income losses if the insured decides not to complete the project.

Reported Values & Coinsurance

From time to time there can be a significant disconnect between the Reported Values submitted for premium rating and risk analysis purposes and the actual loss sustained following an insured event. When this occurs, it will usually send shock waves from claims department up to underwriting and then onto the executive offices where people will ask, "How could you let this happen? Why is the estimated loss so much greater than our maximum potential loss exposure? How could we have missed this so badly?"

While some Builder's Risk policies may be based on an agreed amount endorsement or are subject to audit at the end of the project (known as reporting form policies), other policies contain a coinsurance provision to make the insured a coinsurer and help share the risk in situations where there is an underinsured situation. The forensic accountant can review the accuracy of the Reported Values either before or after a loss and prepare a calculation to determine the coinsurance requirement or participation.

Conclusion

While Builder's Risk coverage can appear to be simple and straight forward, it is actually quite complicated. The many moving parts are entwined and must be identified, separated, sequenced and measured by the adjustment team.

Because the BR policy is unique, careful attention must be paid to the specific language of the entire policy including all endorsements so as to determine the compensable loss under the policy. While there may be similarities to the standard property insurance policy, the BR policy presents its own special adjustment, measurement and coverage challenges best handled by an experienced adjustment team.

About the Author

John A. Damico CPA is a Founding Partner of Matson, Driscoll & Damico, LLP, CPA a forensic and investigative accounting and consulting firm with 33 global offices. Mr. Damico has more than 40 years of forensic accounting experience in measuring complex Property, CGL and Special Risk insurance claims on a world-wide basis. In addition, Mr. Damico has been involved with quantifying losses stemming from Builder's Risk Soft Costs & Time Element claims and has presented seminars to a number of insurance industry organizations and carriers on this and other topics. He has considerable experience serving as an expert witness in both domestic and international venues on a variety of insurance related and commercial dispute cases.

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SIU Q&As from October PCAP Speakers Pusser & Loveland

1) Is there a national database available to law enforcement or the insurance industry that keeps track of gold that's been sold?

The idea would be to see if gold jewelry claimed stolen by an insured can be checked against a database. We checked with an SIU industry analyst who indicated there is not a national database that is utilized by law enforcement or the insurance industry to keep track of gold sold. They contacted the FBI and were told that the Gemology Institute of America has a jewelry database but they weren't familiar with it's function. Other than that, several local law enforcement agencies track pawn shop purchases.

2) What agency is investigating truck cargo theft?

In terms of cargo theft, at this point it is up to each local law enforcement agency to investigate the losses. The California Highway Patrol has the Cargo Theft Interdiction Team (CTIP) and several other task forces have dedicated resources to the effort, but there is no National movement to investigate potential losses. The NICB has supported legislation efforts, hosted conferences and are in the process of trying to put together a National Database for Cargo Theft.

3) Which agency administers the Mexican border license plate reader program?

U.S Customs is the custodian of the License Plate Readers on the U.S side of the Border. This information is given to NICB and is then placed in ISO Claimsearch. There is currently no License Plate Reader program operating on the Mexican side of the border.

4) What agency investigates fraud in shipping cargo claims?

Primarily Customs and Border Protection has authority at all Ports to investigate shipping cargo. However depending on the Port, enforcement efforts can be challenging due to the volume of shipments coming in and out. NICB assists in fraud investigations at the Ports.

Craig Pusser may be reached at: Craig.Pusser@goAAA.com

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Please submit articles for consideration by email, to
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Upcoming PCAP Events Calendar

Thursday, January 21, 2010

Annual Legal Review

Julian J. Pardini

Lewis, Brisbois, Bisgaard & Smith, LLP

Thursday, March 18, 2010

Luncheon Meeting

Thursday, May 20, 2010

Luncheon Meeting

Thursday, July 15, 2010

Luncheon Meeting

Thurs-Friday, September 9-10, 2010

17th Annual Claims Conference of N. California

Hyatt Regency Downtown Sacramento

Thursday, September 15, 2010

Luncheon Meeting

Thursday, November 18, 2010

Luncheon Meeting

**Earn Twelve (12) C.E. Credits for attending
all six (6) PCAP 2010 meetings.**

www.PropertyClaimsAssociation.org

PCAP Treasurer's Report

November 2009

The financial results through November 9 2009:

Beginning Balance 1/1/09 \$4,931

Revenue:

Member Dues & Events \$3,600

Expenses:

Member Events 1,251

Insurance 479

CCNC Sponsor 300

Website 206

Other 526

Total Expenses \$2,762

Net Income \$838

Ending Balance 11/09/09 \$5,769

The financial results through November 9, 2009 are shown above. We continue to return much of the member's annual dues back to the membership in quality programs with free lunch, our newsletters, and continuing education credits, which is our goal. As an added bonus to our members, PCAP underwrote \$15 of the October 2009 lunch meeting at John's Grill to keep the cost to members low at \$10. Non-members paid \$25.

Annual dues notices for 2010 will be sent in late December 2009 and our first member lunch meeting for next year will be on January 21, 2010. Remember, when you pay your 2010 annual dues, the member lunch meetings are free!

**PROPERTY
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San Francisco, California

Property Claims Association of the Pacific

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2010 Membership Application

Please print this page, fill it out and mail it with your check to the address indicated below.

Name _____

Company _____

Current Position _____

Business Address _____

Phone _____

E-Mail _____

Fax _____

Membership dues are based on the calendar year.
Annual dues are \$40 if received before March 1, 2010. \$50 per person thereafter.

Please return application with check payable to

Property Claims Association and send to:

Michael Diliberto III, CPA

RGL Forensic Accountants and Consultants

100 Bush Street, 20th Floor

San Francisco, CA 94104

PCAP MISSION STATEMENT

The purpose of The Property Claims Association of the Pacific is to advance the members' knowledge of:

- legal issues associated with insurance claim adjustments;
- the Statutory and Department of Insurance Regulations governing fair claims handling;
- technical advancements in construction/restoration;
- applicable code changes effecting real and personal property loss;
- consumer insurance related concerns by providing continuing education programs that foster a professional approach to claims handling in the Property and Casualty Industry.

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