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NEWS | SAN DIEGO

Construction roundtable

Industry faces increasingly challenging landscape of regulation, insurance

By ERIK PISOR

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While overall construction activity has declined in San Diego County so far this year, contractors have other concerns, as local and statewide regulatory agencies continue to adopt stricter building provisions and insurance premiums remain on the rise, according to industry experts.

The most recent provision approval came on July 27 when the California Air Resources Board (CARB) adopted its off-road diesel equipment emissions regulations, which require equipment-intensive contractors to meet fleet average emission rate targets for particulate matter (PM) and oxides of nitrogen (NOx) by March of each year.

CARB's decision could prove to be too costly for medium- and small-sized contractors because the value of their existing equipment has and will further decline as a result of these regulations, which will in turn alter a contractor's hidden equity, according to Dan Fauchier, principal of the Fauchier Group.

"The hidden equity that bonding companies and finance companies look to is the market value of equipment," Fauchier said during a recent roundtable discussion hosted by The Daily Transcript. As a contractor's hidden equity declines, so to does its ability to receive bonding and competitively bid and perform work, he added.

According to the adopted regulations, large fleets -- more than 20,000 horsepower -- will have to comply with fleet average targets in March 2010 and medium fleets equal to or less than 20,000 horsepower must begin meeting the fleet average in 2013.

Small fleets fewer than 2,500 horsepower are exempt from the NOx average, but must comply with the PM fleet average requirement starting in 2015.

Focusing on compliance, a company can ensure its fleet meets yearly PM emissions averages by retrofitting 20 percent of its vehicles with verified diesel-emission control devices (VDECs), which are designed for reduction of diesel PM emissions on used diesel equipment.

If a large or medium fleet is unable to meet the NOx target, it must turn over more than 10 percent of its fleet per year.

Unlike CARB's adopted regulations, the proposed regional and statewide stormwater permit requirements will affect more than just diesel equipment-intensive contractors.

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Both the local and statewide permits would establish requirements for cities, contractors and any business that discharges urban runoff into a county storm sewer system. The mandates within the permits would require these parties to reduce the discharge of pollutants in urban runoff to the maximum extent practicable through various methods, including hydromodification and advanced treatment.

"From our perspective, that's where things are becoming much more interesting" in terms of the construction process, said Dennis Stryker, general counsel for **Rick Engineering**. The firm's water resources division, he said, is in the process of designing new methods of treating onsite water runoff prior to it reaching the street.

The San Diego Regional Water Quality Control Board is leading the charge statewide in terms of adoption and implementation of a new stormwater permit.

In January of this year, the board unanimously adopted the language that will make up the new local stormwater permit requirements. The state board is currently in the process of crafting and approving new stormwater regulations.

According to Stryker, construction-related companies that have a broad client base, in terms of geographic area, will not be largely affected by these new regulations.

However, this won't be the case for an architecture firm or contractor that has 30 or fewer employees.

While compliance with these new regulations represents another obstacle in the construction process, one previous problem for construction industry -- the availability of insurance -- has regressed due to the emergence of owner-controlled insurance programs (OCIPs), according to Roger Haerr, an attorney with **Luce, Forward, Hamilton & Scripps LLP**.

Also known as wrap-ups or project policies, an OCIP involves the owner of a project purchasing insurance for other participants involved in the construction process including the contractor and subcontractors. The coverage can include general liability, builder's risk, workers' compensation, design errors and omissions as well as other special coverages.

According to Haerr, an OCIP is an expensive type of policy because the owner is purchasing insurance for all involved parties at one time, for a much greater length of time.

In addition to being very expensive, Jeff Cavnac, president and chief executive officer of **Cavnac and Associates**, explained that OCIPs are also very complex compared to other policies. Thus, he recommended a construction company have its attorney review the entire policy prior to agreeing to the coverage, which at times can be limited.

One advantage of an OCIP is that during litigation, all parties involved on a specific project are represented by one lawyer or firm, which in theory should make the litigation process more efficient, according to Cavnac.

However, having only one lawyer representing the entire project or one company insuring all parties does have its disadvantages.

"The outcome may not be good in terms of coverage of risk," he said.

Under an OCIP, an attorney defends the entire project effort, which eliminates situations where it is unclear which contractor was at fault for the project failure. However, at the same time, there is less coverage overall because there are less sources of recovery, according to Haerr.

Engineering firms tend to dislike OCIPs, as they typically don't have a component that deals with the design team, according to Stryker.

This lack of design team coverage can result in such a firm being blamed for a project failure it may have not been responsible for.

Haerr agreed that engineers and design teams have become greater targets under most recent scenarios. However, he also pointed out that engineering firms can insert



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contractual limitations of liability.

"As a consequence, attorneys know they can't go after the design team," Haerr said.

"The engineer is more exposed but less exposed in the same sense."

Contractual limitations, said Cavnagac, are only asserted on multifamily housing, where insurers anticipate some type of litigation prior to the commencement of construction.

With limited land on which to build in San Diego County, especially for residential construction, the amount of multifamily projects will increase. This could mean more firms asserting such contractual limitations, Stryker said.

While the roundtable panel debated the positives and negatives of OCIPs, Haerr said that since this type of coverage is relatively new to the industry, it can't yet be determined if project-specific policies are the best deal, as the industry forecasts an increase in the amount of construction defect litigation claims.

While the amount of cases is anticipated to increase, the nature of the claims will remain relatively unchanged, according to Haerr, who said lawsuits typically deal with the issues of water intrusion and mold.

However, there have also been recent defect claims brought upon a project because consumers' expectations weren't met in terms of number of elevators or parking spaces.

"That would never be in the purview from the traditional liability standpoint," Haerr said.

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