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Regulatory agencies put pinch on construction industry

By **DOUG SHERWIN**, The Daily Transcript
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Stricter provisions by regulatory agencies and rising insurance premiums are the latest concerns for a construction sector fighting escalating costs, according to industry experts.

Last Thursday, the California Air Resources Board passed a rule requiring companies to outfit their fleet with emissions-friendly diesel engines within the next 20 years. The decision could prove to be too costly for some companies whose value is tied to its vehicles, according to Dan Fauchier, principal of the **Fauchier Group**.

"The hidden equity that bonding companies, finances companies, look to is the market value of equipment," Fauchier said during a roundtable discussion hosted by *The Daily Transcript* Thursday. "So equipment-intensive companies, like engineering contractors, have a lot of value in older equipment, which lasts 35 to 40 years. Those market values, according to Ritchie Brothers Auction Company, have fallen anywhere between 30 and 40 percent in just the last year because of the rules of the air resources board."

According to the adopted regulations, a contractor's diesel engine fleet will be required to meet average emission rate targets for particulate matter (PM) and oxides of nitrogen (NOx) by March of each year.

The largest fleets -- more than 20,000 horsepower -- will have to comply with fleet average targets in March of 2010 and medium fleets equal to or less than 20,000 horsepower will begin meeting the fleet average in 2013.

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

Small fleets are required to report until 2026, while large/medium fleets must report until 2021.

"If the value of their equipment shrinks, which it already has and will continue to do so, the amount of money they can bond, the jobs they can bid, will shrink (and) have shrunk," Fauchier said. "As a consequence, they will do less, grow less and, in fact, will have to start shrinking themselves."

"The medium-sized people -- the family companies -- which is what most of construction is, there's a torpedo heading for them."

Dennis Stryker, general counsel for **Rick Engineering**, said the regulation changes affect how engineering companies design projects. But it opens up opportunities for creativity.

"Our landscape architectural division now steps into a different arena than it did in the past," Stryker said. "It's leading the charge in how we design things from an environmental standpoint."

San Diego's regional water resources board has created even tighter restrictions related to storm water runoff, creating a strain on construction companies.

The insurance industry, meanwhile is reacting to the increased regulatory burden on construction companies and adjusting its pricing accordingly.

The biggest change can be found in residential construction, which now features owner-controlled insurance programs, also known as wrap-ups and or project polices.

"It's about the only way multi-family housing is getting built in California and around the country," said Jeff Cavnignac, president and chief executive officer of **Cavnignac and Associates**. "Underwriters look at multi-family housing -- condominiums -- as guaranteed litigation. Every single large condominium project in San Diego will

be litigated, and so they price their product accordingly."

Any subcontractor who wants to work on multi-family housing has an exclusion in their practice policy for multi-family housing, Cavnac said.

The wrap-up policies have filled a void. A few years ago, according to Roger Haerr, an attorney with **Luce, Forward, Hamilton & Scripps LLP**, contractors said they couldn't get insurance, creating a crisis.

Now that the gap has been met, Haerr said, the claims will start coming.

"The scale of construction that's occurred in the last decade has been such I think we've got a lot further to go," he said. "Although we're already seeing and participating in lawsuits over the coverage, the outcome of those suits is far down the road as to what they'll really mean."

The construction defect claims haven't changed, however, Haerr said. But consumers are complaining about design issues -- whether there are enough elevators or if the common area is big enough -- as their expectations have grown.

"To the extent (the project) was under-designed and you can prove the design professional's performance fell below the standard of care, you can assert a claim under the professional liability policy," Cavnac said.

-- Staff writer Erik Pisor contributed to this report.