WELCAR
INTRODUCING (DEFINED) MICRO LIMITS

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PRESENTATION OUTLINE

1. **CONTRACTING OVERVIEW**
- Understanding Contracting, Contractors & Contracts;
- Overhead & Profit - the real deal.

2. **CAR POLICY INDEMNITY**
- Who is the claimant?
- Basis of Recovery reviewed.
- Examples of Recovery Vs. a new spin on things

3. **SUMMARY**
- It makes sense to me.

Reference to Accompanying Document: “Introduction to Contracting”

OBVIOUS CONTRACTING STATEMENTS

- A contractor is contracted to Perform & Complete Contract Works – otherwise there are mechanisms to cost him financially (Performance Bond, Liquidated Damages, Cost or payment offsets and re-charging);

- The failure of a contractor to perform the 'Work' is a breach of the Contract;

- But for insurance, contractors would have to repair their own errors and omissions at their own cost;

- Construction Contracts cater for 'changes / variations' to the Contract Work;

- Contractors like Contracts. Something in black and white they can touch , refer to, but most of all be able to show their boss; and

  (Not something the sneaky Adjuster made up on the flight over – honestly Mr. Contractor a principle I must apply to your claim is the principle of Indemnity...)

- Contract Variation Rates are circa **50%+ uplifted*** on the rates applied when Tendering the work (Monopoly / Opportunity Costs, tight margins, out of sequence).

* Refer to hand-out

OBVIOUS WELCAR COMMENTS

- WELCAR differentiates between a Principal Assured and Other Assured.
- Most Contractors are defined as Other Assureds under WELCAR Policies.
- Most (95%++?) CAR claims are due to Other Assureds (Contractor) error and/or omissions.
- 98% (++?) of remedial costs are Contractor generated and claimed.
- The basis of recovery is really tailored to a Principal Assured's Claim.
- But who is the claimant. How do we differentiate?

Expressed percentages are assumptions by presenter

WELCAR Limits

- The backbone of WELCAR is Schedule B.
- Schedule B is not generally fully utilised (detailed) as it was intended.
- Due to non-defined Schedule B Limits, policies have almost reached a point of getting two Schedule A's.
- Schedule B should still only be Macro Limits to large losses against the scheduled items.
- Separate to Schedule B, Insurers apply sub-limits throughout the Policy for various heads of claim (Sue & Labour, Wreck removal, Weather Stand-by etc..)
- Whilst the Policy states Indemnity throughout, can Insurers better define (and limit) this indemnity at the micro level in the Basis of Recovery section, depending on and clearly separating between claimants?

CLAIMANT

Who is the claimant?

The Assured obviously, but which one:

- Principal Assured; or
- Other Assured?

Whilst the Policy normally requires claims to be processed through the Principal Assured this doesn't automatically make the Principal Assured the claimant.

Why and how does this affect the claim?

CLAIMANT

INDEMNITY Vs OVERHEADS & PROFIT

The Principal Assured, with the exception of an interest in the completed Project, has no profit linked to the project in its construction stage.

The Contractor, by the acceptance of the work, is deemed to include (some, % unknown) profit. That's why he is the game isn't it?

DISTINCTION

HOW?

CLAIMANT – DISTINCTION:

The distinction between claimant is really in reference to the Contract wording and administration, and how particular incidents are to be handled within the Contract.

Simply:

if the Contractor is not at fault, then the Contractor would be entitled to a variation to repair Works using Contract Variation Rates. Notwithstanding the omission of handover or completion certificates – This would be considered a Principal Assureds claim.

However, If the Contractor caused the damage (e.g. whilst installing a pipeline) with no other interfering factors, the Contractor would not be entitled to a Variation / Change Order, and would have to repair the works in order to discharge his obligations under Contract – This would be considered an Other Assured (Contractor) claim.

Unless the contract specifically allows him to undertake all remedial works under a Change Order (Variation).

CONTRACT ACKNOWLEDGED

Insurers best defence against Other Assureds (Contractor) claims is:

2. SPECIAL CONDITIONS FOR OTHER ASSUREDS

The interest of the Other Assured… Where the benefits of this insurance have been passed to an Assured by contract, the benefits passed to that Assured shall be <u>no greater than such contract allows</u> and in no case greater than the benefits provided under the insuring agreements, terms, conditions and exclusions in the Policy.

What this obviously does is bring the Contract into play and to the fore.

Following a determination on coverage, the Contract should be everyone's starting point, not the Policy, that is a later limiting factor after applying Contract conditions.

However:

VALUATION

Basis Of Recovery

1.

d. *<u>use of prehired vessels/equipment</u> … in the event of physical loss and/or physical damage… repairs… are carried out by vessels … which the <u>Assured have … contracted to them, the cost … shall be based on the …</u> **<u>contract rates</u>** … and shall be so recoverable as a claim hereon.*

We are bringing Contracts into play, but really from a Principal Assureds Claim perspective.

Contractors do not offer up their "books" for scrutiny identifying the behind the scenes sub-contracts or charters. And the introduction of forensic accountants on CAR losses is unheard of (but maybe not wrong)

But we then expand further…

VALUATION Cont'd

Basis Of Recovery

2.

d. *<u>use of prehired vessels/equipment</u> Cont'd…*

*In the event that the Assured utilises its own vessels… for any repair, in respect of physical loss and/or physical damage… then, subject otherwise to the terms and conditions of the Policy, a **<u>reasonable charge</u>** in respect of such work shall be recoverable as a claim hereon.*

Isn't a pre existing (Variation) rate deemed a reasonable rate?

It has been arrived at through an open market tender.

Can we define this reasonable charge, or level of reasonableness?

Well maybe the next sentence will help us?

VALUATION Cont'd

Basis Of Recovery

3.

d. *<u>use of prehired vessels/equipment</u> Cont'd…*

Provided always that the recoverable costs referred to in this paragraph <u>shall not exceed the costs of employing approved vessels … from other available sources</u>.

Well there we have it limited.

A reasonable charge is a Contract rate, which is less than the value of employing another Contractor to come and fix (what would be considered in the main "Minor Work") in a distressed situation, oh and in a hurry please.

I'm sure if we went out for Tender we could get a reasonable price under those conditions to under cut the current Contractor Variation rates!

COMMENTS

Where this fails is that the Principal Assureds have only potentially minor overheads (PM etc), but no profit interest in a Project.

Construction is not their core business

However,
Contractors have every interest in this Project, it is what they do for a living, it is how they make their **PROFIT** and recover their **OVERHEADS**. Even more so by applying Contract Variation Rates

There is a big difference between the two claimants, one wants to recover costs and complete the project to achieve First Oil or Gas, the other just wants to get whatever it can, whenever it can, without being late and paying LD's

& Variation rates potentially let him!

Recovery Example – Principal Assured

Based on the current wording, Principal Assured claim for a pipeline incident (Using Contract Variation Rates):

Search costs		
Say		USD 1,000,000
Recovery costs		
Say		USD 1,500,000
Material supply (Owner furnished)		
Say		USD 2,500,000
Pipeline Repair		<u>USD 25,000,000</u>
	Gross Adjustment	<u>USD 30,000,000</u>
		(cost to Principal Assured)

Full indemnity to Principal Assured

Recovery Example – Other Assured (Current)

Based on the current wording, Other Assured claim for the same USD 30 Mill pipeline incident (Again using Contract Variation Rates, less say the best deal the Adjuster can negotiate (normally between 5 to 12%) here we shall say **7%**) :

Search costs Say USD 1,000,000 (90% of claim reduced by 7%)	= USD 937,000
Recovery costs Say USD 1,500,000 (90% of claim reduced by 7%)	= USD 1,405,500
Material supply (Owner furnished) Say USD 2,500,000 (no change)	= USD 2,500,000
Pipeline Repair USD25,000,000 (90% of claim reduced by 7%)	= USD 23,425,000
Gross Adjustment	= USD 28,267,500 Indemnity to Other Assured

Adjuster achieved a nice little **USD 1,732,500** discount (or **5.775%**).

Recovery Example – Other Assured (New?)

Now if the Policy distinguished between Other Assured claimants, inserting clarity on how Indemnity is to be valued. Again embracing the Contract Variation principles and Rates, but expressing a % to be applied to account for the (enhanced) Overhead & Profit within these rates – Same Other Assured claim for pipeline (Using Contract Variation Rates, less say **40%**):

Search costs Say USD 1,000,000 (90% of claim reduced by 40%)	= USD 640,000
Recovery costs Say USD 1,500,000 (90% of claim reduced by 40%)	= USD 960,000
Material supply (Owner furnished) Say USD 2,500,000 (no change)	= USD 2,500,000
Pipeline Repair USD25,000,000 (90% of claim reduced by 40%)	= <u>USD 16,000,000</u>
Gross Adjustment	= <u>USD 20,100,000</u> Indemnity to Other Assured

A very nice little **USD 9,900,000** discount (or **30.3%**) valued under Policy terms.

COMMENTS

THIS IS NOT A NEW PRINCIPLE

ADJUSTERS **DO** ACCOUNT (DISCOUNT) FOR OVERHEAD & PROFIT WITHIN THEIR ADJUSTMENT

IT JUST DEFINES THE % TO BE APPLIED TO BE CONSISTENT

&

GETS A MORE REALISTIC DISCOUNT AGAINST WHAT YOUR ADJUSTER CAN ACHIEVE SAT IN A ROOM WITH 15 OF THEM AND ONE OF HIM

CONCLUSION

Of course, the Contractor may kick up a fuss:

"But this isn't how we have done this before, AND before that"

But:

1. He is now actually challenging the principle of Indemnity as expressed in the Policy, not the Adjusters keen negotiation skills on the application of indemnity.

2. He would need to open up his 'Books' to seriously challenge the position.

3. Has a Contract (Policy) in black and white to review, mull over and show his boss why he has to accept the principle.

4. "But we are losing money on this Contract"

5. "If we used our vessels elsewhere we could be making (more) money"

DISCUSSIONS

Would the purchaser of the Policy accept such an amendment?

1. It doesn't affect them directly or <u>their</u> claims.
2. It could reduce premium, deductibles and any other manner of pricing mechanisms, as claims are now being managed (**buzz word of your choice**) at a micro level!
3. Are they happy for their Contractor to be making such potentially increased profit levels arising out of their own errors? Lets remember, but for Insurance, it would have cost the Contractor a pretty penny. Currently, they are potentially (almost certainly) recovering enhanced profit (against losses?) !

But:

They would have to review their contract wordings, to ensure this potential change works seamlessly, back-to-back with Policy provisions

However:

A lot of Contracts would appear to have missed this review under the current Policy wording in any event. *Ergo: Status Quo.*

SUMMARY

It is a change to how claims have traditionally been valued / adjusted & settled.

Due to the nature of the Energy repair and its reliance / dependence on Vessels, potentially 90% of a claim by value could be affected, **and reduced by ?%**

I'm sure it would be better than the reduction for P & O/H your Adjuster can currently negotiate.

OBSERVATION

POTENTIALLY:

90% of costs

from 98% of the claim value

from 95% of all CAR claims,

reduced by **(fill in the blank)%**

CLOSING

At worst it would make adjustments globally consistent.

If the above is considered feasible, acceptable, reasonable and implemented.

Just don’t make the Contractor a…

PRINCIPAL ASSURED