

CLM PROFILE

Utilizing Cost Estimation in Claims and Litigation Resolution

By Kurt Ahlich

In addition to causation and degree of responsibility, a critical component of claims and litigation resolution is the underlying "cost to cure," or "cost to repair," the adversely affected component. Participant parties are naturally concerned with their actual financial exposure. Valuations of the cost to repair can vary dramatically and oftentimes are the result of gamesmanship between the parties as each stakes out its position for future negotiations. Other times, the variations result from differences in how the parties determine their own cost to repair.

This process is referred to as "cost estimating," which can be defined as a process that determines the amount of resources required to accomplish project activities, and that involves the approximation and development of costing alternatives to plan, perform, and deliver the project while focusing on finding and allocating optimal expenses for the job.

One needs a basic understanding of cost estimating to identify the most reasonable cost to repair and to reconcile differences in competing cost-to-repair estimates. The cost-estimating approach can be applied to many scenarios, including cost to repair, cost to build, product manufacturing or development, and medical procedures. In the purest sense, an accurate cost estimate should simply account for the resources required for a successful project; or one in which the project scope is achieved (on-budget and on-schedule), the quality expectations are met, and the expected benefits are received by the end users.

There are different methods by which cost estimates are typically performed, but, prior to discussing these methods, let's look first at the importance of the scope of work (SOW). The SOW is

essentially what the cost estimate includes or excludes, and is the fundamental basis on which the cost estimate is prepared.

For a cost-to-repair estimate, determining the SOW can be difficult. Often, the full extent of damage might be hidden, as in behind-the-wall water damage or below-ground-surface foundation failures. Other factors impacting SOWs are code upgrades, over-building to match cosmetic finishes, improvements beyond the pre-incident condition, and simple differences of opinion between the parties. It is typical that variations in cost-to-repair valuations are predicated on differences in the perceived SOW, so reconciling those SOW differences is essential.

As stated previously, there are different methods for preparing a cost estimate, each with its own separate set of strengths and weaknesses. Some of the basic types are:

- Expert Judgment.
- Analogous Estimating.
- Parametric Estimating.
- Bottom-up Estimating.
- Vendor Bid Analysis.

"Expert judgment" estimating relies on the experience and knowledge of experts. Often, this is used early on in the resolution process and is refined as the process progresses. While this method can take into account unique factors that may be specific to the project, it also can be too broad-based or biased.

"Analogous estimating" uses historical data from similar projects as a basis for the cost estimate. This method is also often used in the early phases of the settlement process. While it can be adjusted for known differences

between projects, it can also have accuracy issues.

"Parametric estimating" uses statistical modeling and historical data of key cost drivers of different parameters such as material cost and work task duration. There are commercial systems readily available that use this approach, which can be beneficial in that it provides recognizable points of reference, but this approach is best suited for simpler, more generic-type cost estimates.

"Bottom-up" estimating requires the project to be broken down into individual work packages, often based on specific tasks. The costs of these individual work packages are then estimated and ultimately rolled up to determine an overall project cost. This is generally considered the most accurate method of cost estimating, as it looks at costs from a more granular perspective, but the skill and experience of the cost estimator is critical in this method.

"Vendor bid analysis" compares bids for the full/partial project submitted by multiple vendors. This method is fairly easy, but care must be taken to ensure that all work tasks are included in the vendor bids and that indirect costs, such as overhead, site controls, project management, and project engineering, are accounted for.

By determining and understanding the cost estimating methods used by an individual party in a settlement proceeding, one can potentially discern why there are differences in the end results of the individual cost estimations. This could lead to a resolution/reduction of these differences, and thus control one variance in the settlement process.

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