CONSTRUCTION DEFECT DISPUTES AND THE ABANDONED POLICYHOLDER: GETTING THE CARRIER TO THE TABLE

By Barbara A. Reeves Neal, Esq. and Kenneth C. Gibbs, Esq.

There is much that can go wrong in any large construction project: improper installations, defective products, errors and omissions made by designers, unexpected site conditions—the list is long. Insurance coverage or a performance bond often means the difference between compensating injured parties and a nightmare of litigation and financial distress. Unfortunately, insurance carriers often choose to wait while parties take their disputes through lengthy, expensive litigation, often adding yet more delays to the project. Getting insurers to the table before litigation would save all parties significant time and money. This article is a case study in one method of bringing insurers into settlement discussions early on through cooperative non-binding arbitration among the parties, followed by mediation with the insurance carriers.

The main problem for parties seeking insurance coverage in complicated construction defect cases is that there are too many variables. There is often a tangle of liability issues, as well as confusion over which party the insurer is obligated to pay. Further complicating matters, defective construction claims may involve (1) builder's risk insurance (first-party coverage), (2) liability insurance (third-party coverage) and (3) a performance bond and the responsibility of the surety behind the performance bond. Sorting this out can cause significant delays, particularly if a carrier takes the position that it does not owe coverage or that it is reserving its rights and refuses to come to the table for settlement discussions until after the other parties have fully litigated liability.

A recent case illustrates one solution to these problems. It started when a mixed-use commercial/residential high-rise project took too long, cost too much and sprung a leak. Normally in such a case, the owner would consider options to seek insurance coverage directly on a first-party basis under its property, or all-risk-type, policy, or to sue the contractor and product supplier pursuant to a third-party commercial general liability (CGL) policy. However the owner decided to proceed, the next step would be for the parties to ask their respective insurance carriers for coverage and/or protection in and from a lawsuit. The carriers would then answer yes and grant full coverage, answer no and deny coverage or answer maybe and agree to defend under a reservation of rights to later deny or accept coverage. The latter two answers, of course, will likely to lead to protracted, and expensive, litigation as the parties sort out liability.

The parties in this dispute, however, tried a completely different option. The owner, contractor and subcontractors agreed to submit their claims to non-binding arbitration, with an agreement that the arbitration award would become binding 30 days after issuance if no party rejected it. To expedite the proceedings, they agreed to submit their evidence through written presentations, largely from experts, with cross-examination available at the hearing. All parties agreed that there was some degree of liability on the parts of one or more defendants, although they disagreed about the amount of damages. However, all their efforts to date to involve their insurance carriers in meaningful settlement discussions or mediation had failed. Thus, the parties entered into the arbitration with the expectation of an award in favor of the plaintiff/claimant, albeit in an unknown amount.

The 30-day, non-binding period served two purposes. First, it provided a safety valve to protect the plaintiff/claimant against an award that unexpectedly found no liability or was unsatisfactory to all parties. More importantly, however, it allowed the defendants to take an award to their carriers and again request indemnification based upon the reasoned arbitration award. The issues of each policyholder's liability and amount of the plaintiff's damages were set forth and analyzed thoroughly in the award. The parties thus had an independent adjudication resolving the issues expeditiously, even in the absence of the defaulting insurer. The insurer was able to consider the award, send it up the chain of command for review and thus engage their policyholders in meaningful settlement discussions.

Using this procedure, the parties were able to engage the insurance carriers in settlement discussions that led to a mediation that in turn resolved the entire dispute and allowed the parties finality. This situation provides a good case study for another path parties may pursue as they seek insurance coverage for construction defect claims. It is a much more efficient and cost-effective means of bringing insurers to the settlement table. ■

Barbara Reeves Neal *is an arbitrator, mediator and special master working with JAMS, specializing in insurance coverage and based in Los Angeles. She can be reached at breevesneal@jamsadr.com.*

JAMS neutral ***Kenneth C. Gibbs*** *is one of the leading construction neutrals in the United States. He has an expertise in mediating and arbitrating construction, real estate, insurance, surety, and business disputes involving major commercial projects. He can be reached kgibbs@jamsadr.com.*

This article was originally published by LAW.COM and is reprinted with their permission.

JAMS®