



2021 CLM Construction Conference

Sept 22nd – 24th 2021

San Diego, CA

Delays and Defects and Damages, Oh My!

I. The Hybrid Claim

Hybrid claims involving defect and delay claims are becoming more prevalent. The potential damages in these hybrid claims are often significant and defending the claims can be equally expensive. This session will discuss issues regarding insurance coverage issues, i.e., different policies which may cover the claims such as Builder's Risk and what potentially is and is not covered. Preparing the defense of the hybrid claims, including working with general/personal counsel of the insured. Working with a variety of the experts needed to defend the claim. Additionally, the session will discuss calculating the potential value of the delay claims.

Coverage Issues and the Defense Obligation

Construction projects can be large and complicated, and sometimes involve added costs outside the project itself. Sometimes these additional costs, called soft costs, can be expensive, and their requirements can be time-consuming and cause construction delays. Especially when considering if a loss occurs that affects the project cost and causes delays in getting soft costs completed, such as an increase in interest expense on money borrowed to finance the project, then soft costs could cause a loss in business income as well.

In a typical straight construction defect litigation insurance coverage via the general liability policy is typically triggered based on the allegations of property damage at the construction project. While these typical claims also include aspects of breach of contract or contractual issues that include potential contractual damages they may or may not be covered, it is likely that allegations of delay damages would not be covered under the general liability policy. This often presents an issue and defense of the claim is called for because of the allegations of property damage, but the defense of the delay claim may be an expensive endeavor when calculating the cost of attorney's fees and expert costs.

There may be other policies that can participate in the coverage of these hybrid claims. Insurance coverage that might respond to delay costs claims include builders risk coverage. Physical damage must occur for builder's risk coverage to be triggered; however, exclusions are included, and the policies are not often designed to directly cover delay costs. In addition, insurers may pay for delays but seek compensation from contractors if their actions caused the delay, he said.

Professional liability coverage may also apply to some delay costs if defective professional services cause a delay, but as always exclusions may apply.

II. The Defense of the Hybrid Claim

Delays are inevitable in construction. They can also cause the project owner to lose a lot of money resulting from contractor claims, loss of use of the project, the cost of construction funding and other damages which are incurred when a project extends beyond the scheduled completion date. Delays can be caused by the owner, the designer, the contractor, or a combination of any of these. Owner caused delays may be occasioned by site access issues, delays in obtaining government approvals, financing issues, changes to the scope of work and many other reasons.

Designer caused delays may result from inadequate detail in the plans, lack of timeliness in responding to submittals and requests for information (RFI), design errors and omissions and untimely inspections, among other things.

Contractor caused delays may occur from poor project management and coordination, inadequate financial and labor resources, or defective workmanship. Lastly, unanticipated severe weather—or a pandemic—can also delay a construction project.

As a result, the larger the project the larger the potential delay damages can be. Therefore, the review of the documents becomes paramount in determining the potential delay damage exposure. Where a project is delayed, one or other of the parties will have to shoulder the burden of that late completion in financial terms. Depending on the wording of the contract and the jurisdiction, the employer may be entitled to claim liquidated or general damages for delayed completion. The contractor may be entitled to an extension of time to excuse the late performance, and possibly also to its costs associated with that delay.

Outside of the delay claim, there is the handling of the defect aspect of the claim. This will consider whether the defect exists, has already been repaired or if a repair is being sought. This will also focus on whether property damage has occurred.

III. Damages and Resolution

There are a myriad of complex issues surrounding the measurement of delay, trigger of coverage and loss measurement must be understood. The delay is measured from the date the project would have completed "had no loss occurred". The period of delay assumes that repairs to covered property will be made with the exercise of "due diligence and dispatch".

Familiarity with the following terms is important to understand how the period of delay is measured:

Period of Restoration – The time necessary to perform repairs covered by the property policy to insured property with the exercise of due diligence and dispatch. Period of restoration typically runs from the date of loss and ends when repairs to covered property have been completed. Although this measurement, (unlike normal property losses) can be complicated because two things will happen after a loss occurs:

- Work to repair physical damage is performed.

- Contract work in accordance with the project plans and specifications will continue through completion.

Period of Delay – The period that runs from the date a project would have been completed had no loss occurred, to the date the project is completed. Generally, this time is not expected to exceed the period of restoration, although this measurement is often complicated by any number of things, including but not limited to:

- Project re-sequencing.

- Consequential impacts on the project schedule unrelated to repair of physical damage.

- Repairs to non-covered property.

- Post loss delays unassociated with repair from a covered loss.

Notice to Proceed (NTP) – In many projects, NTP is the triggering date for the commencement of the contract for construction, and completion can often be linked to NTP, as expressed in several days or months.

Date of Substantial Completion – the date that is typically established in a contract between an owner and construction manager/general contractor in which a project is complete to the point that it is put into service for its intended purpose.

Date of Final Completion – the date that a construction manager or general contractor completes his contract, and all work has been accepted by the owner.

TCO Date – The date that a permit granting authority provides a temporary certificate of occupancy for a project or portion of a project. Typically, TCO dates are the dates that define the actual substantial completion dates.

Final CO Date – The date that a permit granting authority issues a final certificate of occupancy.

Project Schedule – The plan for construction of the project which is typically created by the construction manager or general contractor, and which depicts the sequence and duration of construction activities, typically in a Gantt chart format.

Baseline Schedule – The initial project schedule generally developed at or within 90 days after Notice to Proceed is received by the contractor.

Critical Path – The longest continuous chain of activities which establishes the minimum overall project duration.

Activity/Activities – Items of work to be accomplished on a project that are generally discrete, measurable and consume time.

Float - The amount of time that the commencement of an activity can be delayed before its completion causes it to become critical, thereby having the potential to cause delay. An activity which is critical has zero float. Thus, a delay in the completion of any activity on the project's critical path will result in a delay in project completion.

Project Milestone – A date which signifies an important event in the construction or completion of a project.

Acceleration – Changes to the project schedule to either perform work or deliver critical building components/materials on an expedited basis, often at additional cost. In builders risk claims, acceleration is usually a consideration in performing post loss, non-loss related work, to minimize delays to a project, and mitigate time element losses.

Change Order – a change to the contract between an owner and construction manager or general contractor either adding or deleting contract work. A change order typically amends the contract price and/or time.

A loss, which is nothing more than an "event" which causes a change to the project, can impact a project in only 2 ways. First, physical damage to real property may cause a change in the scope of work required to complete the project, resulting in additional cost. Second, physical damage affecting a project's critical path, may cause a delay in the completion of the project.

From the standpoint of measuring economic losses, it is important to note that the only "completion" date that is relevant, is one in which, if delayed, additional expenses will be incurred and/or revenue will be lost. In most large projects, delaying one or more milestone dates can cause increased expenses and lost revenue. For example, high rise condominium projects will typically have rolling turnover dates for apartment units, floors, or areas, which will allow unit closings to take place. These dates will often represent contractual requirements that a contractor or construction manager be obligated to meet, and which are established in a project's schedule. Since condominium unit sales produce the revenue necessary to retire construction debt and provide profit to the developer, it goes without saying that a delayed milestone date caused by an "event" can result in economic loss, even if substantial completion and final completion of the entire project is affected. Likewise, office buildings and retail projects will typically require turnover dates for tenant finishes, Industrial buildings will require turnover to install manufacturing equipment, etc.

Establishing the date by which the insured project would have "completed" had no loss occurred is the first step in any analysis of delay, when measuring time element claims. Determining whether a project was "on schedule" immediately prior to a loss is key in being able to both measure a delay period, if any, or make a decision to "accelerate" work to mitigate anticipated delays and losses. The date a project would have completed absent a loss is generally considered the commencement date for the period of delay for time element losses.

In order to determine the pre-loss completion date and/or milestone dates, a virtual snapshot of the project's progress immediately prior to a loss must be taken and compared to the project schedule. Since project schedules are designed to be dynamic, they are typically updated on a monthly or periodic basis to show how the project is proceeding against the contractor's plan. Therefore, understanding the pre-loss project history is vital to being able to establish a project's accurate pre-loss completion date. The following are typically analyzed in order to determine the accuracy of the pre-loss completion date:

Change order requests or project cost events – requests made by the construction manager, general contractor, or subcontractors to change either the contract price and/or the contract time.

- Executed change orders and related scope of work.

- General project progress prior to the loss including delay.

- Pre loss weather delays

- Other events which can jeopardize the project's milestone or completion dates.

On most projects, a contractor or construction manager will typically update and/or change the project schedule to reflect the realities that arise in construction. Therefore, sole reliance on the baseline schedule is improper and can result in the establishment of an erroneous pre-loss completion date.

It is also important that anticipated future dates (after a loss) be studied to determine whether certain milestones or activity dates affecting the project are expected to be met, thereby affecting the anticipated date of completion. For example, suppose a labor strike at a plant manufacturing component equipment for the project's elevators was underway at a time of loss, and would have affected a future critical path activity. In such a case, the anticipated post loss delay, which may not be related to physical damage caused by a covered peril, could impact the project's completion date. Although the project schedule update prior to the date of loss should reflect this problem, this is not always the case.

The period of delay typically begins on the date a project would have completed had no loss occurred, and ends on the date the project is completed, although in many cases this can be difficult to measure for any number of reasons, including:

- Post loss delays unrelated to the loss.

- Delays which are affected by non-covered issues, including:

- Consequential impacts on the project schedule.

- The need to repair or replace noninsured property.

- The need to correct an uninsured condition such as a product or failure or design flaw.

It is important that pre-loss project schedules be analyzed in their electronic format, in order that the analysis can study (among other things), the project logic, including an activity's predecessor and successor relationships.

The above are all things that need to be reviewed and can be time consuming for a claim for coverage may or may not be afforded. However, the defense obligation that usually comes from a defect litigation, would require counsel to defend the entirety of the action and not just the defect aspect of the claim. Therefore, it is paramount the attorney and the experts properly budget the matter, so the insurance carrier is not caught of guard by the cost of the litigation. This makes early resolution of these matters important given cost of the defense and the cost of the experts.