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A Perfect Storm: Hurricanes and Construction Defect Claims

I. Hurricanes and Financial Impact

In 2017, Hurricanes Harvey, Irma and Maria made landfall, marking the first hurricane season in 12 years with even one Category 3, or major, Hurricane affecting the United States. Harvey and Irma were estimated to have caused nearly \$350 billion in damages. The impact of such devastation is felt throughout the insurance industry, and especially in the area of Construction Defect claims.

Financial Impact to Insurance Carriers

Since 1900, the United States coastline has seen an average of 2.4 major hurricanes per year. 2005 saw 7 major hurricanes and 28 named storms. The four costliest hurricanes in history have all occurred in the last 12 years, with Katrina and Sandy on the list along with Harvey and Irma. In addition to Harvey's nearly \$200 billion in damages, Irma's damage is estimated at \$150 billion, Katrina came in at \$108 billion, and Sandy cost approximately \$65 billion.

Hurricanes account for approximately two-thirds of all insured losses in the United States. JP Morgan estimated that insurance industry losses from the 2017 hurricanes will approach or exceed \$100 billion. These losses will likely result in higher insurance and reinsurance premiums because it will eliminate most of the industry's excess capital. After the 2005 hurricane season saw multiple major hurricanes, including Dennis, Katrina, Rita, and Wilma, insurance premiums rose 10 percent. Experts predict a similar double-digit increase as a result of the 2017 storms.

Financial Impact on Builders

In the days prior to a hurricane, builders are forced to shut down operations and implement hurricane protection procedures. Post-hurricane, the re-mobilization and damage assessment add even more time to the ultimate project completion, often causing severe financial strain on the contractors.

Because of building booms throughout the country in the last few years, contractors have already seen an acute shortage of skilled laborers and material resources. In addition to increased project costs and increased costs of insurance premiums, contractors and builders have also encountered issues with availability of the additional labor required for extra hurricane related work and the increased cost of building materials due to post-storm shortages.

The storms also cause a secondary effect on housing starts and the pipeline for new construction, further exacerbating the financial impact on the builders. Finally, existing home sales slow due to the hurricanes' devastation, causing additional adverse financial effects on the construction industry.

II. Intersection of Construction Defect Claims and Hurricanes

Hurricanes necessarily affect and cause construction defect claims. Geographical areas most often affected by hurricanes already have significant moisture challenges related to construction, regardless of the issues caused by the storms. Construction defect claims in Florida, for example, almost always include an element of water intrusion related to the claim, whether or not related to a hurricane.

Construction Defect Claims

Defect claims generally revolve around three types of issues: design, construction, and materials. Since stricter building code revisions were implemented in the 2000s, more questions arise in construction defect claims as to whether the alleged defect is poor design or poor construction of an adequate design. Choice of materials and use of defective or substandard materials for various types of systems and structures are also part of the liability and damage equation.

Hurricanes

When hurricanes strike, construction claims are increased or changed due to the effects of the storm. Storm surge in low-lying waterfront locations leads to severe water damage. Determinations of whether defect, wind, or rain caused the actual damage add complexity to the claims handling formula. Finally, claims for loss of services in the weeks and possibly months after the storm passes add yet another element to the damage equation related to the claim.

III. Impact of Hurricanes on Claims

Impact on Existing Claims

On claims existing prior to the storm, an initial element of additional claimed damage is claimants/plaintiff alleging increased cost of repairs. This could be based on additional damages allegedly caused by the hurricane, or due to increased costs for labor and materials due to the post-hurricane demand.

Impact on Ongoing Construction

Hurricane damage leads to increased claims under builders' risk policies obtained for construction projects. Delays caused by work stoppage before, during, and immediately after the storm, and additional time to repair work-in-place damaged by the storm add delays to ongoing construction. *E.g., Diamond Beach, VP, L.P. v. Lexington Ins. Co.*, 748 F.Supp. 2d 648 (S.D. Tex. 2010)(according to its terms, the builder's risk policy paid hard costs and soft costs – including delay – caused by direct physical loss or direct physical damage to the insured property caused by Hurricane Ike but did not cover delay damages resulting from the trades' inability to find labor and materials to timely complete the project also allegedly as a result of Hurricane Ike).

Impact on New Claims

The initial aftermath of a major hurricane brings an overwhelming volume of new claims. Already thinly-stretched industry resources are increased to sometimes insurmountable workloads.

When a residential or commercial structure suffers storm-related damages, we can expect that some allegations will relate to claims that the damage caused was greater than it would have been if the property had been defect free.

Other questions arise concerning the sufficiency of the buildings codes. A perfect example was the major revisions to Florida's Building Code after the monumental damages to wood-framed housing in South Florida caused by Hurricane Andrew.

IV. Liability Issues

Causation

After a storm, disputes often arise over whether the damage was caused by defect, wind, or flooding. Also, determinations must be made whether damage was caused, at least in part, by lack of proper maintenance. The most frequent hurricane liability scenarios involve claims where wind conditions were below hurricane force and the property failed to conform to building code requirements. Exclusions to policies can often eliminate coverage depending on the ultimately determined cause. *See e.g., Safeguard Ins. Co. v. Wilmington Cold Storage Co.*, 149 S.E.2d 27 (N.C. 1966)(defendants would have no liability if the damage was caused by Hurricane Helen, an act of God).

Concurrent Cause

When a storm and construction defects act in concert to create damages to a structure, often no single cause can be considered the sole proximate cause. In those instances, courts will apply the concurrent cause doctrine. Generally, the cause that set the other in motion is the cause to which the loss is attributable. Coverage can exist where a covered peril sets into motion an uncovered peril. *Sebo v. Am. Home Assur. Co.*, 208 So.3d 694 (Fla.2016).

V. Damage Issues

Early Determination of Scope of Damages

Damages in construction defect cases do not get better with time, and in the case of storm related damages, this is an even more acute issue. The early determination of damages can be limited due to the fact resources such as inspectors, experts, and claims handlers will be stretched thin due to the volume of claims. Regardless, getting an early handle on the scope of damage is imperative to help minimize the ultimate indemnity payout.

Often, the analysis of damages is hindered by the lack of documentation of pre-storm condition. In existing claims, there may be engineering reports noting alleged defects and providing a snapshot of the pre-hurricane condition. However, where such documentation does not exist, battles will ensue over the true extent of hurricane-related damages.

Quickly determining a cost to repair will allow for earlier resolution of claims. Because of issues discussed elsewhere with labor and materials, a final repair cost will increase, sometimes dramatically, over time.

Delineation of Pre- v. Post-Hurricane Damage

In existing claim situations, damage analysis can be complicated by the need to determine which damage pre-existed the storm. This intersects with the issue above of whether there is sufficient pre-storm condition documentation.

VI. Coverage Issues

Which Policies Apply?

General Liability policies will potentially apply for the construction defect claims. Property damage claims may fall under the ambit of FEMA Flood Insurance policies, or windstorm policies. The determination of wind v. flood is an essential element of storm related coverage determination. For example, the 2017 hurricanes were relatively simple as most damage from Harvey was flood, while Irma was a classic "wind event."

Various specialty coverages can apply to Hurricane related claims. Business interruption claims are complex due to certain exclusions, waiting periods, and issues related to measuring a company's lost income. Of Hurricane Katrina's approximately \$25 billion in insured commercial losses, \$6 to \$9 billion were attributed to business interruption.

Pollution claims after hurricanes stem from effects such as release of sewage, oil and chemical spills, bacteria, and mold left behind after the water recedes.

Since many homeowners' policies have special deductibles for hurricane damage separate from the general deductibles, some insurers offer hurricane coverage that ostensibly pertains to claims not otherwise covered by homeowners' for federal flood insurance policies.

Priority of Coverage

Given the potential multiple policy types covering storm related damage, priority of coverage issues must be addressed. Concurrent coverage occurs where two or more insurance policies provide coverage for the same risks over the same periods of time. Determination must be made as to which policies provide primary coverage – and how that coverage will be shared – and which policies provide excess and/or umbrella coverage and when that coverage will attach.

Because of the different indemnity requirements in first party policies (i.e., Homeowners Policies; Commercial Property Policies) and third party policies (i.e., Commercial General Liability Policies; Professional Liability Policies) liability for and recovery of damages caused by natural disasters frequently arises in the context of subrogation. In a subrogation claim, an insurer (typically a first party insurer) has paid the claim and then “stands in the shoes of the insured” seeking recovery from the tortfeasor for the damages suffered by the insured for which the insured has already been compensated.

As with any type of claim for recovery – indemnity, contribution, subrogation – it is extremely important to know the relevant applicable law which may impact the ability to recover even where liability is clear. *See e.g., Giambrone v. Meritplan Ins. Co.*, No. 13-CV-7377 (MKB)(ST), 2017 U.S. Dist LEXIS 29128 (E.D.N.Y. Feb 28, 2017)(homeowner’s insurer could not recover for damages paid due to Superstorm Sandy because its claim was one for subrogation (and not indemnity) which was barred by the applicable statute of limitations).

VII. Claims Handling and Litigation Strategy

Many strategies to assist in handling the large volume of post-hurricane claims must be implemented prior to the storm. All team members – claims professionals, experts, and counsel, must be on the same page to assist in ensuring quality resolutions of hurricane related claims. The approach must be multi-faceted, using initial investigation, traditional and non-traditional claims handling strategies, as well as use of experts and defense counsel to work towards an effective, efficient, and economical resolution of the claims.

Investigation

An important aspect of short term post-storm claims handling is to triage the claims to place resources where they can most effectively be utilized. Some insurers rely on independent licensed catastrophe claims adjusters to assist with the influx of claims after a storm. In the construction defect field, the shortfall of qualified adjusters even in the best of times makes this process more difficult. The processing, follow-up, and resolution can go on for years. Claims handlers should also be well-versed in the various jurisdictions’ notice requirements.

Claims Strategies

Claims handlers must be vigilant in the post-hurricane timeframe to make sure they only take as much work as they can handle. Open lines of communication with clients and policyholders during the early stages is crucial. The balance between speed and accuracy in providing adjustment of claims must be meticulously maintained.

Technology also provides opportunity to more rapidly process and close the claims. Communication is now virtually instantaneous, allowing for more rapid response to pending issues. One example of relatively newer technology assisting in this process is the use of drones to more quickly assess damage. Even where a structure may not otherwise be accessible, or may not yet be deemed safe, inspections may be completed with the use of drones and the process kept moving forward.

Regardless of how the claims are adjusted, the resolution team must focus on early resolution of claims, where appropriate. Depending on the policy, mandatory mediation or arbitration may be utilized to resolve claims expeditiously in the period shortly after the storm.

Expert Strategies

One way to provide better service is the more strategic use of experts. In recent years, the insurance industry has more fully developed its use of various experts on the construction defect claims. These experts are even more crucially important dealing with the unique issues of hurricane defect claims. The experts can include independent adjusters, contractors, building consultants, architects, engineers, and forensic accountants. Depending on the claim, these individuals will make a tremendous difference in the ability to quickly and effectively close these claims. Also, the hiring of independent experts can assist in avoiding allegations of bad-faith handling.

Defense Strategies

Defense counsel, when involved, can assist the team in resolving claims by providing thorough early claims assessment. Not only does this set the framework for negotiations with claimants/plaintiff's, but allows for an early reserve analysis that provides a well-thought examination of the likely indemnification and defense costs for each claim.

Counsel can also be enlisted to assist with the selection and supervision of experts, coordinating different specialists, where necessary, and providing detailed liability and damage analysis and recommendations based upon the investigation results to allow for a more streamlined resolution process.