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Out of the Frying Pan, Into the Fire: When Reconstruction Goes Wrong Following a Property Loss Claim and How to Prevent Future Perils Through Mediation and Claim Resolution

I. First Party Property Loss – PD, Business Income & Extra Expense

Once a loss occurs it is imperative to the success of the claim for the insurance carrier to communicate with the policy holder. The first contact with the policyholder should be a call to discuss the facts of the loss, if any urgent mitigation needs to take place and what the process will be going forward toward resolution of the claim. Depending on the state, the time line for onsite inspection needs to be communicated to the policyholder during the first phone call to ensure timely inspection of the property.

Upon inspection of the property, the field appraiser needs to have independent judgment as to whether a building consultant or engineer is needed as well as a contractor. If the insured has a contractor in mind, an insurer should encourage the insured to have the contractor present during the inspection to expedite not only repairs but an agreed cost of repairs.

The carrier should not direct the policyholder as to a specific contractor. It is allowable in some states to use a preferred vendor list and provide same to the policyholder, but the carrier should always be cautious in directing the work of the contractor.

If the policyholder decides to contract with a Public Adjuster, the field adjuster should work directly with the Public Adjuster at the onset of the claim and work toward an agreed cost of repairs. Depending on the state, it is imperative for the desk adjuster and field adjuster to be aligned in the scope of the damages and undisputed payment even if there is a disagreement.

Most policies provide calculation examples and interpretation which the field adjuster and public adjusters should be familiar with for each state. Each claim requires a thorough review of each policy to understand the coverage available, the limits and how deductibles are applied.

If a dispute arises, and where the policy language and state statutes allow, insurers will typically pursue the appraisal clause as soon as possible. Where a state's appraisal clause statute and/or case law are indefinite, or where coverage is in dispute, alternative dispute resolution should be considered. ADR along with agreed joint inspections can effectively and quickly resolve those items or issues in dispute. Online dispute resolution is a quick and cost effective forum to resolve first party property disputes. Online dispute resolution can be handled within a digital platform wherein each party uses a secure and private skype like platform. The mediation can be completed in 2 or 4 hour mediation sessions and each party can participate using a lap top or computer with a camera in the comfort of their office or home.

First party claims within each state have specific statutes regarding the claim handling requirements. The key to avoiding bad faith is regular communication, along with clear and concise response to coverage disputes as well as scope and damage disputes. There are states with a more stringent claim handling requirement which can trigger bad faith allegations even when the claim is being handled appropriately. The key to a first party claim is transparent communication with offers of resolution throughout the life of the claim, including but not limited to making undisputed payments quickly and offering dispute resolution early on to pin point the issues in dispute.

II. Representing the Contractor

More complex issues arise in situations with contractors retained to perform the repair work after a properly loss. In the effort toward resolving claims and avoiding claims from the repair and reconstruction project, communication is key.

First, the relationship among the contractor, owner and carrier is very important. The contractual relationship should be clearly drawn so that the legal obligations, scope of work, and requirements for payments are understood and laid out carefully. The parties must understand the work being done and the more clearly laid out the contract is the better. In many jurisdictions there are specific provisions that must be included in the repair contract, which if not followed can have severe repercussions. Furthermore, preparing the contract terms carefully to include clearly understood dispute resolution protocols may assist with preventing future claims on the reconstruction work. Often, an owner's understanding of the scope of reconstruction work needed is at odds with the opinion of the carrier and/or expert. As such, in order to make up for a smaller remediation scope than wanted, owners may focus on alleged inadequate reconstruction efforts to expand the damages claimed against the policy.

For instance, if there is damage to the ceiling, walls, and some kitchen cabinets from a plumbing leak at the second floor, the owner may decide it is time to do that kitchen remodel. If the contractor agrees to do this job and there are problems, who is responsible for the issues? Even if the reconstruction work and remodeling work are contracted for separately it can lead to substantial problems, including questions of coverage for the subsequent loss.

From the contractor's perspective, the contract is of utmost importance, and it is critical to ensure that the contract includes a specific term to show where payment is coming from to pay the contractor – carrier approval, escrow accounts, etc. Are joint checks required?

Clear communication and contracting are essential in limiting follow on claims after performing restoration work from a loss. For example, if the contractor is not paid in full, it may have to record a lien on the property and be forced to litigate to enforce the lien. However, more often than not in these circumstances, the response to a lien claim is a counter-claim asserting defects and deficiencies in the work of the contractor. Then the parties are off to the races in litigation to address issues that could have been cleared up with careful documentation and communication about the source of payment and the scope of work. Nevertheless, the contractor should ensure that it has sufficient and proper insurance coverage for any repair work being conducted in the instance that a claimed defect action is commenced once the work is done.

Another issue facing the repair contractor is licensing requirements and ensuring that all of the details to maintain a license in good standing are followed. For example, in California, if a contractor is not licensed at the time the job commences and throughout the time the work is being conducted not only does the contractor have no ability to pursue a claim (for nonpayment for example), but it also is required to disgorge any payments on the partially completed work. In California, there are exceptions for “substantial compliance” with the licensing requirements, but they are narrow. Various other states have different contractor’s license laws so it is important to do a careful analysis of your state’s laws. Indeed, due to the harsh ramifications for not having the proper license in place, contractors must be vigilant about the licensure status, including ensuring that taxes are paid timely and that all necessary and proper workers’ compensation insurance is procured.

For the subcontractors, issues abound on restoration projects after a property loss. The same issues that fact the general contractor apply here as well – licensure and proper workers’ compensation coverage; however, there are also issues of agency and wage and hour claims, both of which can take the subcontractor away from its business on the job site.

As a result of all of these issues, it is important for the repair contractor to ensure that it has proper insurance to address the claims, not only the amount of coverage but also the type. Furthermore, a robust dispute resolution protocol is highly recommended to be implemented on these complex matters even before the repair effort commences.

III. Third Party Claims for Property Damage

When an owner makes a claim for damages against the contractor (also known as a third-party claim, the contractor’s insurance and/or bond is typically requested to participate and adjust the claim. Where there is a bond on the project, the bonding company may be one source of funds; however, bonds are typically secured by a personal guarantee from the contractor and any payments made by the bond may very well trigger a subrogation claim. The carrier must ensure to follow all necessary insurance requirements and guidelines for communication with the insured during the pendency of a third-party claim. Moreover, it would behoove the carrier to maintain clear lines of communication and document all communications with the third-party claimant, including any lien claims.

As set forth above, where there is damage to repair work that has been performed following a property loss, there are a number of potential coverages that may be triggered. In order to ascertain insurance coverages, it is often key for the carrier to examine the damages that may occur during the repair process and segment out damages that arise from improvements.

Once coverage is determined to attach, the carrier must determine the process by which the repair contractor is retained and paid. For instance, should the carrier enter into a contract for repair with the contractor? Should the claimant be required to contract with the contractor? Should an escrow account be created to deposit approved amounts by the carrier for distribution by the insured? Who is responsible for approving work performed? What if the insured decides not to pay the contractor? The extent of carrier involvement in the repair process has a number of complicated factors and pitfalls that can arise. With this in mind, an insurer must understand and communicate dispute resolution concepts and provisions so that minor disputes can be addressed in a reasonable and timely fashion.

Failing the resolution of disputes during the repair process, there are a number of related actions that typically arise.

Foreseeable actions include:

1. Contractor files breach of contract suit and/or lien against Owner for amounts not paid under contract. Owner cross-complains for construction defects.
2. Owner files bad faith suit against property carrier, disputing valuation of property damage, business interruption and extra expense.
3. Owner files suit against contractor for construction defects. Contractor cross-complains against subcontractors and suppliers. Potential actions against insurers for defense and indemnity obligations can also be filed.
4. Owner files suit against contractor for failure to include appropriate contract provisions and/or failure to maintain a valid contractor's license.

V. Dispute Resolution Dynamics

A. First Party dispute resolution dynamics

First party property loss disputes between the insured and insurer can be generally classified in a number of categories.

First, there could be a technical disagreement on coverage. For instance, where there are alleged underwriting issues, including, but not limited to failure to insure, cancellation, nonrenewal and rating issues. Disputes related to the legal interpretation of policy provisions and terms; statute of limitations and contractual limitations on filing periods; in the absence of Guaranteed Replacement Coverage, claims in excess of limits; and extra-contractual claims.

Second, disputes can arise from scope, valuation and accounting disagreements. Issues in this category include: the scope of loss, including a lack of information; mandated building code upgrades, dwelling versus other structure coverages; pre-existing damage versus proximate cause issues; additional living expense amounts; proof of loss for personal property claims. Assuming that the jurisdiction supports arbitration of these claims, it is typically in the carrier's interest to move forward with the demand for

arbitration/appraisal as soon as possible. Unfortunately, once the demand is filed for arbitration, many insureds and insurers cease to communicate on a productive level and overlook potential opportunities to resolve the dispute.

Finally, disputes can arise where there are conflicting personality types. Insured and insurers are people after all, and certain personality types work better with others. As part of any dispute resolution efforts, there has to be an inquiry of the impact and extent that the different personality types involved in the claim are impeding the ability of the parties to communicate.

Where it is apparent a personality issue is involved in the dispute, insurers, on a management level, need to understand the strengths and weaknesses of their claim team in order to place the insured with an appropriate claims professional. There has to be a fundamental understanding of the claims professional's skill set, including experience, and ability to understand, evaluate and communicate the issues involved in the claim.

On the other side, insureds can utilize numerous resources, including internet research, non-profit organizations, state insurance commissioner's offices, public adjusters and attorneys to help determine the issues impacting the successful resolution of a claim. Where it becomes apparent that personality is a significant factor impeding resolution, insureds can also reach out to claims managers for assistance in the process.

Each step of the dispute resolution process requires an assessment and evaluation of the potential impediments to resolution so that they may be overcome. It is essential to the claim process to obtain consensus between the insured and insurer as to overall goals, priorities and the sequence of events.

Dispute resolution has a traditional hierarchy, which begins with the insured and line claims professional. Where the dispute continues, typically the insured will retain either a public adjuster or attorney to take over the communication process. Prior to this occurring, there is an oft missed opportunity for the insurer to de-escalate and resolve the dispute. However, this requires the line adjuster's acknowledgment that another in the claim organization, whether it is a supervisor or upper management's interdiction would be determinative. Unfortunately, this recognition requires both training and a claims environment that fosters this behavior, without negative repercussions to the line adjuster.

Early dispute resolution can also include the introduction of a neutral throughout the claim process. Depending upon the basis of the dispute, a variety of forums are available, including telephonic, online and in person mediation. Strategic utilization of knowledgeable neutrals can ensure the claims process is successful for both the insured and insurer. By having an ADR process in place at the beginning of a claim, discussing the process with the insured and obtaining their buy in to the process, maximizes the fair and expeditious claim process.

B. Third Party Dispute Resolution Dynamics

When a dispute arises between a claimant and contractor in a property loss claim, a number of issues immediately present themselves. Of particular importance in the dispute resolution process is the identification of not only the claims, but the damages being sought. The types of damages being alleged, or potentially being alleged, have a direct impact on the applicable coverages.

A neutral's understanding the different scopes of coverage as they relate to the damages alleged is paramount. For instance, where there are exclusively contract damages being sought, the role of the contractor becomes much more prominent in the negotiations. However, where the contractor is alleged to have damaged previously undamaged and unrepaired property, the commercial general liability carrier's participation is more pronounced.

As the claim becomes more complicated, personal counsel for the insured and coverage counsel for the carrier appear. To emphasize points of view, companion suits can be filed for either bad faith or declaratory relief, each adding a layer of sophistication and expense to the resolution process.

A successful mediation is not something that just happens. Success is unlikely unless the claimant, contractor and insurer have properly prepared. To properly value the claim, each party must understand the claim's strengths and weaknesses, including contractual requirements, the impact of any statutes and/or case law on the claim, and the insurance policy coverages.