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“It’s the End of the World as We Know It”

I. The Significant Impact of Catastrophic Events

Identifying Each Party’s Point of View

Catastrophic events such as hurricanes, wildfires, and earthquakes, are having have a significant impact on construction defect litigation due to recent trends taking place in these claims and litigation. Traditionally, parties to a defect action seek information on causation, damage and risk transfer. When a catastrophic event impacts a structure in the throughs of litigation, the focus of the parties can change dramatically especially considering first party and/or FEMA shortfalls. Claims of damage to the structure from an event can be amplified where there are pre-existing deficiencies in building design, manufacture, and construction.

Initially, claimants are faced with a multitude of issues when a catastrophic event impacts their structure during a dispute. Issues run the gamut from expanded damage claims to a sudden loss of evidence. However, with the introduction of a new cause of damage, comes the potential for new allegations on both causation and damages, new potential insurance coverages and new potential third party defendants help fuel a potential construction defect claim where none previously existed.

These additional claims, along with potential proof problems, significantly complicate the matter and can make the dispute difficult to resolve. To determine how a matter changes following a catastrophic event, it is helpful to identify each party’s point of view as well as the associated expectations and assumptions. Utilizing skilled claims professionals and mediators knowledgeable in insurance can help focus the dispute and bring resolution when Mother Nature and Construction Defects Collide.

The Complicating Effects of a Catastrophic Event on Claims

Prior to a catastrophic event, through a right to repair process or lawsuit, a claimant already has a belief that the structure was not constructed consistent with the design, building codes, and industry standards. Counsel and experts have been retained, and at a minimum, initial inspections have taken place. The initial inspections are conducted to ascertain the cause, nature and extent of damage. Based upon these inspections, claimant’s experts can determine the need for invasive or destructive testing when the underlying cause of the damage appears to be located within the building envelope, ceiling plenum, roof or below grade. However, now with the potential for inclusion of a claim for mother nature’s wrath, many experts will opine on structural deficiencies, with a focus on the element of nature’s wrath compared to the claims at issue, without the aid of destructive testing, and will typically include them in a notice, report, defect list, or cost of repair.

Should there be a catastrophic event during the early phases of the dispute process, typically no destructive testing will have yet taken place to confirm the early observations and opinions of claimant's consultants. Without the destructive testing to support the allegations and further identify significant damage from an event, claimants will point to the previously alleged construction deficiencies as the direct cause of the observed resultant damage after the catastrophic event. This could stem from claimant's fundamental belief that the catastrophic event would have had little impact on the structure, or at the very least a lesser impact had it been constructed consistent with the design, building codes and industry standards. Significant damage therefore becomes the substantiating cause of the prior allegations, i.e. *hoc ergo propter hoc*.

Take for example, following a hurricane, significant water damage is observed in the structure and it appears to have come through the chimney. Upon investigation, it is apparent that the chimney shroud has blown off, thereby providing an access point for water. At first glance, the resulting damage appears to be directly related to the event. However, this assumption shifts dramatically where the claimant has previously alleged that the chimney shroud was defectively designed, manufactured or installed on the structure. The causal connection between alleged deficiency and damage becomes more substantial.

Consistent with this, however, claimants must now also confront issues of intervening causation as it relates to the damage. This is especially true where damage to the structure can be directly traced to the impact of wind driven debris on the structure. As is typical in hurricanes, it is not only the presence of wind and rain, but debris within the wind and rain that have a detrimental impact on structures. Where the source of debris can be traced, say for instance, nearby construction sites that failed to adequately secure its building materials, creative claimants have been known to expand the dispute to include new defendants.

Where the structure is not a total loss, catastrophic events can act as de facto "destructive testing", revealing once obscured building components and thereby providing additional evidence in the dispute process which, prior to this new blend of allegation would have gone completely unnoticed but for this new attempt at recoupment. Not only is the structure now open to inspection, it is also open to significant further damage. Where there are identifiable deficiencies, the claimant's ability to show a connection to more extensive damage increases.

For the claimant, at first blush, documentation of the extent of damage to a structure as a direct result of a catastrophic event is clear. Typically, the claimant will allege that the underlying construction deficiencies are the primary proximate cause of the additional damage. As a result, the defense will have significant additional burdens to show that the presence or absence of pre-event deficiencies did not contribute to the additional damage. This burden becomes more difficult where the structure is a total loss, thereby limiting the available evidence to establish causation and, risk transfer.

Where the structure is a total loss, evidence of the link between original construction and its impact on damages becomes harder to substantiate but with a total loss of the structure because of a hurricane, wildfire or earthquake, allegations of construction defects become paramount to claimants' case. Claimants will typically rely upon prior inspections and opinions to establish the causal connection between deficiencies and expanded damage claims.

II. Impact on Advanced Destructive Testing

What happens when the dispute process is more advanced and destructive testing is underway when a catastrophic event occurs? As in the 1994 Northridge earthquake in California, claimants amended their claims to include allegations associated with the failure of the structure due to magnitude of the earthquake to further enhance their claims. The amount of damage that an event can have on a structure with open destructive testing sites can be devastating. Often, the testing sites are left open for defense observations, sometimes the claimant is not financially capable of completing the repair following testing, and/or based upon comprehensive allegations of deficiencies, repair to the site without significant additional work and expense is inconsistent with the claimant's position.

Where a structure has open destructive testing sites and a catastrophic event is threatening, the contractor performing the testing would likely limit its exposure in the claim by protecting the structure. With open testing sites, the damage claim can increase by several magnitudes. Questions of causation once again confront the parties to the dispute, now potentially including the contractor conducting the destructive testing. In this instance, the parties to the dispute can anticipate that the defense will assert that the claimant and/or its agents (counsel/experts) failed to prevent further damage to real and personal property because of their failure to take temporary measures to seal off points of potential moisture intrusion, such as roofs, windows and doors.

III. First Party Property Claim

Once a catastrophic event occurs during pending construction litigation, the claimant's property insurance may come into play. From the point of view of the property carrier, the contract of insurance was underwritten and issued with the fundamental assumption that the structure was built consistent with the design, building code and standards of care in the industry. As a result, where a construction defect dispute is underway, the claimant's first party carrier will be confronted with significant impediments when attempting to identify potential coverage.

Sometimes helpful in the resolution process, damage caused by an event can trigger the claimant's property or "all-risk" policy. In particular, "all-risk" property policies typically contain exclusions for collapse; wear and tear, marring, deterioration; faulty, inadequate or defective design; neglect; existing damage and weather conditions. Even if a structure is built consistent with the design, building codes and construction standards, the condition of the structure at the time of the event may limit the coverage.

For example, a claimant's failure to regularly maintain a roof structure, including the failure to replace broken or missing tiles/shingles could easily be traced as a source of water intrusion into the roofing system. Ongoing water intrusion weakens the structural integrity of the roof, further compromising the roof and exposing the structure to significant additional damage when impacted by a catastrophic event. Interestingly, the property carrier's identification that the cause of damage falls within an excepted cause is strikingly similar to many of the arguments advanced by the defense in the construction defect dispute.

However, in many jurisdictions, while the insured has the initial burden to show that the loss is potentially covered under the policy, the carrier has the burden to show that an exclusion applies. The carrier's burden becomes much more difficult where the concurrent cause of the loss falls within the policy's coverage, even when it was not the prime or efficient cause. For instance, recent Florida case law has criticized the use of jury instructions that place the burden on the claimant to show primary proximate cause for an "all-risk" policy, instead, allowing the claimant to fulfill its initial burden through evidence of concurrent cause. Thereafter, the carrier has the burden to show that the loss arose from a cause that was excepted. This burden shifting has a significant impact on the scope of the first party coverage following a catastrophic event. As described above, evidence of the primary cause of loss becomes more complicated following a catastrophic event.

However, despite the above, first party carriers now another opportunity to recoup their subrogation rights against potential contractors and/or their subcontractors amongst other potential defendants.

IV. The Builder

Contrast the claimant's expectation that deficient free construction will make a structure impervious, or at least highly resistive to a catastrophic event, with that of the builder's expectation that codes and industry standards, even if followed, will not make a structure damage free when impacted by hurricane winds, rain, flooding, firestorms or earthquakes.

When a matter is in right to repair process or litigation, and no catastrophic event has occurred, the builder, its counsel and carrier are initially consumed with an analysis of claimant's allegations and an allocation of risk through the identification of potential responsible parties. Identifying subcontractors, suppliers, and manufacturers implicated by the claim and naming those parties to the dispute is typically a time-consuming process that evolves as the claimant's allegations mature.

When a catastrophic event occurs during this process, much of the builder's ability to isolate and tie the deficiencies and damages to a party is disrupted and impacts its ability to mount a proper defense. Add to this the sympathy factor of jurors in the affected areas of the claimant's loss who, themselves, may have faced similar destruction. In fact, the destruction of claimant's structure limits the evidence of negligent or deficient construction. As a result, risk transfer becomes problematic, leading to potential additional exposure to the builder and its carriers.

The Builder's Liability Coverage

Further complicating the dispute, with the cause of damage and/or extent of the damage now being questioned, the builder may very well be faced with new and varying insurance coverage issues, not originally contemplated in the original construction defect litigation. The builder's commercial general liability carrier can be expected to identify the catastrophic event as the primary cause of loss and damage. Consistent with the first party carrier's investigation, the builder's liability carrier will also identify the claimant's role in additional damages as not covered by the contract between itself and the builder.

The builder's liability carrier, however, is confronted with the same risk transfer obstacles as it's insured, where evidence of causation is impacted by a catastrophic event. Without the ability to identify causation, the builder's subcontractors and materialmen will have less incentive to participate in the resolution of the dispute. As a result, the exposure of both the builder and the carrier potentially may increase.

V. Conclusion

When a catastrophic event impacts a structure or structures in an ongoing construction defect dispute, damage allegations and cost of defense are certain to increase dramatically. Once an event occurs, causation considerations become paramount. For the claimant, the catastrophic event becomes the proof that the original construction was deficient. Not only are there additional parties that may be named in the loss where the claimant can trace additional damage to a new source (i.e. construction debris), but the claimant's property coverage may also be implicated.

After a catastrophic event impacts an existing claim or litigation, causation also becomes the focus of the builder and its liability carrier. Where there is little initial evidence of construction deficiencies, the builder and its carrier will focus on the event as the intervening primary cause of loss. The lack of evidence of causation potentially has a direct impact on the builder's ability to transfer the risk to the subcontractors and materialmen as well.

When claims and causation collide, disputes following a catastrophic event are complex and multi-layered. With divergent fundamental assumptions and vastly different perspectives on causation, these complicating factors make it even more important to get into an ADR process with a knowledgeable neutral who understands the complexity of the insurance issues, and can coordinate the parties, allegations, and damages to achieve resolution.