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Changing Face of Construction Litigation:
Emerging Trends Which Are Disrupting the Industry

I. DISRUPTION TREND: CLIMATE CHANGE AND IMPACT ON CONSTRUCTION CLAIMS

In 2018, the impact of climate change was heavily felt nationwide as natural disasters wreaked havoc across California, Florida, Texas, the Carolinas, and other states. In California specifically, the Camp Fire in northern California burned more than 150,000 acres, including the entire city of Paradise, making it the most destructive wildfire in the state. In southern California, the Woolsey Fire concurrently burned almost 100,000 acres. The fires burned for almost two weeks causing extensive damage, prompting evacuations of hundreds of thousands of people, and are estimated to total a combined $15 to $19 billion in total losses, according to Corelogic Inc. These estimates provide a small glimpse into the long lasting effects these fires will have not only on the impacted communities, but on the legal landscape as well.

Headlines before the fires focused on the drought which magnified construction issues when torrential rains arrived in later years, testing weather proof systems and spurring claims.

Due to the ever changing climate change and impact on construction, it is anticipated that new theories of liability will be tested out in the courts. Expected claims will test those handling construction defect, environmental, bodily injury, and professional liability claims, amongst others. Defendants will include not only the usual suspects, but will expand its reach as new theories of liability are tested and tried. In the short weeks following the 2018 fires, California courts were the recipient of numerous filings seeking damages for a host of theories from what others deemed an Act of God. How this impacts construction claims is powerful and wide-ranging.

A. Effects on Insurance Claims

According to AIR Worldwide, it is estimated that insured losses from the southern California Woolsey fire will total at least $2.5 billion. The total economic losses from the Woolsey fire are estimated to be anywhere from $4 to $6 billion according to Corelogic, Inc. Standard homeowners insurance policies include damage from fires; thus, it is likely the insured losses could be higher than the estimated $2.5 billion. Immediately following these disasters, one is hard pressed to avoid the plaintiff bar hosting educational "workshops" on filing insurance claims not only on homes that were lost due to the fires, but also on those homes that affected by smoke damage, loss of electricity, and more.

With the uptick in filed insurance claims, a pattern that will continue to be seen is that rebuilding homes will be a challenge. Homeowners will realize that despite having homeowners insurance, because of the devastating size of the damage caused by the fires, it will cost a lot more to rebuild than is covered under their insurance policies.

Homeowners may find themselves underinsured and unable to rebuild as quickly as they would like. There already is a construction shortage in the state of California as it is; however, it is felt most deeply when catastrophic events like these hit. Homeowners who are insured will find that builders and supplies will be in short supply and high demand. Rebuilding entire communities that were lost from the fires will prove to be a very expensive task. Construction materials are already more expensive with the impact of tariffs looming large. The combination of expensive materials, a shortage in the construction workforce, and a high demand to rebuild will yield an expensive result. In turn. those impacted by the catastrophic events of nature may find allure in the litigation which connects new theories and parties than the garden variety defect claim.

B. Mixed Claims Grow from Statute of Repose

After major wildfires, the types of claims that have historically been filed include construction defect lawsuits against the developers of the affected homes. However, California has a ten-year statute of repose that applies to these types of claims. Since many homeowners may find themselves potentially statutorily barred from claiming construction defect, they may attempt to file other types of claims. Bodily injury claims are prime for this genre of litigation. For example, California has a statute of limitations of two years for personal injury claims. In these next two years, developers, product manufacturer and carriers may find themselves defending allegations of bodily injury claims on products that are well past the construction defect statute of repose. This will prove to be problematic for developers who may not have all the information, records, contracts, subcontracts and more, on hand to prepare themselves for these kinds of claims. When the alleged victim is a minor, defendants may be expected to

hold on to their records for an even longer amount of time, since the statute of limitations does not start ticking until they reach the age of majority.

In addition to personal injury claims, there may be professional liability claims brought forth not only against those involved in designing and building the homes, but also against those involved in designing and building the cities affected by the wildfires. Insurance agents who placed policies squarely at issue may also be in the cross hairs, particularly when the recoveries fall well short of out of pocket losses

II. DISRUPTORS IN MEDIATION OF CONSTRUCTION CLAIMS

A. Single Residential Construction Claims

Mediation continues to be an effective and popular form of resolving construction disputes, from large multi-party commercial disputes to smaller, two-party residential construction disputes and everything in between. Many construction agreements require the parties to submit their dispute to non-binding mediation prior to arbitration or the initiation of a lawsuit. While the mediation process in commercial construction disputes remains consistent in the personalities, types of issues and damages involved, a potentially disrupting trend in construction mediation is the rise of claims involving single-family residential homes prosecuted by affluent claimants.

One of the many challenges in resolving these types of claims is the emotional component --- the claimant may feel angry, upset, righteously indignant, and more. Mediators and opposing parties must learn not to overlook or minimize the emotional component in these types of claims, lest they become an impasse to a successful negotiation. Many times these emotional stances result in claimant's unwillingness to negotiate below a hard-line number, a fixation on a specific damage claim, or a refusal to compromise on even the smallest issue. The more emotional claimant is, too, sometimes the less control his or her counsel has over the process.

Another potential disruptor in construction claims mediation is the affluence of the claimant. Many custom home construction claims are brought by owners who have paid a large amount of money to build their "dream home", and any deviation from that dream can become a claim. One of the challenges in these types of claims is managing expectations, managing emotions, and defending against a cost of repair paid for out of pocket by the affluent claimant.

B. Coverage Disputes And Co-Carrier Battles

Coverage disputes and co-carrier battles will continue to be disruptors in the construction claims resolution process. The major issues affecting quick and global resolution include disputes among multiple carriers insuring a mutual insured; the non-

participating carrier; Time On Risk (dis)agreements; and the applicability of pre-existing damage endorsements. Further, in the additional insured context, there are a host of issues that arise when tender is made including the types of information needed to make a coverage decision; primary and excess coverage positions and priority of coverage; and the presence or absence of contractual defense and indemnity rights which may ultimately effect equitable subrogation and reimbursement rights.

Another potential disruptor is the increasing frequency of disputes involving strict constructionist carriers versus business decision maker carriers. A strict constructionist carrier believes in the literal or strict interpretation to be given to the policy. For example, when evaluating covered "property damage", the strict constructionist carrier will refuse to indemnify for anything other than pure resultant damage. Although the position may be legally defensible and supported by the policy language, the position can be a disruptor to the successful compromise of a claim where the cost of the defense of the lawsuit may be higher than the total amount of the resultant damage plus a share of the cost of repair of an insured's defective work. A business decision maker carrier, on the other hand, may be more fluid in its interpretation of coverage and its compromise of a claim, taking into consideration a variety of factors including coverage, business relationship with the insured, costs of defense and efficiency in claims settlement.

Entrenched positions, whether by a single custom home claimant or by another carrier, can lead to resolution impasses and drive up the costs of claims. Critical to the efficient and productive resolution process is to acknowledge the factors driving each party and provide avenues of opportunities to allow the process work fairly and productively. In dealing with carrier versus carrier disputes, the strict constructionist may want to stand firm on its position and make the business decisionmaker carrier, or the insured, make up the difference or force the lawsuit. A good first step in determining whether there will be a problem is to discuss an appropriate allocation scenario in the event of a reasonable demand by claimant/plaintiff to settle the insured's liability. Written communication can be sufficient to express the carrier's position, but at the end of the day a telephone call can achieve much more than a letter writing campaign. It can also save the carrier money on paying coverage counsel to fight.

Where an agreement before mediation cannot be reached, there are a number of resolution strategies including seeking a coverage mediation or engagement in other alternative dispute resolution processes. The advantage of this route is that ultimately it saves the parties time and expense in fighting in the courts. It also avoids the fight at the liability claim resolution session where, depending on the laws of the state, an insured can make an argument that the carriers' refusal to participate in settlement is bad faith because the carriers are placing their own interests (paying what is "fair" under the coverage landscape) over the interests of the insured in being removed from harm's way.

Other resolution strategies include an agreement to disagree. That is, the carriers might accept an allocation proposal but agree to dispute the allocation after the claim settles. Some carriers will forego these ADR attempts in favor of a declaratory judgment action, sometimes filed during the pendency of the liability action or afterwards. In general, for a court to exercise jurisdiction under the Declaratory Judgment Act, there must be a "substantial controversy, between parties having adverse legal interest, of sufficient immediacy and reality," *Maryland Casualty*, 312 U.S. at 273, which has "crystallized to the point that there is a specific need" for a declaratory judgment. *J.N.S. Inc. v. Indiana*, 712 F.2d 303, 305 (7th Cir. 1983). The Declaratory Judgment Act allows the federal court, at its discretion, to adjudicate the parties' rights and obligations on a disputed matter, even if a claim for damages has not yet arisen. 28 U.S.C. §2201(a). A district court, however, is under no compulsion to exercise that jurisdiction. *Brillhart v. Excess Insurance Company of America*, 316 U.S. 491, 494 (1942). "In the declaratory judgment context, the normal principle that federal courts should adjudicate claims within their jurisdiction yields to considerations of practicality and wise judicial administration." *Wilton v. Seven Falls Co*., 515 US 277, 288 (1995). Where circumstances warrant, the district court is authorized either to dismiss or stay the declaratory relief proceeding. *Id*. at 283. One such circumstance is where a "parallel action" exists --- ie, an underlying liability action pending in state court where overlapping factual questions are being determined.

Throughout the process of claims settlement, whether by mediation or otherwise, carriers should try to work together on providing a substantive and effective defense for the insured. The carriers should also try to find reasonable opportunities to settle the claim and the issues between them, to avoid needless and protracted litigation going forward.

III. DISRUPTOR: IMPACT OF TECHNOLOGY IN CONSTRUCTION CLAIMS

A. Emerging Technologies in Video Storytelling: Impact on Trier of Fact

The insurance and construction industry are two of the earliest commercial adopters of drone technology. Many insurance companies have sought approval to fly light weight drones to evaluate disaster site damage, and many construction experts currently use drones to evaluate damage claims in both the commercial and residential context. Drone technology promises to bring benefits to the insurer and the policyholder, improving the claims process with increased efficiency, improved accuracy and quicker claims resolution.

Historically insurers have used new technology to improve the amount and quality of data gathered during an investigation and to better assist the recording and evaluation of such data. Insurance claims investigating has come a long way from an adjustor's observations, measurements and handwritten notes. Laptops, tablets,

cameras, sophisticated estimating software (Colossus, Xactware and others) and inspection tools such as thermal imaging have all improved the claims process. More recently, insurers have adopted mapping technology, geographic information systems as well as aerial photography to better inspect roofs and investigate hail and other types of property damage.

Like aerial photography and other investigation tools, drone technology may bring new perspectives to pre- and post-claims loss investigation. The fan-powered drone such as the quadcoptor, is capable of vertical take-off and can be outfitted with devices such as cameras, infrared devices, microphones and sensors. These drones can be used to evaluate smaller scale damage to buildings and roofs. Both types of drones can be used in underwriting investigations to better assess the risk represented by an insured, or in fraud investigations.

On a state level, over 42 states have introduced legislation aimed at regulating or restricting drone use. Twenty states have enacted laws addressing drone issues, such as defining what a drone is; placing limitations on drone use by law enforcement or other state agencies; and regulating the use of drones by the public. Some of these new laws make it a crime to intentionally observe a person or their property without their consent, and provide for civil causes of action for those whose privacy is violated. For example, Indiana law makes it a crime to knowingly and intentionally electronically survey the private property of another without permission; Louisiana makes it a crime to intentionally use a drone to conduct surveillance of a targeted facility without the owner's prior written consent; and in Texas it is a crime to possess or distribute images gained from the illegal use of a drone. In Oregon, a landowner can bring a trespass action against an operator flying a drone lower than 400 feet over their property and under certain conditions.

Insurers still need to adopt safety regulations, training programs, and standards by which the drone will operate. In addition, insurers will face a patchwork of state regulations on drone use. It may also be necessary to craft a privacy policy in connection with the technology.

Privacy issues raise a host of potential problems for an insurer and can surface despite the fastidious habits of a claims investigator. What if, while using the drone, a claims investigator captures an image of criminal activity near the property being inspected? Or inadvertently records a private conversation next door while surveying a property? Or flies the drone too low over an adjoining property? In addition to any statutory regulations, there are potential exposures to common law torts, including invasion of privacy and trespass actions.

If history is any guide, the use of this new technology in the construction claims process will not be immune from criticism and may potentially lead to litigation. Some time ago policyholders challenged the insurance industry's use of Colossus, a

comprehensive claims valuing software program. Policyholders claimed in bad faith lawsuits that the program failed to include certain variables, and therefore its recommendations were inaccurate, or that the adjustor failed to demonstrate independent thought for valuing a case by mandatorily applying the stated Colossus value to settle claims. Like the technology that went before it, an insurer's use of drone technology could be subject to challenge based on its accuracy (the device or the operator) or perhaps by an insurer's over-reliance on the data gathered.

It is also possible that an insurer could face challenges to *not* using drone technology. If drone technology promises better accuracy, efficiency, and quality data, could the intentional decision not to use that technology, be a possible failure to promptly and fairly investigate a claim? A challenge along these lines---for instance, if a drone could have recorded damage not visible to an investigator---is within the realm of possibility with the new reality of drone technology.

IV. DISRUPTION: INSURANCE PRODUCTS AND RISK TRANSFER

Owner controlled insurance programs (OCIPs) or contractor controlled insurance programs (CCIPs), also known generally as "Wraps", partners the owner/developer, general contractor and subcontractors together to provide commercial general liability coverage under one policy. Wraps have been used for large commercial projects but can be used for all sized of residential construction projects. The benefits to such a program is to achieve cost savings and reduce litigation and cross resolution, and to provide uniformity in coverage terms, limits and defenses. One of the most-cited reasons for obtaining a wrap is that one policy and program should mean simplification of insurance and fewer coverage disputes with more efficient claims handling.

There are signs that wraps may lose some of its prevalence in the construction industry, and there may a return to the traditional multi-policy model, endorsed with higher per-project limits and excess coverage requirements. Risk transfer agreements will continue to be significant in diffusing the costs and liability of construction. A further potential disruptor will be developers/general contractors seeking additional insured coverage to be broader than what can be contracted for under a defense and indemnity agreement. There may be an "end run" around anti-indemnity statutes by requiring broader additional insured coverage.