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COVID Construction Boom to Bust: Who Pays When Buyers Regret Fleeing to the Burbs.

I. Change in Conditions Leading to Potential Uptick in Litigation

A. COVID-19

One of the very first noticeable socio-economic consequences of the COVID-19 pandemic was the surge in unemployment. For those unaffected by loss or downturn in employment, the next trend was relocation to more remote areas. For many of this meant moving out of urban centers like New York City, Philadelphia, Chicago, and Los Angeles for more suburban areas. This ebb and flow between trendy urban center and up-and-coming suburbia is nothing new to major metropolitan areas. These trends have repeated themselves in a somewhat cyclical manner for decades, if not longer. Often the young and unattached or young couples opt for the urban centers with easy access to nightlife, restaurants, and cultural facilities such as museums and the arts. As this population ages, growing families often seek to move to the suburbs. Empty nesters sometimes return to the city. There are other extraneous events such as upticks in crime in urban centers, increase in property taxes or even population growth within suburbs themselves that cause the dynamic to shift over time. These changes usually take years if not a decade to result in appreciable change whereas the events of 2020 and early 2021 led to massive changes in a period of months. Simply put, urban populations tended to be more immediately impacted by higher COVID numbers and spread. It was more difficult to isolate in an urban area than in a suburban area. As the epidemic progressed, eventually a more even distribution by population emerged. However, many who loved the bustling frenzy of the city and the close connection to other humans, had already opted for their suburban single-family home. In addition to the COVID health crisis, the country has gone through a significant political divide and social justice movement. These factors on a secondary basis may also have contributed to the push to the suburbs. Those who kept their employment and income streams steady, if not moving to the suburbs were looking for a more remote place to escape. This often-meant secluded mountain towns and shore resort towns. A combination of the above factors has led to significant increases in both the primary and secondary home markets. At present, this trend continues upward. Albeit related to Covid-19, another key factor that has driven the relocation to the suburbs and purchase of an increase in resort or second homes has

been driven by the remote work option that was first made a necessity. As many employers have continued the remote option at least on a part-time basis, families have considered where they would like to spend the majority of their time versus how much of a commute they can tolerate.

So how is this social economic phenomenon a claims and legal issue? Simply put, what goes up is likely to come down. Prices paid for suburban and resort properties have been well over historical values. Those who did not opt to relocate or purchase a second home may have made expenditures to update their homes. Projects may have included additions, renovations for office space, pools, and other in-home amenities. Cost of renovation and updates to homes as well as new construction of homes come at a time when the cost of raw materials and in some cases, labor are well above historical cost. The more people pay for something, the more they expect of it. Similarly, the more likely they are to become dissatisfied with the item or work. The result is that we may see an increase in construction defect or real estate-related litigation.

Labor and material shortages as well as the shutdowns and other regulatory restrictions imposed by the pandemic itself lend themselves to contractual disputes based upon delay and force majeure.

II. What's on the Horizon?

A. Increase in Traditional Construction Defect and Small-Scale Construction Defect Claims.

According to the popular website Houzz, remodeling professionals, architects and designers have reported the highest level of business activity in the second quarter of 2021 since the launch of the Houzz Barometer in Q4 2014.ⁱ Businesses are faced with soaring homeowner demands, supply/material chain constraints and unrelenting labor shortages. All of these challenges are not only causing challenges to construction professionals on the front line, but also have the potential to be the "perfect storm" of factors brewing for the next wave of construction defect claims to roll in. With long project wait times, dramatically increased material costs, frustrating labor shortages, and the overall stress that has been ushered in by the pandemic, both business owners and homeowners are inevitably going to take out their frustrations somewhere and your insured construction professional could be the next unintentional target.

We expect an increase in traditional construction defect claims particularly in the new construction and single-family home area. We also anticipate construction defect and breach of contract-type claims to be brought in the small-scale construction area as well as in home renovations.

It is important to be able to differentiate between the true construction defect case versus buyer's remorse. Red flags to look for in cases include the over-involved plaintiff who obsesses over every detail as well as kitchen sink-type claims. No, not the actual kitchen sink but the metaphorical kitchen sink. A true construction defect claim will often focus on a few key areas whereas buyer's remorse claims particularly in a single-family homeowner context may include everything under the sun, rational and otherwise. Quick resale of the home for substantially less than what was paid without a real explanation as to why the property was disposed of with such great haste can also be a red flag that the "claim" arises more out of the buyer's personal financial crisis than any defect with the home or the property. When propounding discovery and deposing a plaintiff be sure to inquire about the motivations and decision-making process for the relocation or the renovation as well as whether and to what extent the plaintiff(s) circumstances have changed since completion of the transaction. Look at whether plaintiff has a true engineering expert versus a host of "reports" prepared by vendors in various trades criticizing conditions and proposing expensive remedies.

With an uptick in construction and sale transactions, there is likely to be a statistical corollary in increase of claims. It is important to distinguish between this normal incidence of new claims and those which are driven primarily as a result of buyer's remorse or regret over having made a high-ticket impulse purchase. Thus far, we have been primarily discussing residential projects. However, those businesses able to secure financing or who were healthy enough to fund the renovations themselves may have commissioned their own construction projects. For example, restaurants with the funds rush to put up outdoor decks and patios or install window walls that would open to accommodate the requirements for "outdoor" dining. Many businesses simply put-up temporary plastic partitions whereas other businesses may have commissioned more permanent social distancing measures.

There are some identifiable features to look for that may help sort these new "Buyer's Remorse" claims from the rest of the pack. Some red flags to be on the lookout for include, but are not limited to, the following:

- Geographic location – is the claim in an area of the country that was traditionally a smaller market and has seen a recent increase in population (e.g. Buffalo, New York)? Or in a more suburban or rural area?
- Recent home sale – was the home at issue recently purchased by the claimant during the pandemic? Did the claimant recently relocate from a larger market?

- Emotional reaction – does the claimant appear to be unusually emotional? Pay attention to the tone and reactions visible in emails and early correspondence. Was this a headache project for your insured/client?
- Increased estimates – Did your insured/client have to increase their original estimates due to increased material costs and/or supply shortages? Did the project end up significantly over budget?

In addition to the red flags discussed above, the sheer number of transactions and rapid changes within the housing market are likely to lead to an uptick in fraud claims as well. We may see an increase in fraudulent claims as alluded to above. However, we may also see an increase in claims of fraud in the transaction. For example, home purchaser expends a significant sum to relocate to the suburbs or to the beach may be more apt to sue the seller or even the involved real estate professionals when a significant problem with the property comes to light. Successful suits against home sellers are relatively rare. However, given the potential for fee shifting provisions and certain consumer friendly statutes, we may see an increase in claims sounding in fraud arising out of the purchase of a home even where no real construction defect allegation exists.

Many of us who had not even contemplated the term force majeure since law school decades ago were reminded of the doctrine at the outset of the pandemic. There are occasional Acts of God and other unavoidable circumstances which create impossibility of performance under a contract. However, never before in recent memory has an event such as the pandemic truly highlighted the need for comprehensive force majeure provisions in contracts. We often think of impossibility of performance as a company going out of business, a temporary situation such as a hurricane, or a minor delay in obtaining materials. However, the pandemic and some of the more recent events such as the Suez Canal debacle and pipeline cyber-attack should remind us that when working with our clients, we need to ensure that the contract documents include appropriate language specifying how such delays and impossibilities will be handled. The parties are always best served when their true intentions are specified. This avoids surprises when unforeseen circumstances arise. Particularly after the pandemic, counsel must consider the unexpected and urge their clients to plan for the unexpected.

B. Potential Defenses

If you find yourself the unlucky recipient of a “Buyer’s Remorse” claim disguised as a construction defect claim across the desk, not all hope is lost. There are a range of various defenses to traditional construction defect claims that may be especially applicable and helpful towards successfully defending against a “Buyer’s Remorse” claim.

1. Betterment/unreasonable upgrade and enhancement issues.

One of the damages defenses that claims professionals and defense counsel may find themselves utilizing with increased frequency with this new wave of “Buyer’s Remorse” construction defect claims is the unreasonable upgrade defense (a.k.a. “betterment” or “added benefit” defense). Generally speaking, in breach of contract actions, the typical rule is that damages awarded should only place the plaintiff in the same position he would have been had the contract been performed properly (i.e., made whole), but they should not be awarded more than the benefit they would have received had the promisor properly performed the contract. *See also the Restatement (Second) of Torts § 920 (Benefit to Plaintiff Resulting from Defendant’s Tort).*

This is likely going to be a prominent defense in the new wave of construction defect claims for various reasons, such as:

- Dramatically increased material costs: During the project, the business or homeowner may have had to resort to using lower quality/cheaper materials than they otherwise would have, due to some construction material and component costs being 3 to 7x higher than normal. Due to budgetary constraints, or the limited amount of inventory on the market, business and homeowners may have had to select the lower quality and priced items for the project, and then later ending up with a case of “buyer’s remorse” after installation when that inferior floor tile selected starts cracking, and the claimant ended up replacing it with a higher quality tile that is now available as the pandemic starts waning and the market begins stabilizing.
- Material/supply shortages: Computer chips and paint primer have been scarce. Treated lumber is now worth more than gold and under lock and key to prevent theft. Maybe that HVAC unit the designer originally designed for was not available due to lack of computer chips/inventory shortage and the business or homeowner who did not want to wait 6 mos. Agreed to install a unit with less “bells and whistles” that was available to keep the project on schedule, but was never quite happy with the product’s inherent limitations? Investigate thoroughly to see if the alleged “repair” needed is actually an upgrade to a better product.

Take a close look at the alleged “repairs” needed to address the construction defect issues alleged. Are they of same “like kind and quality” as the originally installed items? Are they a true “replacement” of the defective work that had to be removed? Or rather are they an upgrade from the originally installed product? Be aware of the quintessential “Ford v. Cadillac” situation in the construction defect context, where the business or homeowner originally did not want to pay for more than a Ford Focus, and after complaining, later replaced it with a Cadillac—the claimant is not entitled to a windfall with a Cadillac just because the Ford Focus may have had a design flaw.

2. Economic Waste.

“Repair” v. “replace is a classic example of an economic waste defense. If you find yourself defending a claim where complete systems, components or portions of a building were replaced, analyze your claim closely and ask for your insured’s/client’s input and/or expert’s opinion as to whether the same result could have reached with less expensive repairs versus a complete demo and replacement. Could the owner’s HVAC system been satisfactorily repaired (and much less costly) by swapping out existing roof top units relatively easily to help address humidity problems

inside a building, rather than also removing a drop ceiling and demolishing the existing ductwork and re-installing new ductwork and a new drop ceiling?

3. Reduction for Use or Depreciation

This defense is not as often utilized as one may think, but the challenges inherent in the market during the pandemic may set the stage to utilize this defense more frequently. The reduction for use/depreciation defense applies when an owner replaces or repairs a project after a number of years, and if so, the damages may be potentially reduced to reflect the extended life expectancy of that part of component. The classic situation this can arise in is claims involving faulty roof installation (e.g., 20-year life expectancy). If the claimant waits 5 years to replace portions of a leaky roof, the replacement costs and/or damages awarded may be reduced by the upon the years of actual use.

4. Repair/replacement issues in an unstable market

Other aspects of the “repair v. replacement” issue to consider going forward during the next wave of post-pandemic construction defect claims is the higher-than-normal repair costs during the pandemic or supply shortages holding up the repair/replacement process. If the owner decides to have a portion of the project repaired during a very unstable market, when the price of treated lumber is 5 to 7x more than average, and OSB board is over \$50 per sheet, who should have to shoulder the cost of unusually expensive repairs, only made more expensive than normal due to current market conditions, for a pre-pandemic project? Are they going to be considered “actual costs incurred” that are reimbursable to a claimant? Or is there an argument to be made that had the owner not “jumped the gun” or waited a few months until the material was more readily available and prices decreased to something more reasonable? Beware of claimant-owners trying to rely upon repair/replacement estimates in support of their claims that were dated during the pandemic. By the end of 2021 or going into 2022, updated estimates may need to be sought to reflect (hopefully) downward trending prices. You may also encounter the rush to sell an alleged defective property. Timing of repairs can be a double-edged sword when you have a business interruption claim in a tight supply market.

III. General Considerations.

Construction defect claims, by their nature, are typically wrought with coverage issues. Claims professionals have to perform a thorough review of the claims alleged and the specifics involved with each claim to determine what coverages apply and what is not covered for these types of claims.

1. Occurrence

One of the primary issues for a claims professional to analyze of course is whether the matter at hand constitutes a covered “occurrence” sufficient to trigger coverage under a CGL policy. It is difficult to predict outcomes when the law varies, sometimes drastically, from state to state. Does faulty workmanship constitute an occurrence if that faulty work was unexpected and unintended by the insured and the property damage was not anticipated or intentional? Does it require there

to be damage to third-party property in order to be an occurrence? Or is the claim situated in a state where defective construction does not rise to the level of an occurrence?

2. Consequential Damages v. Work Product Issues

One of the other fundamental coverage issues that arises in most construction defect claims is the consequential damage v. work product analysis that must be undertaken. As a general rule of thumb, replacement and/or repair of the "Work itself" performed by your insured/client is not usually a covered claim. However, if there is an allegation of resulting property damage from your insured's/client's Work—the most common example perhaps is water intrusion and damage from an allegedly defectively installed roof—then that may be a consequential damage that is covered under the policy language. The permutations and exceptions to the exceptions in your own work versus consequential damages arena can sometimes complicate your case or ease your settlement depending upon where you sit.

3. Contract obligations v. Policy Language

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Every project has a contract - or 12. In addition to your insured/client having challenges on the frontline with all the added stresses in a volatile construction market, they may very well find themselves in a situation where their contractual obligations to the owner and/or multiple upstream entities are broader than the coverage provided to your insured/client under the policy. Although most contractual indemnification provisions on their face do not provide for reimbursement from one party to another for construction defects and faulty workmanship claims—as they are traditionally limited to claims for personal injury, death, or property damage—there are certain situations where the contractual indemnification provision does expressly include indemnification for claims for faulty workmanship or defective work, and depending on the insured's/client's insurance policy, there may not be coverage available under the policy. Where counsel is involved at the contract stage, it is important to make sure your client makes the broker aware of all contractual insurance obligations and of its intent to procure insurance sufficient to comply with its contractual obligations. Often contractors do not take this necessary step. Sometimes due to the market or the size or experience of the contractor, the required coverage is not available.

4. Duty to Defend v. Duty to Indemnify

The dichotomy that makes the construction litigation world go 'round. At odds with each other frequently, of course, is the carrier's duty to defend versus their duty to indemnify. As often is the case with construction defect cases, your insured/client may be receiving a defense funded by the carrier based on the claims alleged, but the reality of the situation is there will be little to no indemnity afforded under the terms of the policy. During settlement discussions, your insured/client may be asked to contribute to a settlement out-of-pocket, either financially or through contributing materials/labor, to facilitate a global resolution and the repair/replacement process of the claimant.

B. Key Areas for Investigation.

Thoroughly investigating your construction defect claim has always been one of the most critical components of defending one, but will now even be more so given the anticipated “Buyer’s remorse” type claims we will likely be seeing in this next wave of construction defect claims. A team approach through the claims professional, defense counsel, insured/client construction professional and expert(s) will be the key to identifying those novel “buyer’s remorse” claims and maximizing your chances of successfully resolving the new onset of claims arising during the COVID-19 pandemic’s volatile market. Key areas to focus your investigation should include:

- Recent property transaction(s) and history of the property: Was the property recently purchased by the claimant during the pandemic’s inflated market? Did the claimant recently flee to the burbs or to a smaller market shortly before the project involved? Does the sales price seem unusually high? Does it appear the claimant may owe more on the property than it is worth? Was there an appraisal done recently on the property in support of a sale or home equity loan? Are there recent changes to the claimant’s family, home, work or other financial situation that could be motivating factors for a subsequent move or the claim itself?
- Type of project: Was the renovation project a necessity or an elective enhancement of the property? Was this an addition for a growing family in need of additional bedrooms? Or a business which was required to make HVAC improvements to meet new stringent health/safety criteria? Or was this a luxury project to transform the home to provide an outdoor living center, pool, home movie theater and personal gym? Or to add a third vacation home to a family’s portfolio of vacation properties? Be suspect of the projects that seem to have been elective or optional projects undertaken during the pandemic, as they may involve a potential “buyer’s remorse” claim. Again, look for change back life situations such as a return to in office work, no time for the pool, and the like. Look to what motivated the construction or the project and whether those original motivating factors are still present or have receded over time.
- Volatile market conditions: Was the underlying project impacted by the pandemic’s volatile market conditions? Was the project re-estimated by your construction professional multiple times due to increasing lumber prices, etc.? Were material/supply shortages an issue? Is the alleged estimate for repairs/replacement work touted by the claimant a true reflection of current costs to effectuate the repairs?

C. Adapting to Virtual/Hybrid Litigation, ADR and Trial.

Our industry has seen significant changes over the past year and a half due to the pandemic’s transition to a remote workforce. Many courts are now completely virtual, holding daily status conferences and oral argument via Microsoft Teams and Zoom platforms. Depositions and mediations are also now largely conducted remotely. While the transition to virtual or hybrid litigation may have been easier for cases involving your garden variety general negligence claims, the transition was inherently more difficult for more complex and document intensive cases, such as construction defect claims. Successfully litigating the next wave of construction defect claims ushered in from pandemic-era is not only going to be dependent upon one’s ability to substantively defend the claim as may have been the case in the past, but will also be dependent upon one’s ability to adapt to a virtual environment and embrace new available technology

and the virtual platforms being utilized. Doing so may just give you the “winning edge” over your opponent.

Prepare, prepare, prepare. Whether it is organizing and pre-marking your construction contracts and plans prior to deposition using exhibit share software or readying yourself for trial, preparation is key. Always familiarize yourself with the system(s) that will be used. Practice putting up your exhibits and sharing them ahead of time. Have them organized in a way that is easy to retrieve during your proceeding. Make sure you know how to mark up or highlight an exhibit or how to ask a witness to mark up an exhibit as you walk them through the project. Remember, just because they may be remote, your “audience” still wants to see a clear, concise and efficient presentation. As you never wanted to be the lawyer befuddled with the tear off pages of the write on easel at closing, you do not want to be the one learning how to use the highlight tool at trial or a key video deposition.

¹ Houzz Barometer Points to Strength in the Home Renovation Market, Bryan Anthony, April 14, 2021.