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WHEN CATASTROPHES AND CONSTRUCTION DEFECT LITIGATION COLLIDE

WHEN A CATASTROPHE STRIKES DURING ONGOING LITIGATION, EXPECT COMPLEX AND MULTI-LAYERED DISPUTES

BY STACY LA SCALA AND DAVE STERN

Catastrophic events such as hurricanes, wildfires, and earthquakes are having significant impacts on construction defect litigation. Traditionally, parties to a defect action seek information on causation, damage, and risk transfer. When a catastrophic event impacts a structure in the process of litigation, the focus of the parties can change dramatically.

Initially, claimants are faced with a multitude of issues when a catastrophic event impacts their structures during a construction defect dispute. Issues run the gamut from expanded damage claims to a sudden loss of evidence. Beyond that, with the introduction of a new cause of damage comes the potential for new allegations concerning both causation and damages. New potential insurance coverages and new potential third party defendants help fuel a possible 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 cat-

astrophic 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

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, the claimant's experts are able to 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.

When Catastrophes and Construction Defect Litigation Collide

However, with the potential inclusion of a claim stemming from nature's wrath, many experts will opine on structural deficiencies, with a focus on the element of nature's wrath rather than the claims at issue, without the aid of destructive testing, and they 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 taken place to confirm the early observations and opinions of the claimant's consultants. And without the destructive testing to support the allegations and further identify significant damage from an event, the claimant may point to the previously alleged construction deficiencies as the direct cause of the resultant damage after the catastrophic event.

This could stem from the 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.

Take, for example, significant water damage observed in a structure following a hurricane, where the water appears to have come in through the chimney. Upon investigation, it is apparent that the chimney shroud has blown off, 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 if the claimant has previously alleged that the chimney shroud was defectively designed, manufactured, or installed. The causal connection between the alleged deficiency and damage becomes more substantial.

Claimants must now also confront issues of intervening causation as it relates to the damage. This is especially true when damage to the structure can be directly traced to the impact of wind-driven debris. As is typical in hurricanes, it is not only the presence of

wind and rain, but also debris carried by the wind that can damage structures. When the source of debris can be traced to, for instance, nearby construction sites with inadequately secured 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 that, prior to the catastrophe event, would have gone unnoticed. Not only is the structure now open to inspection, but also it is open to significant further damage. Where there are identifiable deficiencies, the claimant's ability to show a connection to more extensive damage increases.

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 when the structure is a total loss because evidence of the link between the original construction and its impact on damages becomes harder to substantiate, even as allegations of construction defects become paramount to the claimant's case. Claimants will typically rely on prior inspections and opinions to establish the causal connection between deficiencies and expanded damage claims.

Impact on Advanced Destructive Testing

What happens when the dispute process is more advanced and destructive testing is underway when a catastrophic event occurs? After the 1994 Northridge earthquake in California, claimants amended their claims to include allegations associated with the failure of the structure to further enhance those 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.

Questions of causation once again confront the parties to the dispute, now potentially including the contractor conducting the destructive testing. The defense may assert that the claimant or its agents (counsel/experts) failed to prevent further damage to real and personal property as a result of their failure to take temporary measures to seal off points of potential moisture intrusion, such as roofs, windows, and doors.

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 design, building codes, and industry standards.

"All-risk" property policies typically contain exclusions for collapse; wear and tear, marring, or deterioration; faulty, inadequate, or defective design; neglect; and existing damage. Even if a structure is built consistent with the design, building codes, and industry standards, the condition of the structure at the time of the event may limit the coverage.

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 more difficult when the concurrent cause of the loss falls within the policy's coverage, even when it was not the primary or efficient cause.

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TYPICALLY, THE CLAIMANT WILL ALLEGE THAT THE UNDERLYING CONSTRUCTION DEFICIENCIES ARE THE PRIMARY PROXIMATE CAUSE OF THE ADDITIONAL DAMAGE.



For example, 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 of allowing the claimant to fulfill her 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.

The Builder

Contrast the claimant’s expectation that deficient-free construction will make a structure impervious—or at least highly resistant—to a catastrophic event with 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 its carrier are initially consumed with an analysis of the 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 particular party is disrupted, impacting its ability to mount a proper defense. Add to this the sympathy factor of jurors who may have also faced similar destruction, and the fact that the destruction of the claimant’s structure limits the evidence of negligent or deficient construction, and risk transfer becomes problematic, leading to potential additional exposure for the builder and its carriers.

The Builder’s Liability Coverage

With the cause of damage and/or extent of the damage now being questioned, the builder may 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 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 its insured. 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 for both the builder and the carrier may increase.

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 also the claimant’s property coverage may be implicated. Causation also becomes the focus of the builder and its liability carrier.

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 is able to coordinate the parties, allegations, and damages to achieve resolution. ■

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