

Building Better Outcomes

# CONSTRUCTION CLAIMS

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## WILL FEDERAL LAW PREEMPT YOUR CONTRACT?

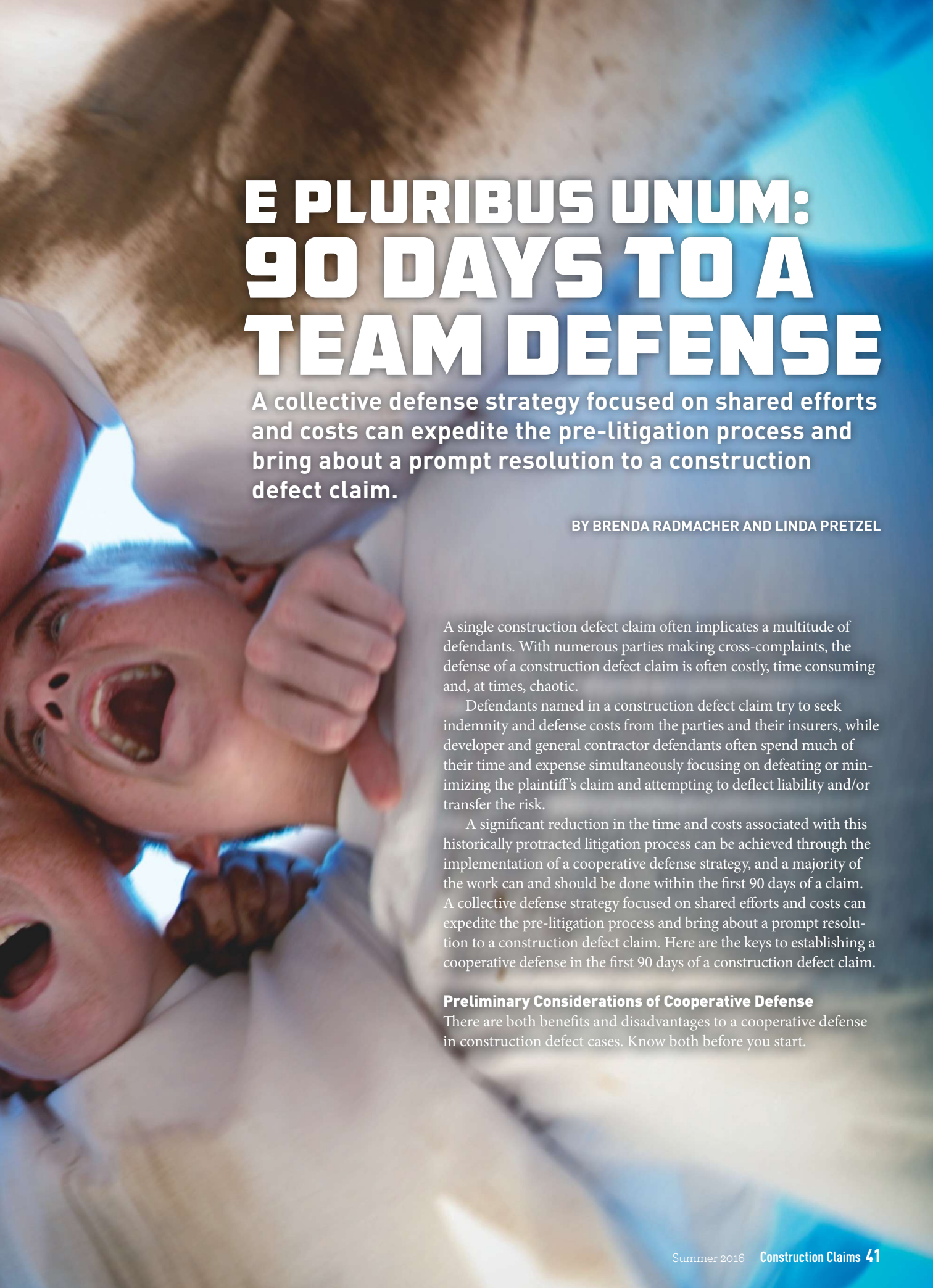
Substantive provisions of the Federal Arbitration Act of 1925 preempt state arbitration law in many construction contracts. P32

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# E PLURIBUS UNUM: 90 DAYS TO A TEAM DEFENSE

A collective defense strategy focused on shared efforts and costs can expedite the pre-litigation process and bring about a prompt resolution to a construction defect claim.

BY BRENDA RADMACHER AND LINDA PRETZEL

A single construction defect claim often implicates a multitude of defendants. With numerous parties making cross-complaints, the defense of a construction defect claim is often costly, time consuming and, at times, chaotic.

Defendants named in a construction defect claim try to seek indemnity and defense costs from the parties and their insurers, while developer and general contractor defendants often spend much of their time and expense simultaneously focusing on defeating or minimizing the plaintiff's claim and attempting to deflect liability and/or transfer the risk.

A significant reduction in the time and costs associated with this historically protracted litigation process can be achieved through the implementation of a cooperative defense strategy, and a majority of the work can and should be done within the first 90 days of a claim. A collective defense strategy focused on shared efforts and costs can expedite the pre-litigation process and bring about a prompt resolution to a construction defect claim. Here are the keys to establishing a cooperative defense in the first 90 days of a construction defect claim.

## **Preliminary Considerations of Cooperative Defense**

There are both benefits and disadvantages to a cooperative defense in construction defect cases. Know both before you start.

## A unified defense also allows the individual parties to shift their focus from minimizing their own individual fault to minimizing the plaintiff's claims, potentially resulting in lower claim amounts for all.

A cooperative defense expedites the discovery process, which results in a quicker claim resolution and lower overall costs. The collective defense also allows for streamlined pre-litigation procedures whereby all defendants can efficiently share discovery information or expert analysis. Not only are overall costs reduced when these pre-litigation procedures are streamlined, but the use of cost-sharing agreements ensures that all parties will incur lower costs. A unified defense also allows the individual parties to shift their focus from minimizing their own individual fault to minimizing the plaintiff's claims, potentially resulting in lower claim amounts for all.

While there are many benefits to cooperation, a cooperative strategy can be detrimental to an efficient defense in certain circumstances. One potential disadvantage of the cooperative defense strategy is that joint efforts and allocation of costs can be difficult to determine when a host of parties are involved. Similarly, determining how joint efforts will be apportioned can foster mistrust amongst the defendants. The sharing of information, experts and strategies can potentially lead to a general mistrust of the other defendants or their attorneys, especially if it appears as if these attorneys or claims managers are too involved or not involved enough in the cooperative defense efforts. Furthermore, there is a constant potential for conflicts of interest and disclosure of confidential attorney-client privileged information.

Another potential barrier to an effective cooperative defense is personality conflicts. One particular conflict might arise for those defendants who took pride in the work they performed on the project. These defendants might feel as if they should not have to defend other workers whose poor work caused the alleged claim. Some defendants might also feel that agreeing to cooperate might be perceived by others as a form of admission of that defendant's poor work product or fault in the matter.

With the costs and benefits weighed, you should first look to identify the defense and indemnification obligations of those parties implicated in the construction defect claim before implementing your cooperative defense strategy.

### Additional Insureds and Defense Obligations

Prior to bringing all of the potential parties together, it is imperative that you identify the subcontractors' insurers who have additional insured obligations to the contractor/developer for the project. In addition to identifying the parties, the terms of the additional insured policies should be evaluated so that the indemnification and defense obligations are understood at the outset. It is also important to know whether the coverage is subject to a reservation of rights.

You must also familiarize yourself with the laws of your jurisdiction with respect to additional insured endorsements and defense obligations. In states like California, standard comprehensive

liability insurance policies state that the insurer must provide for both the defense and the indemnification of suits brought against its additional insured as long as those suits are within the scope of the policy coverage. An additional insured endorsement obligates the insurer to provide defense until the end of the underlying lawsuit or until it has been shown that there is no potential for coverage. Similarly, under Florida law, an insurance company must defend an action where the facts alleged against the insured would give rise to coverage, even if the insurer is uncertain whether coverage exists under the policy.

### Contractual Obligations to Defend and Indemnify

After determining the additional insurance coverage provided by the subcontractors' insurers, the contractual obligations of the defense and indemnification provisions established in the separate subcontracts must be analyzed. In the absence of additional insurance coverage, the contractual language that establishes the defense obligations of the subcontractor to the contractor/developer is especially important. It is also critical to determine whether the subcontractor's insurer will cover the subcontractor's costs to defend the third party.

It is important to understand how your specific jurisdiction interprets contractual language with regards to a subcontractor's duty to defend. For instance, in *Crawford v. Weather Shield Manufacturing, Inc.*, the California Supreme Court held that, unless parties expressly state otherwise, indemnity provisions in a subcontract obligate the indemnitor to defend the indemnitee against any claims that might potentially implicate those indemnification provisions. The court held that this duty to defend is created at the moment of the tender of defense. Similarly, in Nevada, a subcontractor's contractual duty to defend arises when a notice containing a claim of construction defect that implicates

the subcontractor's work is sent to the subcontractor.

It is important to remember that it is not enough to simply evaluate the contractual obligations or policy limitations at the beginning of this process. These items require an ongoing analysis to determine how the facts discovered in pre-litigation proceedings might affect the contractual obligations or policy limits of all parties involved.

### Forming a Cooperative Defense

Once the insurance endorsements and subcontracts are evaluated, the first step in forming the cooperative defense is to tender all potential parties implicated in the plaintiff's original defect list. Early communication with the tendered parties regarding the desire to cooperate in the defense is critical to ensure maximum time and cost savings. Counsel for the contractor/developer with the assistance of a mediator should schedule a mediation exclusively for all the defendants for the purposes of establishing the parameters of the cooperative defense. At this mediation, the structure of the cooperative defense team can be established to suit the needs of the case. For instance, the parties might find it beneficial to structure the representation for the parties in such a way as to have all of the subcontractors share counsel, while the contractor/developer is represented in the joint defense by separate counsel.

The mediation also affords all parties the chance to contribute to the creation of a joint defense funding agreement. A joint defense funding agreement can be used to efficiently allocate defense costs amongst all of the parties. Varying methods of cost allocation can be utilized in these agreements, including: the equitable contribution of all parties; splitting the developer's share equally amongst the additional

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insured carriers; a time phase allocation, which readjusts the allocation of costs at different stages of the pre-litigation process; and a tier-based system based on the scope of each subcontractor's work, among other options. The parties should retain the services of a third-party administrator to record and apportion defense costs.

A joint defense funding agreement that establishes cost allocations offers advantages to both the contractor/developer's insurer as well as the subcontractors' insurers. For the subcontractors, a joint defense funding agreement can reduce administrative costs as well as ensure that each party is paying its pro rata share of the defense costs. For the developer, a joint defense funding agreement eliminates the burden of having to fund the entire defense up front.

### The Non-Participants

With all the time and money that can be saved through cooperation, there seems to be little incentive to opt out of a cooperative defense. Yet there will always be those who are skeptical or uncom-

fortable with this concept. Accordingly, you will want to have a plan in place to handle those who refuse to participate in a cooperative defense.

After the initial mediation and agreement, identify those parties that have refused to join the cooperative defense and the reasons for refusal to participate. Instead of battling a stubborn holdout from an adversarial position, it might be more beneficial to suggest that the party partially join the defense by contributing some portion of defense costs subject to a reservation of rights and reallocation as the case proceeds.

If a non-participant still refuses to join in the cooperative defense or join in the cost sharing, your next step would be to file a cross-complaint for indemnity or contribution. Another option is to simply ask the plaintiff to name the parties as direct defendants in the matter.

Claims professionals and defense counsel can greatly reduce the high costs typically associated with construction defect litigation and bring about a prompt resolution of claims through a carefully planned cooperative defense. Yet a careful assessment of the particular parties, their contractual obligations, and the jurisdictional laws must be undertaken prior to implementing any such plan. Early action and careful planning can help you effectuate an efficient cooperative defense that will save all parties time and money. ■

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