

So Many Defects, So Little Coverage

A practical guide to handling SB800 Claims & “Work” and “Product” Exclusions

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Panelists



Larry Kent, Panel Leader

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Insurance coverage



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Complex construction disputes



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Carrier perspective

Key Points

- ✓ **When do SB800 violations trigger coverage ?**
- ✓ **Assessing coverage on a case by case basis**
- ✓ **Pleading & mediation strategies**



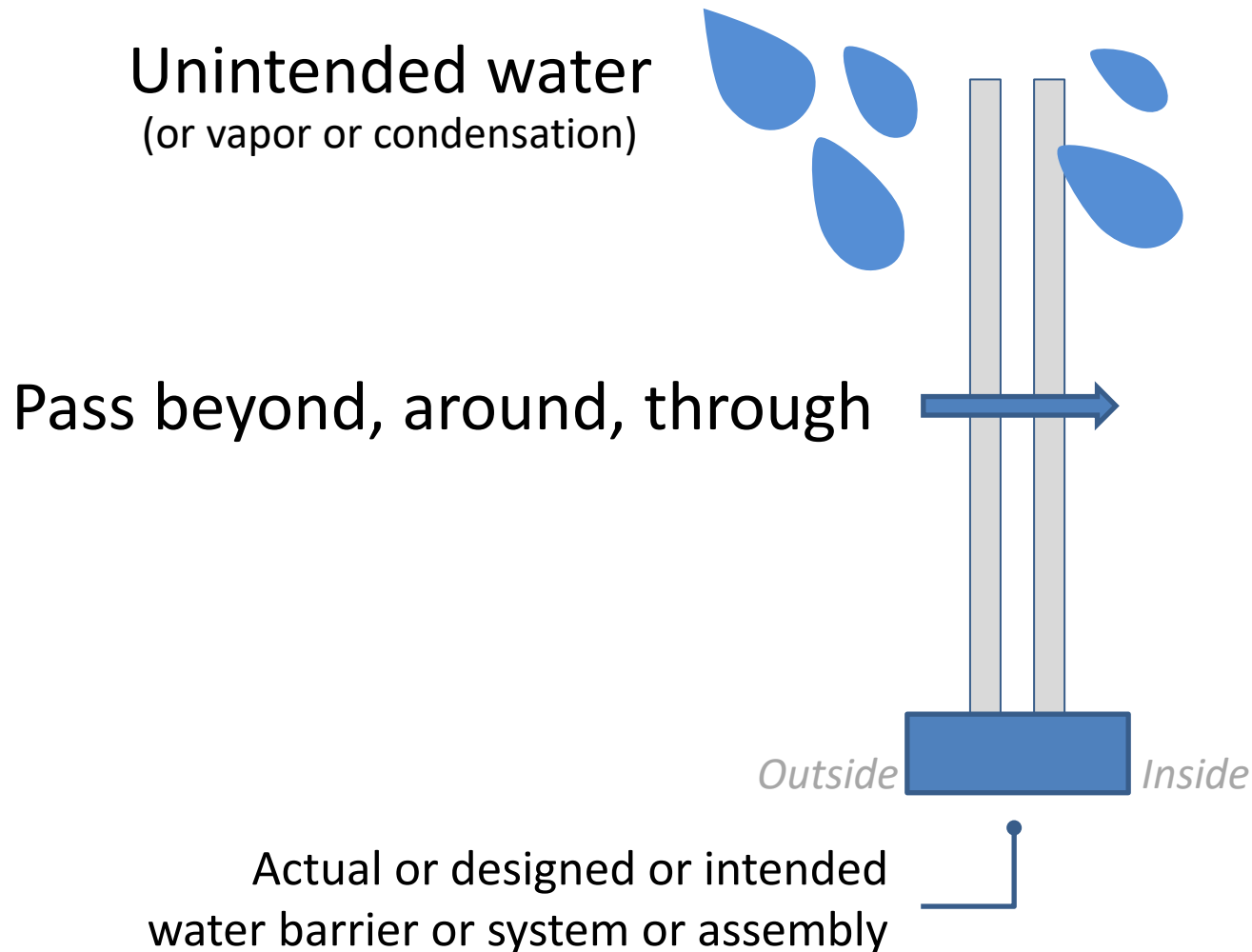
SB 800 Coverage Triggers

By the numbers

Analyzing SB800 for Triggering Language

- ✓ SB 800 language is not uniform
- ✓ Caution: must read each section carefully
- ✓ Look for express language e.g. “pass into adjacent structure” or “cause damage to another building component”

SB 800 Word Salad



- > Pass into adjacent structure
- > Come into contact with
- > Enter the structure
- > **and cause damage**
- > **So as to cause damage**
- > **Cause damage to another building component**

Carrier's Perspective

- ❑ Carriers must analyze and communicate covered vs. uncovered analysis to their insureds as soon as possible.
- ❑ Coverage position letters need to be timely and updated as facts develop

Analyzing Resultant Damage (R/D) in SB 800 Claims

896(a) (1) A door shall not allow unintended water to pass beyond, around, or through the door or its designed or actual moisture barriers, if any.

Resultant Damage Analysis:

- ▶ By its terms, this statute does not require resultant damage (R/D) to be actionable
- ▶ However, R/D may be inferred on a case by case basis

Civil Code § 896(a) ➔ Water Issues



Component	R/D Required?	Triggering Language
Doors 896(a)(1)	No	beyond, around, through
Windows, patio doors, deck doors 896(a)(2)	No	beyond, around, through
Excessive condensation 896(a)(3)	Yes	enter the structure and cause damage
Roofs 896(a)(4)	Maybe	enter the structure or to pass beyond, around, through the designed or actual moisture barrier
Decks, balconies 896(a)(5)	Maybe	allow water to pass into the adjacent structure
Decks, balconies 896(a)(6)	Maybe	allow unintended water to pass within the systems themselves and cause damage to the systems

Civil Code § 896(a) ➔ Water Issues



Component	R/D Required?	Triggering Language
Foundation systems 896(a)(7)	Yes	allow water or vapor ... so as to cause damage to another component
Foundation (floor) 896(a)(8)	No	so as to limit the installation of ... flooring materials
Hardscape 896(a)(9)	Yes	to cause water or soil erosion to enter or come into contact with the structure so as to cause damage to another building component
Stucco (water) 896(a)(10)	Maybe	beyond, around, through designed or actual moisture barrier of the system including internal barriers w/in the system itself
Stucco (condensation) 896(a)(11)	Yes	allow excessive condensation to enter the structure and cause damage to another component

Civil Code § 896(a) Water Issues



Component	R/D Required?	Triggering Language
Retaining & site walls 896(a)(12)	Yes	Unintended water to pass beyond, around, or through its designed or actual moisture barriers including, without limitation, any internal barriers, so as to cause damage
Retaining & site walls 896(a)(13)	No	shall only allow water to flow beyond, around or through the areas designated by design
Plumbing, sewer lines 896(a)(14)	Maybe	shall not leak
Plumbing, sewer lines 896(a)(15)	No	shall not corrode so as to impede the useful life of the systems
Sewer systems 896(a)(16)	No	installed to allow designated amount of sewage to flow
Shower and bath 896(a)(17)	Maybe	shall not leak water into the interior of walls , flooring systems, or the interior of other components
Ceramic tile 896(a)(18)	Yes	shall not allow water into the interior of walls, flooring systems or other components so as to cause damage

Civil Code § 896(b) → Structural Issues

Component	R/D Required?	Triggering Language
Foundations, load bearing components & slabs 896(b)(1)	No	shall not contain significant cracks or significant vertical displacement
Foundations, load bearing components & slabs 896(b)(2)	No	shall not cause the structure, in whole or in part, to be structurally unsafe
Foundations, load bearing components, slabs and underlying soils 896(b)(3)	No	constructed to materially comply with the design criteria set by applicable government building codes, regulations, and ordinances for chemical deterioration or corrosion resistance in effect at the time of original construction

Civil Code § 896(c) ➔ Soils Issues

Component	R/D Required?	Triggering Language
Soils and engineered retaining walls 896(c)(1)	Yes	shall not cause, in whole or in part, damage to the structure built upon the soil or engineered retaining wall.
Soils and engineered retaining walls 896(c)(2)	No	shall not cause the structure, in whole or in part, to be structurally unsafe.
Soils shall not cause, in whole or in part 896(c)(3)	No	the land upon which no structure is built to become unusable for the purpose represented at the time of original sale by the builder or for the purpose for which that land is commonly used.

Civil Code § 896(g) ➔ Other Areas of Construction

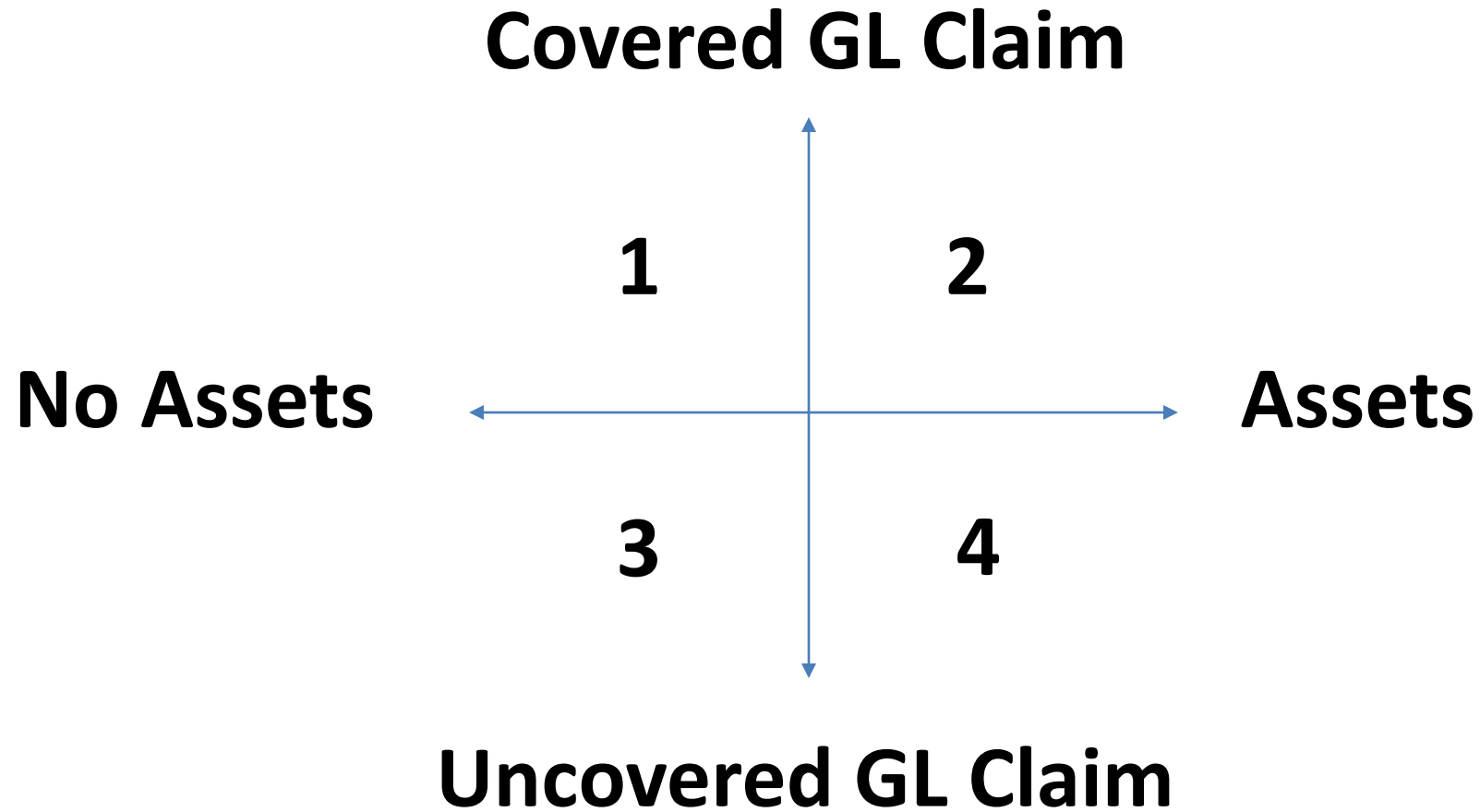
Component	R/D Required?	Triggering Language
Exterior pathways, driveways, hardscape, patios 896(g)(1)	No	shall not contain significant cracks or separations
Stucco, exterior siding, and other exterior wall finishes 896(g)(2)	No	shall not cause the structure, in whole or in part, to be structurally unsafe
Irrigation systems and drainage 896(g)(7)	Yes	shall operate properly so as not to damage landscaping or other external improvements

Commercial Builder with Assets



- ▶ Wrap or Separate GL Policies
- ▶ No coverage, no problem, if defendant has assets.
- ▶ Ex. These are not “property damage” under CGL Policy:
 - Noise attenuation
 - HVAC insufficient
 - Seismic code violations

Mass Builder with Assets



Builders Risk: LEG* 1, 2, & 3 Exclusions



- ❑ Some Builder's Risk policies provide first-party coverage for damage to insured property arising from an error or defect, if the damage is caused by an insured peril that ensues from the error or defect.
- ❑ In the 1990's, LEG developed three exclusions, LEG1, LEG2, and LEG3.
- ❑ Though LEG 1,2&3 are properly "exclusions", they actually provide coverage

** LEG stands for London Engineering Group, a part of the Association of British Insurers. Sometimes referred to as endorsements, LEG 1,2&3 are exclusions.*

Builders Risk — LEG 1, 2, & 3 Exclusions



Comparison of costs covered by each level of LEG wording

	LEG 1	LEG 2	LEG 3
Costs to remedy defects where no damage has occurred	Red	Red	Red
Costs to remedy resultant damage due to defects	Red	Green	Green
Costs to remedy resultant damage to property supported by defective property	Red	Green	Green
Costs to remedy defective property	Red	Yellow	Green
Costs to remedy defective part, portion or item	Red	Red	Green
Loss, damage or costs incurred to access defective part	Red	Red	Green
Costs to improve original design, plan, specification, workmanship or material	Red	Red	Red

Red	Typically Excluded
Yellow	Possible - Depends on Circumstance of Loss
Green	Typically Covered

Source: IRMI Construction Risk Conference

Policy Types



All policies are
not created equal

Project Type



Commercial Claim
Considerations

Project Type



Residential Claim
Considerations



Developer Considerations

- Type of Project- Residential or Commercial/Industrial
- Progress of Project
 - Status of Completion & Completion Dates (Multiphase Project)
- Insurance - WRAP/GL Applicability & Limits
- Evaluation of Standards/Repairs
- Indemnity & Risk Transfer



Developer Considerations

- OCIP/CCIP policy doesn't change coverage if defect hasn't resulted in property damage.
- Some wrap policies remove the "your work/work product" exclusions.
- Some wrap policies remove "ongoing ops" and only leave "completed operations"
- CGL policy not intended to do provide coverage during course of coverage
- Had CGL policy that did not provide for defense obligation but had "ongoing operations" coverage

Plaintiff's Perspective

- ❑ Evaluate ROI on client's lawsuit
- ❑ Advise client of impact of lawsuit on property
 - ❑ Stigma & Civil Code § 1102
- ❑ Pleading considerations in light of covered vs. uncovered claims
 - ❑ Fraud claims
- ❑ Dealing with defense counsel who focus on the carrier as their "real" client



Coverage and Express Indemnity

- Don't forget express indemnity rights are separate from insurance
- Caveat:** express indemnity void when Wrap coverage applies for residential construction projects
 - Cal. Civil Code § 2782.9 — what are its implications?
 - Ans: no one knows — there is no reported decision interpreting the application of this statute

CIVIL CODE § 2782.9



Construction contracts **on which wrap-up insurance policy applicable; Agreements indemnifying another from liability void**; Equitable indemnity; Waiver or modification, Cal Civ Code § 2782.9

Summary

- (a) **All contracts**, provisions, clauses, amendments, or agreements contained therein entered into after January 1, 2009, for a residential construction project **on which a wrap-up insurance policy**, as defined in subdivision (b) of Section 11751.82 of the Insurance Code, or other consolidated insurance program, **is applicable, that require an enrolled and participating subcontractor or other participant to indemnify, hold harmless, or defend another** for any claim or action covered by that program, arising out of that project **are unenforceable**.
- (b) **To the extent any contractual provision is deemed unenforceable** pursuant to this section, **any party may pursue an equitable indemnity claim** against another party for a claim or action unless there is coverage for the claim or action under the wrap-up policy or policies. Nothing in this section shall prohibit a builder or general contractor from requiring a reasonably allocated contribution from a subcontractor or other participant to the SIR or deductible required under the Wrap ...



Mediator's Perspective

- Understand the coverage positions of the carriers: what is covered, what is not covered
- Is there joint and several liability – focus on covered claims
- Exchange documents, photos, expert investigation reports focusing on covered damages
- Identify the driving issues and parties in the case – parties that must be part of a global resolution
- Focus on non-covered claims such as fraud or breach of contract that may encourage early settlement
- Identify other potential claims, parties or insurance not part of WRAP



Mediator's Perspective

- ❑ Find creative solutions such as assignment of claims, parties, insurance
- ❑ Talk to non-parties or parties without insurance/assets to fill in scope of work, sequencing, and other factual support of claims. Exchange of information is the pathway to resolution.
- ❑ Narrow focus on parties, claims and damages that are viable; joint and several liability may make these claims uber valuable
- ❑ Establish worst case/best case scenarios for cost of defense/prosecution vs. potential verdicts and recoveries (given insurance and collectability limits)
- ❑ Determine realistic range of settlement based on all above factors and work hard to achieve optimum result for least cost/time/effort

Carrier's Perspective

- Importance of carriers to communicate coverage issues (appropriate reservation of rights) early and often to the insured, broker and mediator to allow time for parties to address what funding is available for certain defects and where that funding is coming from.
- If insured insolvent, plaintiff must be aware of coverage issues as it will impact how the plaintiff directs its claims and manages the expectations of its client.
- If appropriate, carrier may need to file a DJ to address the coverage issues. These are typically stayed while the underlying matter is pending so best to defer these to avoid complicating settlement.
- Be sensitive to the total cost of risk which includes defense costs. Even if coverage defenses are strong, if a duty to defend exists you must factor in the impact of this on your settlement analysis. This has greater importance if AI also at issue.
- Be sure to evaluate choice of law if the insured and policy were delivered in a state other than the state where the litigation/project is located.

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