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The Complexities of Maneuvering Through a Commercial Catastrophic Loss Claim

1. Complexities of a pre-suit catastrophic commercial construction loss

Sudden catastrophic commercial construction events, including building collapse and plumbing and mechanical failures, often require immediate intervention. Unique claims handling issues are presented, including determining whether a defense is owed and defining who the "insured" is before pleadings are drafted. While insurers struggle with whether to defend, emergency repairs by claimants are often necessitated. Lack of focus on capturing forensic documentation can impair the defense's subsequent exposure analysis and risk transfer efforts. Consider the benefits "controlling the narrative" could have by engaging counsel and experts to retain vital evidence that might otherwise be destroyed during claimant's remediation. Effective risk transfer pursuit is further complicated when downstream contractors and their respective carriers refrain from participating until suit is filed and defense counsel is faced with weighing the benefits of issuing expert reports before claimant may have presented the full scope of the claim. Defining the claim can also be convoluted if the claimant continues to expand not only the alleged defects, but also the damages model, including delay claims and lost income. Additional wrinkles can occur when controlled insurance programs are at play, or in determining whether commercial general liability and/or builders' risk is implicated. Moreover, the implications of how the excess carrier engages in the claim could make the difference between early resolution or heated and expensive litigation.

a. Immediate intervention often necessary

Building collapse, plumbing burst, crane failure, balcony shearing … these are all examples of potential catastrophic losses that require immediate intervention from multiple resources. Local and even state agencies, owners, tenants, and the surrounding community immediately complicate the event, with multiple layers of demands to the insured. The insured may be required under the law, or subject to contractual requirements, to engage in immediate clearing of rubble, demolition of unsafe conditions, or expedited repairs. Such losses do not lend themselves to the typical path of claims handling. Rather, claims handlers are often faced with insureds urgently tendering such a loss and then expecting immediate intervention and assistance from the insurance carrier. Moreover, such claims may have also resulted in bodily injury, instantly complicating the claims handling process.

b. Unique claims handling issues presented.

i. Determining whether a defense is owed.

While the insured is receiving a multitude of demands to engage in remediation or repairs, the claims handler often receives the urgent request to intervene and fund the process. Catastrophic loss claims are often tendered to the insurer immediately and well before any suit is ever filed. A claims handler is faced with receiving a tender on a loss where the insured has not been sued. The insured is seeking the carriers' intervention to fund the remediation or repairs, creating the question of whether a defense is even owed or whether coverage is even triggered under the policy.

ii. Defining who the "insured" is before pleadings drafted

To further complicate the claims handler's analysis, the suddenness of a catastrophic commercial construction loss can create confusion as to which named entity may be alleged responsible for the defects and damages. Obtaining the pertinent contracts is essential in determining not only privity relationships between the parties, but also the scope of work performed by the insured in cross-reference to the policy of insurance procured.

c. Impact of sudden remediation efforts upon claim handling and defense

i. Emergency repairs

Emergency repairs are often required when a catastrophic commercial construction loss occurs. Building or partial building collapses can create unsafe conditions to the surrounding area. To secure the public's safety, local and state governments can demand insureds immediately demolish and remove debris, as well as quarantine the area to reduce the potential for further damage or injuries to those that might have access to the location. Costs can surge quickly, as efforts are deployed to rectify the situation. Twenty-four-hour security guards or fire marshals can be an unexpected but a costly increase to the damages model.

ii. Lack of forensic documentation

When a catastrophic commercial construction loss occurs, the focus is often on securing and protecting the area, as well as repairing it, for example, to stop a massive pipe burst that is flooding the entire building and its tenants' property. More damage can be created every hour that passes. Forensic documentation should be considered a major factor in the process of the claims handler's investigation. Causation is often a multi-faceted question involving multiple trades on the

construction project. Claims handlers are faced with tenders of defense and indemnity when causation and allocation of fault have not even been determined.

iii. Impact upon exposure analysis

Analyzing exposure is often met with a maze of impediments such as lack of forensic review by an expert consultant, lack of documentation, potential spoilation of evidence, and lack of an attorney to assist the claims handler through the morass of demands being made to the insured. Contractual obligations, additional insured issues, code requirements and standard of care all must be considered in the analysis of exposure. However, pre-suit matters only present an opportunity for the parties to voluntarily cooperate with one another versus the more formal avenues of written discovery and depositions once suit is filed. Incomplete documentation and lack of evidentiary support needed for exposure analysis makes it difficult to determine if the remediation and repair efforts being proposed are reasonable or necessary as the urgency to address the defect and damages can create disregard for those issues otherwise at the core of defense analysis.

iv. Risk transfer challenges

Lack of documentation from the insured often impedes the risk transfer process. Insureds are focused on the remediation and repair efforts thus they often do not consider the need to produce their job files, much less their insurance information to the claims handler or attorney assigned to represent the insured. Questions as to "who else might be implicated" can be met with resistance from an insured, citing business relationships and expectations that the insurer will simply intervene and take care of funding efforts to resolve, remediate and repair the defects and damages without further questioning. Moreover, first party insurance may be at play, already funding portions of the loss, especially when tenant's property has been damaged. Trying to quantify the first party carrier's involvement, scope of the first party loss, any duplication of damages being asserted related thereto, and potential for subrogation further complicates the claims handling process.

d. Control the narrative.

i. Timing of retaining counsel and experts.

Catastrophic commercial construction losses typically present large loss numbers. The need to retain expert consultants to engage in analysis of causation and to assist with preservation of the evidence prior to remediation and repairs is often essential in the equation of exposure assessment and risk transfer pursuit. Engaging counsel to secure protection of the expert's opinions should be strongly weighed against the notion that a defense might not be triggered yet. The risks of retaining an expert only to learn that the insured may have substantial fault,

without counsel attached, can be detrimental. Assigning counsel to retain the forensic consultant, discuss defense strategy and evaluate contractual obligations, along with assessment of risk transfer options often results in substantial cost saving to the insurance carrier in the long term.

ii. Weighing the risks and benefits of issuing pre-suit expert reports

Once defense counsel is retained, a determination of the scope of expert retention should be made with counsel. The contractual defense and indemnity obligations between the parties involved, as well as the goals or objectives of the parties and their insurers, should be holistically evaluated to determine whether pre-suit expert reports will be produced. That determination often rests on whether defense counsel recommends a joint scope and cost of repair be considered with the other parties, as well as whether the experts' opinions are helpful to the resolution process. Withholding of expert opinions that could be construed as detrimental to the insured's exposure analysis if the case proceeds to formal litigation will need to be evaluated with counsel.

iii. Expansion of defects

While the catastrophic loss triggers certain identified damages, the event may reveal other potential defects. Determination of whether to issue expert reports related to the catastrophic loss when the claimant may potentially expand its list of defects should be closely assessed. Expert's opinions could be altered with the emergence of new information and invasive testing and inspections, including an expanded view of allocation of responsibility allowing for a more robust risk transfer push.

iv. Expansion of damages model

Claimants incurring damages in a commercial construction catastrophic loss are often unable to evaluate the full scope of their damages early in the process. Rather, catastrophic losses can result in protracted expansion of the claimant's damages model, even if the insured immediately intervenes to engage in remediation and repairs. Often such repairs can be temporary, serving only to stop the expanding property damage, allowing for a more comprehensive long-term repair to be determined later once experts evaluate the full scope and extent of the cause of the event. Diminished property values, delays in the timing of the projects completion and relocation of tenants can drastically increase a claimant's damages model, which often cannot be fully determined until after temporary remediation efforts are undertaken.

e. Pre-suit resolution efforts

i. Resolution by claim handler or attorney

Catastrophic commercial construction losses are often financially significant enough for a claims handler to consider retaining counsel to assist in exposure analysis, risk transfer pursuit and pre-suit resolution efforts. However, if a claims adjuster finds the loss to be nominal to their specific insured, be cautious in entering into release language as it may not be as comprehensive as intended.

ii. Defining scope of claim being released

Exposure of a catastrophic commercial construction loss lends itself to the likely necessity of counsel being retained during the pre-suit phase and to negotiate and draft any settlement agreement and release. Defining the full and complete scope of the release as part of the settlement is critical in order to prevent settlement funds being levied only to be faced with another leg of the same claim in the future. Even if counsel is not retained as part of the discovery and exposure analysis phase, claims handlers should consider retaining counsel to draft the settlement agreement and release to ensure that the scope of the claim being funded is the same as what all parties understand the scope of the claim to be. Caution is warranted when piecemealing a settlement to address certain portions of a claim, as such can lead to confusion in the release language itself, as well as setting of a precedent for how the other parties allocate any future settlement, or whether they participate at all. Any partial settlement should be critically reviewed and analyzed to articulate not only what is being settled, but also what is being excepted from the agreement to add further transparency.

iii. Incentives to participate in resolution efforts.

While the contractor at the center of the dispute is often more likely to engage and be responsive to demands for remediation and repairs, funding that process could be problematic without the carrier's assistance. Opting not to facilitate remediation and repairs prior to litigation could result in the claimant funding such efforts at an unreasonable cost and based upon an unnecessary scope. Claimants will contend that "they had no choice" but to engage in the scope and cost of repair because the insured and its carrier refused to participate. This can be detrimental to the defense argument that other alternative measures could have been engaged in which would have otherwise reduced the damages.

Moreover, catastrophic commercial construction losses typically increase from a damages' perspective, as loss of use, diminution in value, relocation of tenants breed an onslaught of economic damages increasing the monetary value of the claim. Delaying intervention to controlling the narrative typically only increases the exposure to both the insured parties implicated and their insurers.

Downstream subcontractors and their respective insurers are also difficult to engage in the pre-suit process of remediation and repairs. Tender early to both the downstream subcontractors and their carriers and invite them to participate in the investigatory process, inspections, and any resolution process. Should they continue not to engage, defense counsel may want to consider discussing with the insured the possibility of assigning to claimant any contractual rights of the insured to any recalcitrant downstream contractors to assist in further funding any efforts to resolve the matter before formal litigation commences. If assignments are considered, a close review of any contractual obligations to others which could result in bringing the insured back into the matter is needed, or a potential defense and indemnity agreement by the claimant to the insured, while difficult, might be in order.

2. Contractual considerations arising from a pre-suit catastrophic commercial construction loss

a. *Indemnity and Defense*

i. Contractual Indemnity

Contractual indemnity is one of the most effective methods of risk transfer utilized in construction contracts. Whether the client or insured is up or downstream, evaluating the indemnity provisions of the contract at issue is key to determining whether there will be an option to either transfer or at least share the risk if the contractor is upstream, or if the insured is downstream, whether the client will have increased exposure.

Tenders of the insured's defense and indemnity under the contract are typically the initial step to triggering a downstream contractor's obligation to share in the risk. However, with the onset of the Anti-Indemnity Statutes across the country, the scope of risk being tendered as to certain types of claims is often modified to only the Subcontractor's scope of work, or only for injuries to specific workers downstream. Additionally, a General Contractor may not want to tender or even pursue via litigation its risk to its downstream contractors, often citing to business relationships. Discussing with the insured the impact not pursuing an implicated downstream contractor could be different from the strategy the contractor's insurer may have in its litigation plan.

Pre-suit litigation makes this issue even more difficult in that clients often do not have their files and documents in order, do not know where the written contracts are or sometimes whether they even have written contracts. Because there is no formal discovery process in pre-suit claims, claims handlers or counsel are limited to documents produced by the client/insured, which are often initially incomplete. This makes it difficult to determine scopes of work of contractors, privity relationships, the existence of any change orders or sub-subcontractors and whether the upstream contractor holds any privity relationships with any design professionals. Tendering to design professionals can be particularly challenging, as professional liability policies are time sensitive. Design professional contracts can also include reverse indemnity agreements whereby

the contractor may be required to indemnify the design professional, resulting in a tender from the design professional back to the contractor.

ii. Additional Insured Tenders

While contractual indemnity is being pursued, practitioners representing upstream contactors must not forget to pursue separate tenders under additional insured obligations. Finding the client's certificates of insurance and policies is a challenge in litigation but trying to access that documentation from the insured in the pre-suit stage is even more daunting. Anti-Indemnity Statutes can also have a significant impact on certain cases, leaving the state of recovery by an upstream contractor for defense fees and costs questionable under the law.

b. *Impact of Anti-Indemnity Statutes*

i. Know your state.

Nearly every state in the union has either an anti-indemnity statute or case law which attempts to define the scope of recovery of an upstream contractor against a downstream contractor. Gone are the days in construction defect claims when upstream contractors could assert indemnification for both their active and passive negligence, and in some states even sole negligence had been permitted under contract. Instead, the vast majority of states have narrowed the scope of an upstream contractor's indemnification by a downstream contractor's scope of work or negligence. A downstream contractor will frequently argue that the scope of what it is required to indemnify the upstream contractor for has not been determined in a pre-suit matter and must be adjudicated before the upstream contractor can fully assert its rights under the contract.

Moreover, states will often have variations in their statutes or case law which require special insight into how they may impact the insurer's ability to recover. Some states only have anti-indemnity statutes which apply to residential versus commercial construction litigation. States, such as Texas, may also allow for continued contractual risk transfer by way of an over-action claim to the downstream contractor or employer of the injured party, even if the upstream contractor's sole negligence is involved. This may lead to the drafting of separate indemnity provisions within a construction contract of an insured, to address the broader scope of indemnification allowed under the law for bodily injury claims versus property damage.

States, such as California, may carve-out the anti-indemnity statute from additional insured, while other states, like Texas, may specifically apply the full weight of anti-indemnity to a downstream contractor's additional insured obligations, limiting the endorsement for property damages to that arising from that downstream contractor's own negligence or fault. Such restrictions make recovery under a pre-suit additional insured tender extremely challenging. Anti-indemnity statutes often serve to further complicate the upstream contractor and its insurer's effort to include downstream subcontractors into the pre-suit process, potentially placing an insurer in the

position of deciding whether to "pay and chase" to cap the loss, risking inability to recover those funds subsequently.

ii. Insurance industry's response

In an attempt to respond to the complexities of the varying state anti-indemnity laws, ISO issued its newest additional insured endorsement form in April of 2013. Form CG 20 38 04 13 (ongoing operations) and CG 20 37 04 13 (completed operations). These endorsements were seen by many as an attempt to avoid the necessity of "state specific" additional insured endorsements in order to comply with respective anti-indemnity laws. ISO's 2013 form reveals an increased focus on aligning scope of coverage with contract terms requiring additional insured coverage. The attempted impact of the 2013 form is to (1) restrict coverage to the extent permitted by law; and (2) restrict coverage scope to that which is required by contract. This form makes it even more imperative that additional insured requirements be clearly delineated in the contract. However, how those requirements are to be delineated is flagged with caution for those contracts impacted by the anti-indemnity statute.

3. Coverage issues triggered

a. *Tender and allocation issues*

Insurers in catastrophic construction matters are wise to act quickly to fully understand and involve all of the parties and duties of implicated parties and their insurers. It is paramount that people who are experienced in complex construction matters involve themselves on behalf of at least the primary layer of insurance. For this reason, primary carriers and some excess carriers often hire both coverage counsel and monitoring counsel to fully explicate all of the insurance and indemnity issues.

The first and most immediate job for the insurers is to make sure that all potential parties and insurers have received an appropriate tender of insurance. Even to get a basic understanding of the contractual obligations involved will be difficult for insurers or coverage counsel to do without the cooperation of pre-suit counsel and the insureds themselves. To this end, it is imperative that lines of communication with both attorneys and insured representatives be started almost immediately after the claim is reported. This often requires pre-suit counsel be appointed, even before all of the potential coverage and allocation issues are fully understood. In these situations, almost regardless of the jurisdiction, insurers will be wise to issue a reservation of rights letter that plainly explains as many of the potential coverage limitations as might eventually be presented by the case. Some states (e.g., Georgia, Louisiana, Alabama, and Missouri) absolutely require that the reservation be sent prior to pre-suit defense counsel taking any action on behalf of the insured.

Insurers will want to quickly work with pre-suit defense counsel to identify as many potential contractual (indemnity and insurance) obligations that are owed to and by the insured. This will require copies of contracts and as many insurance policies as can be acquired. Often, it makes sense for an experienced claim representative to call her counterpart at other insurers to "team up" to acquire and disseminate all relevant policies and contracts.

Once the documents are obtained, the insurer will need to make appropriate judgments as to who owes what, both as to indemnity and defense. Tenders to all of the pertinent parties and insurers will need to follow that analysis. Insurers should be mindful that in some states (e.g., Texas), insurers will not accept a tender of defense from another insurer, so it may be necessary to work with pre-suit counsel to tender to another insurer. Part of the tendering process will necessarily involve assessing an appropriate allocation, initially of the defense obligations but eventually of any indemnity obligations. Insurers are wise to state their tentative conclusions in this respect in letters sent to insureds and other parties and their insurers. One of the most fundamental problems faced in early mediations in these kinds of cases is that the parties and insurers do not know (and often have not even formulated) the coverage and indemnity positions of the other necessary players. Beyond simple tender letters, it is crucial for insurers to let others know what they have concluded as to the appropriate allocation of coverage and indemnity.

b. CGL, Builders Risk or OCIP/CCIP

One of the initial questions for insurers and their insureds will be to assess the nature of the coverages provided, i.e., CGL, Builder's Risk or OCIP/CCIP. Sometimes, all three of these forms of coverage will exist within the context of a single catastrophic claim. "Stacking" and harmonizing these potential coverages is fraught with complex legal and factual issues, particularly when there are commensurate or conflicting indemnity obligations. Again, having competent coverage counsel involved early on can sometimes be crucial to sorting these issues out before they become serious impediments to the orderly resolution of the case.

In general, CGL insurers will not participate in either defense or indemnity of an insured if there is a builder's risk policy in place. Builder's risk policies provide coverage for accidental loss or damage to a contractor's work and physical property (including equipment, materials, and supplies) that occurs during the course of construction. Often the underlying project contracts will require that certain parties acquire builders risk insurance that cover some or all of the project. Commonly, the owner will acquire such coverage, though it is intended to cover the interests of the owner, general contractor, and subcontractors. Since this coverage pays without regard to responsibility of the respective policies, it is often useful in the context of catastrophic accidents. After an accident, however, it is often the case that subcontractors will be asked by the owner or general contractor to invoke their own CGL coverage instead of builder's risk. This presents a frequently and problematic coverage issue. CGL insurers almost never will not pay for damage when there is a builder's risk policy in place because standard "other insurance" clauses will, at most, make the CGL insurer excess of the builder's risk. Some CGL policies actually exclude

claims involving builder's risk. Wishing to avoid the negative impact of loss history, subcontractors and their counsel often will themselves prefer that the builder's risk policy pay instead of their individual CGL policies. Particularly when an owner or general contractor have a contractual obligation to obtain builders risk coverage, any attempt to avoid invoking that policy itself can amount to breach of contract.

Introduction of an OCIP or CCIP policy into the mix of insurance can present similar issues to the builder's risk scenario. Like builder's risk, OCIP and CCIP policies are programs that apply to a particular jobsite or major project. Most of these programs contain workers compensation, general liability, and umbrella/excess coverage applicable to owners, general contractors, and subcontractors. Because they are often purchased for large projects, these programs can frequently be implicated in catastrophic losses. Unlike builder's risk, these "wrap up" programs often extend the expiration date of the coverage for several years so as to capture damage within the products completed operations hazard. As with builder's risk, CGL insurers almost universally either exclude coverage or make themselves excess where OCIP or CCIP programs are implicated. One of the key initial questions will be for insurers and counsel to ascertain which insureds are actually enrolled in the coverage. If a contractor is not actually enrolled (and they often need to take affirmative steps to do so), the OCIP/CCIP will not provide protection and a CGL policy may actually apply. Regardless, insurers and insureds both will need to map out the appropriate order of coverage at the outset of the claim to ascertain whether and how any CGL policies will participate with "wrap up" programs.

c. Excess carrier participation

Excess carriers are often loathed to become active until and unless there is some immediate indication that underlying insurance may exhaust. In the case of catastrophic loss, this reflex can be highly prejudicial to the interests of that excess carrier. Catastrophic claims often present losses that equal or are in excess of all of the available coverages. In these cases, excess carriers must not only become active earlier, but it may be crucial for them to become active in assessing and managing the claim almost immediately. In practical terms this means that the excess carrier should quickly consider employing a number of actions, including the following: (1) retain monitoring counsel to assess the liability and potentially triggered damages and to report on day to day activities in the development of the claim, (2) interact with the primary carrier to develop common strategies to address and potentially resolve the claim, (3) interact with any pre-suit counsel hired by the primary carrier regarding any assessment of liability and damages, (4) interact with other excess carriers about their assessment of the claim, and (5) where it would be appropriate, consider organizing early settlement discussions including mediation. Critically, then, excess carriers need to have mechanisms to identify and take immediate actions in these kinds of cases.