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Science or Fiction – The Art of Allocation in Claims

I. Is it really Science? Or is it fiction, magic, or guesswork?

The Problem

In construction claims, allocating damages among multiple trades whose work is implicated in a construction defect is complicated to say the least. The Plaintiff has the burden of proof at trial to show a causal connection between a defect and a responsible party. But in construction cases, the work of many trades typically overlaps each other and allocating damages among these potentially responsible parties can be extremely challenging.

The crux of the problem is establishing a reasonable basis for allocating damages when the damages are often indivisible or hopelessly intertwined such that a reasonable allocation is not feasible. If a defect exists, it's not the Plaintiff's fault that the damages can't be easily separated but the Plaintiff must carry the burden of proof to establish the claim. Some trial courts require the Plaintiff or a Third-Party Plaintiff (general contractor or developer) to allocate damages among multiple defendants (typically subcontractors). Some trial courts will shift the burden of proof to the Defendant once the Plaintiff makes a prima facia case of liability. Courts vary in how they address these problems.

The Claims Arenas Affected

The allocation of damages has ramifications among the entire spectrum of claims evaluation, handling, negotiations and litigation:

1. Exposure Analysis
2. Insurance Coverage – Time on the Risk
3. Selection of Experts - Qualifications
4. Litigation

    - Depositions
    - Pretrial Motions – Motions in Limine and Rule 702 Challenges to Experts
    - Trial – Burden of Proof and Admissibility of Evidence
    - Jury Instructions

5. Negotiations – How are allocations used? Who benefits? How can the allocation be challenged and used in negotiations?

II. The Wild West – No Established Methodologies

What are the methodologies used to allocate damages? Is there a reliable or scientific method that an "expert" can use that can be reasonably understood and evaluated? Are there verifiable methods or is it simply the subjective, biased opinions of paid experts who will advocate for a construction trade?

More importantly, is this method productive in resolving claims and lawsuits in a legitimate and equitable manner? Expert opinions should be supported by reliable evidence and based on sound scientific principles. Now, there are no consistent or agreed up methods and repair costs are often allocated to the party with the with the deepest pockets. Allocating damages to the party with insurance or deepest pockets is unfair and undercuts the credibility of the allocation expert.

Some Allocation Methods:

1. Subcontractor Scope of Work – Amounts Paid under the Contract
2. General Contractor – Amount of Profit/Mark-up
3. Equal Shares Among Overlapping Trades
4. Design Professionals – Different Methods to Allocate?

III. Real Word Example – Water Leak Around Window

A water leak behind a window provides a good example of how design and construction defects might contribute to the same defect and damages.

Potentially Responsible Party	**Negligence**
Architect:	Improper Design or Specifications or poor product selection (i.e., wrong stucco for climate, wrong interface between dissimilar materials, poor building paper)
General Contractor:	Poor oversight, improper sequencing and/or Poor Subcontractor Selection
Framing Subcontractors:	Poor framing or improperly Installed Flashing
Stucco Subcontractor:	Improper Application
Window Manufacturer	Poor Design or Inadequate Instructions
Developer	Failed to Fix Problem before Sale

How can damages be reasonably and credibly allocated among these diverse trades? What different approaches can an expert use to shift liability between these diverse trades?

IV. Claims Implications

1. Insurance Coverage - Time on the Risk Assessment

Some insurance, like a commercial general liability policy held by a contractor, provide coverage based on when the injury occurred. This type of policy is considered an "occurrence" policy. Other insurance, such as errors and omissions policy (typically design professionals), provides coverage based on when the claim is made. This type of policy is called a "claims made" policy.

Allocating the risk between separate policies when the damage is continuous is difficult. Typically, when the damages are ongoing, as in the case of corroding or decomposing building components because of a water leak, coverage may be had under each occurrence policy in effect since the injury was first occurred. The process of dividing liability under such a coverage scheme is referred to as "time-on-the-risk." (See Time on the Risk Spreadsheet, **Exhibit 1**).

While the calculus of the time-on-risk can be complicated, its primary purpose is to equally divide risk among policies so no one policy is exposed to a greater risk to enhance coverage.

2. Insurance Coverage – Damages Assessment:

General liability policies generally only cover "resulting damages." However, jury verdicts often do not specify with precision the type of damages or how they arrived at their damages award. These issues can sometimes be resolved using "special interrogatories" that juries answer to can address questions of covered versus non-covered damages. Comprehensive allocation reports can assist the claim handler on the insurance coverage analysis.

3. Claims Liability Analysis

How do allocation reports help the analysis of the claim? Are there instances when an allocation report hinders the analysis?

V. Litigation Implications

1. Evidentiary

Evidence that is speculative is not admissible. Trial courts are the gate keepers to evidence that is admitted at trial. Courts evaluate the quality and quantity of the evidence to determine admissibility. Trial court have wide discretion in determining admissibility, although this latitude is limited by established general rules of evidence. In addition, jury Instructions in most states have a standard instruction advising them that their verdict cannot be based on speculation. On the other hand, Pro Rata Liability statutes require a jury to allocate damages among multiple defendants, or other "non-parties" by assigning a percentage of total damages to each party. The allocation must be based on the evidence and cannot be arbitrary. But a jury's verdict only needs to be based on some evidence and a jury's conclusion will not be reversed on appeal unless there was no evidence to support the verdict. This is a low standard.

2. Expert Qualifications

What makes a someone a qualified allocation expert? Do they need actual experience as a builder, general contractor or construction manager? The best expert should have experience with many different trades and understand all aspects of construction including supervision, sequencing, selecting capable subcontractors, materials, design and product selection. This will enable the expert to withstand challenges to their qualifications at depositions or trial.

3. Challenging Experts' Qualifications or Methods - Rule 702 Challenges

The typical method to challenge an expert's qualifications prior to trial is through a pretrial hearing often called a "Rule 702" or "Daubert" hearing. The procedure is called a "Daubert" hearing because Federal Rule 702 was amended due to the Supreme Court's decision in *Daubert v. Merrell Dow Pharmaceuticals, Inc*., 509 U.S. 579 (1993)). Most states have adopted similar versions of Rule 702, but for the purposes of a general discussion, Rule 702 states:

> A witness who is qualified as an expert by knowledge, skill, experience, training, or education may testify in the form of an opinion or otherwise if:
>
> **(a)** the expert's scientific, technical, or other specialized knowledge will help the trier of fact to understand the evidence or to determine a fact in issue;
>
> **(b)** the testimony is based on enough facts or data;
>
> **(c)** the testimony is the product of reliable principles and methods; and
>
> **(d)** the expert has reliably applied the principles and methods to the facts of the case.

The general rule is to allow expert testimony and 702 challenges are often denied or only result in orders that merely limit the scope of the expert's testimony. The presumption is that for most jurors, who are unfamiliar with the complex process of construction, it is helpful to have an expert explain the construction process, the means and methods used by various trades, and provide a reasonable basis as to how damages should be allocated between multiple defendants.

Rule 702 is broadly phrased. The fields of knowledge which may be drawn upon are not limited merely to the "scientific" and "technical" but extend to all "specialized" knowledge. Similarly, the expert is viewed in a general way as a person qualified by "knowledge, skill, experience, training or education." Therefore, qualified experts are not just experts in the strictest sense of the word (e.g., physicians, physicists, and architects), but also a larger group recognized as "skilled" witnesses, such as construction managers or cost estimators. These generalized standards of what constitutes an expert makes it relatively easy for some unqualified construction experts to serve as allocation experts.

The court in *Daubert* identified a non-exclusive checklist for trial courts to use: (1) whether the expert's technique can be or has been tested—that is, whether it can be challenged

in some objective sense, or whether it is instead simply a subjective, conclusory approach that cannot reasonably be assessed for reliability; (2) whether the technique has been subject to peer review and publication; (3) the known or potential rate of error of the technique; (4) the existence of standards and controls; and (5) whether the technique has been generally accepted in the scientific community.

V. Conclusion

Because there is no consensus on the methods of allocating damages among multiple defendants in construction cases, significant challenges and opportunities exist for the lawyers and claim representatives. On one hand, allocation reports can greatly assist in the evaluation and settlement of complex construction cases because they at least provide some basis for allocating damages. On the other hand, allocation reports can be quite frustrating because there is no consensus on how damage should be allocated, and the allocation is highly debatable. Some states have considered requiring a peer review process prior to allowing an expert's report to be used in litigation. However, until uniform standards are implemented, lawyers and claim handlers should scrutinize allocation reports and evaluate their credibility and admissibility in litigation.