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MEDIATING WITH THE THREE C's: CONSTRUCTION DEFECTS, COVERAGE AND CONFUSION

I. OVERVIEW OF CONSTRUCTION DEFECT LAWSUITS IMPLICATING COVERAGE ISSUES

Generally, construction defect lawsuits can be categorized by certain types of claimed deficiencies:

- Improper Design—Architects and engineers may design structures that do not work as intended. For example, a poorly designed roof may cause or contribute in causing water intrusion.
- Deficient Materials—Building materials may be defective, resulting in failure such as water intrusion being caused by the installation of damaged windows.
- Poor Workmanship—Deficiencies in the work performed by contractors, typically not in conformance with local building codes. As an example, the improper application of stucco can cause cracking which results in water intrusion.

The "typical players" in construction defect lawsuits frequently involve Condominium Associations and homeowners as plaintiffs, and general contractors, developers and design professionals as defendants. General contractor defendants typically assert third party claims against subcontractors under theories such as contractual and/or common law indemnity. A recent trend has developed in several jurisdictions, wherein general contractors are also asserting claims against the insurers of their subcontractors, seeking declaratory relief that the general contractor is entitled to additional insured coverage under the subcontractors' liability policies.

II. UNDERSTANDING COMMON COVERAGE ISSUES

One of the greatest impediments to a successful construction defect mediation can be participant or mediator lack of understanding of the coverage provided by CGL policies. Coverage issues that typically arise in construction defect cases include the following:

A. Choice of Law

The choice of law rules of the jurisdiction in which the coverage action (not the underlying construction defect litigation) is brought will determine the method the court uses to determine what state's law applies. Each policy is an individual contract between the insured and the carrier, so different states' laws may govern the insurance policies of different parties involved in the same project.

1. Lex Loci Contractus

In the absence of a contractual choice of law provision, the court applies the law of the state where the contract was executed. *State Farm Mut. Auto. Ins. Co. v. Roach*, 945 So. 2d 1160, 1164 (Fla. 2006). In theory, this is a simple rule, but in practice it is an intensely factual inquiry. *Granite State Ins. Co. v. Am. Bldg. Materials, Inc*., No. 8:10-CV-1542-T-24, 2011 WL 6025655, at *6 (M.D. Fla. Dec. 5, 2011), aff'd, 504 F. App'x 815 (11th Cir. 2013). *Lex Loci* is the minority rule.

2. Restatement (Second) Most Significant Relationships Test

The majority of courts now apply the Restatement (Second) most significant relationships test, which requires consideration of the following factors: (1) the needs of the interstate and international systems; (2) the relevant policies of the forum; (3) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue; (4) the protection of justified expectations; (5) the basic policies underlying the particular field of law; (6) certainty, predictability, and uniformity of result; and (7) ease in the determination and application of the law to be applied.

3. Statutory Choice of Law Provisions

Some states prescribe choice of law by statute. For example, South Carolina Code, Section 38-61-10 provides that: "All contracts of insurance on property, lives, or interests in this state are considered to be made in this state . . . and are subject to the laws of this state."

B. The Insuring Grant

The terms of commercial general liability (CGL) insurance policies vary, but most follow the same basic format. Many insurers use the standard Commercial General Liability Coverage Form promulgated by the Insurance Service Office, Inc. (ISO) and various standard endorsements also promulgated by ISO. The following discussion addresses standard ISO forms, but bear in mind that many insurers use their own forms and manuscripted endorsements, which can deviate substantially from the ISO forms. Each policy must be considered on its own terms.

The insuring grant in the current ISO standard CGL Coverage Form (CG 00 01 12 07) defines an "occurrence" as an "accident, including continuous or repeated exposure to the same general harmful conditions." It further defines "property damage" as: "a. Physical injury to tangible property, including all resulting loss of use of that property . . . or b. Loss of use of tangible property that is not physically injured." The policy thus provides coverage for legal liability for "property damage" that takes place during the policy period and is caused by an "occurrence."

1. Does Faulty Workmanship Constitute an "Occurrence"?

A growing number of courts hold that defective work that causes resulting damage constitutes an "occurrence" under the standard CGL policy definition. Typical of such cases is *United States Fire Insurance Co. v. J.S.U.B., Inc*., 979 So. 2d 871 (Fla. 2007), in which the Florida Supreme Court held that faulty workmanship by a subcontractor that is neither intended nor expected from the standpoint of an insured general contractor can constitute an "occurrence" (i.e., an accident) under a post-1986 standard CGL policy. *Id*. at 891.

The law is unclear on the question in several jurisdictions, but a few state courts reject an expansive view of the term "occurrence." *See Kvaerner Metals Division of Kraevner U.S., Inc. v. Commercial Union Insurance Co*., 908 A.2d 888 (Pa. 2006) (holding that claims the insured contractor defectively designed and constructed a coke oven battery did not constitute an "occurrence", even if faulty work by a subcontractor caused damage to the roof on the structure itself); *State Farm Fire & Cas. Co. v. Tillerson*, 777 N.E.2d 986 (Ill. App. Ct. 2002) (allegations of faulty workmanship "do not fall within the meaning of an accident or an occurrence").

A few states have passed statutes attempting to regulate how the term "occurrence" should be interpreted for the purposes of insurance in construction defect cases. *See, e.g*., Colo. Rev. Stat. §13-20-808 (2010); Ark. Code Ann. §23-79-155 (2011); Haw. Rev. Stat. §431:1-217 (2011); S.C. Code Ann. §38-61-70 (2011).

It is not unusual for construction projects of any significant size or in locations close to state borders to involve parties from different states. If controlling state law governing parties' insurance differs on the threshold issue of whether faulty construction constitutes an "occurrence"—or if a governing state's law is uncertain on this point—this can pose a significant roadblock to settlement at mediation.

2. Is There Property Damage?

An "occurrence" of faulty workmanship, standing alone, is not sufficient to give rise to coverage. The "occurrence" must also cause "property damage" within the meaning of the policy to fall within the insuring grant. *J.S.U.B*., 979 So. 2d at 888. Significantly, there is, as stated by the *J.S.U.B.* court, "a difference between a claim for the costs of repairing or removing defective work, which is not a claim for 'property damage', and a claim for the costs of repairing damage caused by the defective work, which is a claim for 'property damage.'". *Id*. at 889. In the companion case of *Auto-Owners Insurance Co. v. Pozi Window Co*., 984 So. 2d 1241 (Fla. 2008), the Florida Supreme Court reiterated the requirement that the "occurrence" of faulty or deficient work must cause damage to property other than the faulty or deficient work to fall within the coverage provided by a CGL policy. Specifically, the court held that "the mere inclusion of a defective component, such as a defective window or the defective installation of a window, does not constitute property damage unless that defective component results in physical injury to some other tangible property." *But see Maryland Cas. Co. v. Reeder*, 270 Cal. Rptr. 719 (Cal. Ct. App. 1990) ("[I]t is possible for a manufacturer or contractor to use inferior materials or methods without causing any property damage . . . where the defect in fact has caused either physical injury to or the loss of use of tangible property, liability coverage has been found").

Coverage for "property damage" is one of the most often misunderstood concepts in construction defect cases. Plaintiffs and, sometimes, insureds, can have unrealistic expectations because they believe that if insurance is involved then all of the damages must be covered. It is critical that they understand that CGL policies do not provide coverage for the cost to repair or replace the faulty work itself, but only for resulting or consequential damage caused by the faulty work.

3. Did Property Damage Occur During the Policy Period?/Trigger of Coverage

The insuring grant requires that the property damage must take place "during the policy period." In the case of a discrete, identifiable event, such as a hurricane, it is easy enough to

identify when the property damage occurs. The problem arises when damage is latent and takes place over an extended period of time.

The courts have developed four generally accepted trigger of coverage theories over the years, none of which is specifically provided for in the standard ISO CGL coverage form. They are the following: (1) exposure; (2) manifestation; (3) continuous; and (4) injury in fact. *In re Celotex Corp*., 196 B.R. 973, 1000 n. 187 (Bankr. M.D. Fla. 1996). Under the exposure theory, the property damage occurs when the defective product is installed. *Id*. Under the manifestation theory, property damage occurs at the time the damage manifests or is discovered. *Id*. Under the continuous trigger theory, property damage occurs from the time of installation until discovery. *Id*. Under the injury in fact theory (sometimes called an actual injury trigger), coverage is triggered when the property damage underlying the claim actually occurs. *Id*.

Trigger of coverage problems typically result in inter-carrier disputes in situations in which different states' law governs different policies or where a single controlling state's law is undeveloped or conflicting on the question of trigger of coverage. In addition, some carriers have manuscripted coverage forms that alter the standard coverage grant by requiring, for instance, that the property damage be discovered during the policy period.

C. Common Exclusions

1. Business Risk Exclusions

The standard ISO CGL coverage form contains a set of exclusions commonly referred to as "business risk exclusions." The general purpose of these exclusions is to preclude coverage for risks associated with the insured's cost of doing business. They include exclusions for property damage to the insured's work, the insured's product, and property that is impaired by the insured's work or product. The exclusions that tend to be the most relevant in the construction defect context are the "Damage to Property" exclusions, j(5) and j(6) (sometimes referred to, respectively, as the Ongoing Operations and Faulty Workmanship exclusions), and the "Your Work" exclusion, l.

Both exclusion j(5) and j(6) apply to the insured's ongoing operations. Exclusion j(6) is broader than j(5) because it addresses "any property" rather than just "real property," and courts frequently construe them together. Several different standard versions pre-dated exclusion j(6), and they, and it, are generally referred to as the "Faulty Workmanship" exclusion.

The "your work" exclusion, bars coverage for: "'Property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard'." This exclusion is designed to apply to damage that occurs after the insured's work is completed, and completion is defined in the definition section of the coverage form under the term "products-completed operations hazard." Probably the most significant part of the standard your work exclusion from the standpoint of a general contractor or a subcontractor employing lower tier sub-subcontractors is the exception to the exclusion, which provides that the exclusion "does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." In *United States Fire Insurance Co. v. J.S.U.B., Inc*., 979 So. 2d 871 (Fla. 2007), the court focused heavily on the subcontractor exception to the Your Work exclusion and determined that the exclusion did not apply to preclude coverage to a general contractor for property damage to completed homes caused by improper site preparation by its grading subcontractors.

ISO has issued a standard endorsement, form CG 22 94 10 01, titled "Exclusion—Damage to Work Performed by Subcontractors On Your Behalf." The endorsement eliminates the subcontractor exception to the standard Your Work exclusion. Many carriers have manuscripted endorsements that have similar effect under a variety of titles.

2. Other Exclusions

An exclusion of particular concern to contractors is ISO's Products-Completed Operations Hazard exclusion (form CG 21 04 11 85), which entirely removes completed operations coverage from the policy. *See, e.g., Bresee Homes, Inc. v. Farmers Ins. Exchange*, 293 P.3d 1036 (Or. 2012) (holding products-completed operations hazard exclusion did not eliminate insurer's duty to defend where complaint did not allege that the work was completed when alleged damage occurred).

Among the standard exclusions that have been heavily litigated in construction defect cases is the standard ISO Fungi or Bacteria Exclusion (form CG 21 67 04 02). *See, e.g., Empire Indem. Ins. Co. v. Winsett*, 325 Fed. App'x 849 (11th Cir. 2009) (holding exclusion barred coverage for claims of mold-related damages and injuries resulting from insured's failure to install a vapor barrier).

The total pollution exclusion has also received much attention, particularly in Chinese drywall cases. *See, e.g., Bayswater Dev. LLC v. Admiral Ins. Co*., No. 105001/10, 2015 WL 1058437 (N.Y. App. Div. Mar. 12, 2015) (applying Florida law and upholding pollution exclusion); *Granite State Ins. Co. v. American Bldg. Materials, Inc*., No. 8:10-cv-1542, 2011 WL 6025655 (M.D. Fla. Dec. 5, 2011) (applying Massachusetts law and determining that Chinese drywall emissions constitute industrial or environmental pollution to which a total pollution exclusion would apply, not "injuries resulting from everyday activities gone slightly awry").

Other commonly encountered exclusions include prior work or operations exclusions, continuous or progressive injury or damage exclusions, residential construction exclusions, and height exclusions.

D. Additional Insured Coverage

A significant source of conflict between general contractors and subcontractors, or subcontractors and lower tier sub-subcontractors, and their respective insurance carriers involves additional insured coverage. Additional insured coverage is separate from, and exists independent of, any contractual indemnity rights that may exist under a construction subcontract and corresponding contractual liability coverage that may be available to the named insured under a CGL policy. An additional insured has a direct contractual relationship with the "additional" insurer, which a mere contractual indemnitee does not have. An additional insured generally has a right to a defense from the time it tenders the defense to the insurer, depending upon the complaint allegations or the underlying facts, whereas an indemnitee may not.

Insurers use two general methods to include additional insureds on their policies. First, either by manuscripted endorsement or manuscripted language in the "who is insured" section of the coverage form, insurers will include language to the effect that an "insured" under the policy includes "any person or organization for whom the named insured has agreed in a written contract or agreement to designate as an additional insured" or similar language. Carriers may also add additional insureds and projects under standard ISO additional insured endorsements by using language such as "As required by written contract" in the endorsement schedule.

Endorsements in this first category are referred to as "broad form" or sometimes "blanket" additional insured endorsements.

Since broad form endorsements are generally dependent upon the underlying subcontracts, those agreements require close scrutiny. Some typical issues that arise under subcontracts include:

- To what policies is the general contractor or owner to be added as an additional insured—CGL, excess, or umbrella?
- What are the required limits of insurance?
- Is the additional insured coverage on a primary and non-contributory basis with the additional insured's own coverage?
- Is additional insured coverage required for ongoing operations only, or for completed operations also?
- How long is a subcontractor required to maintain completed operations additional insured coverage?

The second method by which carriers may include additional insureds is to specifically name them to their policies by endorsement. The benefit of being a named additional insured is that one generally need not look beyond the endorsement to determine additional insured status. Again, these additional insured endorsements can be manuscripted or ISO forms, and the scope and possible limitations on additional insured coverage can vary significantly from policy to policy.

E. <u>Contractual Liability Coverage</u>

Contractual liability coverage arises in a CGL policy by negative implication under an exception to the standard ISO contractual liability exclusion. The exclusion states that the insurance does not apply to: "'Bodily injury' or 'property damage' for which the insured is obligated to pay damages by reason of assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages . . . [a]ssumed in a contract or agreement that is an 'insured contract' . . . ." The policy definition of "insured contract" is lengthy, and insurers are increasingly tinkering with it, but as generally applicable in construction defect cases, it means a contract in which the insured assumes the tort liability of another to pay for bodily injury or property damage to a third party.

Unlike additional insured coverage, the insurer's obligation under contractual liability coverage runs directly to the named insured, not to the contractual indemnitee. Thus, the contractual indemnitee has no privity with the insurer and no standing to directly enforce the terms of the policy. Another significant difference between contractual liability coverage and additional insured coverage is that the indemnitee's defense costs are damages that are within and reduce the limits of insurance. This is in contrast to defense costs payable under additional insured coverage, which more often than not, are outside limits and therefore do not reduce policy limits.

Assuming contractual liability coverage is available, within limits, it will coincide with the insured's liability under the terms of the indemnity provision in the underlying contract. This may ultimately be broader or narrower than what coverage may be available directly to the indemnitee if it is also an additional insured under the same policy. In addition, many states have passed anti-indemnity statutes—particularly prevalent in the construction context—that limit the ability of a party to indemnify another for the indemnitee's own negligence.

F. Priority of Coverage

When dealing with multiple liability insurance policies, priority questions often arise. The issues are usually two-fold, involving: (1) which policy(ies) must defend, and (2) which policy(ies) pay first. Insurers attempt to control these questions in "other insurance" clauses that address what should happen if multiple policies insure the same loss. The current standard ISO CGL coverage form contains an "other insurance" clause. Under this language, if a general contractor is covered under its own CGL policy and is also an additional insured under a subcontractor's policy, and assuming both policies have the same or similar "other insurance" clauses, the general contractor's policy will be excess and the subcontractor's policy will be primary.

However, not all "primary" policies contain the standard ISO language, and conflicts arise as a result. In general, there are three types of "other insurance" clauses, although some jurisdictions recognize more. These are: (1) pro rata, or "proportionate recovery" clauses, which contain language to the effect that in the event of other insurance, the loss shall be borne on a pro rata basis dependent on the monetary limits of coverage; (2) excess clauses, providing that the policy "shall be excess over any other valid and collectible insurance applicable to the liability"; and (3) so-called escape clauses, which state that "if there is other valid and collectible insurance, the policy shall not apply" or some similar language. *Auto-Owners Ins. Co. v. Palm Beach County*, 157 So. 2d 820, 822 (Fla. 1963).

Courts have developed rules to determine priority of coverage. In Florida, for instance, when two policies provide equal levels of coverage and contain competing excess, pro rata, or escape clauses, the clauses "are deemed mutually repugnant and both carriers share the loss on a pro rata basis in accordance with their policy limits." *Fireman's Fund Ins. Co. v. Tropical Shipping & Constr. Co.*, 254 F. 3d 987, 1005 (11th Cir. 2001). Carriers with mutually repugnant "other insurance" clauses will thus be treated as co-primary carriers. In cases where an escape clause competes with an excess clause, the escape will be enforced. *American Bankers Ins. Co. of Florida v. Leatherby Ins. Co.*, 350 So. 2d 353 (Fla. Dist. Ct. App. 1977), *adopted*, *Leatherby Ins. Co. v. American Bankers Ins. Co.*, 371 So. 2d 488 (Fla. 1979). Similarly, where two policies "each contain 'other insurance' clauses, but one is 'pro rata' and the other is 'excess insurance,' effect is given to the latter." *Progressive Am. Ins. Co. v. Nationwide Ins. Co.*, 949 So. 2d 293 (Fla. Dist. Ct. App. 2007). The rules vary in other jurisdictions.

"True excess" policies that do not attach until exhaustion of specified underlying insurance policies, typically receive favored treatment by the courts and generally do not have a duty to defend or a duty to "drop down" and provide coverage unless and until the underlying insurance is exhausted. *See, e.g., Allstate Ins. Co. v. Executive Car & Truck Leasing, Inc.*, 494 So. 2d 487, 489 (Fla. 1986).

1. Defense Costs

In virtually every jurisdiction, the duty to defend is broader than the duty to indemnify. Because construction defect claims can be extremely expensive to defend, the question of which carrier or carriers has/have a primary defense obligation is critical. In some jurisdictions, co-primary carriers have a right of contribution or subrogation for defense costs. *See, e.g., Fireman's Fund Ins. Co. v. Maryland Cas. Co.*, 77 Cal. Reptr. 2d 296 (Cal. Ct. App. 1998). In a minority of jurisdictions such as Florida and South Carolina, co primary carriers have no right of contribution or subrogation for the cost of defending a common insured, even where one carrier

wrongfully refuses to defend. *Argonaut Ins. Co. v. Maryland Cas. Co*., 372 So. 2d 960 (Fla. Dist. Ct. App. 1979). The anti-contribution rule does not, however, apply to excess insurers seeking to recover defense costs from primary insurers. *American & Foreign Ins. Co. v. Avis Rent-A-Car Sys., Inc*., 401 So. 2d 855, 857 (Fla. Dist. Ct. App. 1981).

2. Indemnity

Unlike the duty to defend, the duty to indemnify is based upon actual facts bringing all or part of a loss within the coverage provided by a policy. Thus, even in a state that prohibits contribution among co-primary carriers based upon defense costs, an insurer that pays a loss that falls within another carrier's policy should ordinarily have a right to contribution, provided it reserves that right in a settlement. *See, e.g., Pennsylvania Lumbermens Mut. Ins. Co. v. Indiana Lumbermens Mut. Ins. Co*., 43 So. 3d 182 (Fla. Dist. Ct. App. 2010).

G. Miscellaneous Issues

Other coverage problems that tend to appear in construction defect cases include issues with different types of insurance or sources of recovery. By way of example, to the extent they have insurance, design professionals named as defendants in a construction defect case usually have professional liability, not general liability, insurance. Professional liability policies are frequently claims-made policies under which the claim must be made and reported to the insurer within the policy period (or any retroactive date or extended reporting period). Also, these policies typically have so-called "burning limits", under which defense costs reduce the amount of indemnity dollars available to respond to a claim.

On large construction projects, it is not uncommon for an owner controlled insurance program ("OCIP") or a contractor controlled insurance program ("CCIP")—otherwise known as "wrap up policies"—to provide general liability coverage to some or all of the project participants. These policies typically have a single limit applicable to all participants as a group, leading to erosion problems, and subcontractor CGL policies often have exclusions that bar coverage where such a wrap-up policy is in place. In addition, questions sometimes arise about who is or is not covered under a wrap-up policy.

It is also not uncommon to see disputes between sureties who have issued performance bonds, which are designed to respond to construction that does not meet contractual requirements (i.e., incomplete or defective construction), and CGL carriers, whose policies are intended to cover legal liability arising from property damage. Bonds are not "insurance" because, among other reasons, the bond principal typically indemnifies the surety for any loss, but this distinction is usually lost on plaintiffs.

All of the issues mentioned are subject to varying layers of complexity created by the facts of any particular case, multiple levels of insurance, the financial status of carriers and parties, the law on any particular question in the jurisdiction or jurisdictions at issue, and the contractual language of each policy in the mix. This writing presents a basic outline of common issues. It is not intended to be exhaustive.

III. PRACTICAL PROBLEMS

In addition to unresolved legal issues involving coverage, a number of practical problems can also stall mediation. These typically include gaps in insurance information and participation, gaps in factual information, and gaps in participant communication and understanding.

A. Gaps in Insurance Information/Missing Carriers

Policyholders purchase liability insurance for discrete periods of time, typically, year by year. When latent defects cause damage over several years, a number of policies may be implicated, and it is not uncommon for these policies to have been issued by different carriers. Although all of these carriers should be placed on notice of the claim, this does not always occur. The result is missing carriers and gaps in coverage, leaving shortfalls in potential recovery sources available to resolve a case.

In addition to their own insurance, general contractors and subcontractors who employ sub-subcontractors frequently have some type of additional insured coverage requirement in their contracts with lower-tier subcontractors/suppliers. When a claim arises, however, the upper-tier contractor does not always do a good job of tendering defense and indemnity to carriers who may provide additional insured coverage, not to mention direct coverage to responsible subcontractors. In latent claims, this frequently occurs because the party who may have additional insured coverage lacks information about carriers who issued insurance to lower tier parties after project completion. Again, the result is missing carriers and coverage gaps. Further, assuming the tendering party qualifies as an additional insured, the tender to the additional insured carrier is necessary to trigger a duty to defend and pay associated defense costs of the additional insured.

In cases of any size, it takes some effort and discovery to obtain the full insurance picture. But completion of the insurance matrix is critical to mediation success.

B. Gaps in Factual Information Necessary to Determine Coverage

CGL policies pay for covered damages for which the named insured is legally liable. Thus, the basic requirement from any insurer's perspective is that its insured is responsible for the plaintiff's damage. It is therefore important to determine precisely what the insured's scope of work was on the project. Little will bring a mediation to a grinding halt faster than a dispute between parties over who did what work. Such disputes can occur between a general contractor and its subcontractor on any particular part of the project, a subcontractor and its lower-tier sub-subcontractor or subcontractors, and between successive or concurrent subcontractors. Without the most basic information about who, exactly, did what on the job, it is impossible to even begin to figure out who might be legally responsible for any damage. This is one primary reason why early mediations fail—because this basic factual information has not been crystalized in discovery.

Lack of good information about scope also leads to disputes about additional insured coverage. Additional insured endorsements generally limit additional insured coverage to liability of the general contractor caused by the named insured's work or operations. Carriers therefore cannot determine whether or not they provide additional insured coverage without clear information about the named insured's actual scope of work. This is a fundamental issue underpinning whether or not the general contractor is actually an insured under a policy for any particular loss.

C. Gaps in Participant Communication

Demands, tenders, and critical information first communicated on mediation day are counterproductive. Insurance adjusters cannot make decisions in a vacuum. They rely on

evidence-based and legally-justified analyses of defense counsel for the insured, which must be reported to the adjuster sufficiently in advance of mediation to allow the insurance company to evaluate. In a case of any complexity, this requires the assimilation of many components, including the amount of the claim, the input from the insured, key depositions, sworn testimony, and documentation obtained in discovery, evaluation of the range and risk of potential outcomes based on the information developed, cost and fee budgets, and updates. In addition, the policy terms, time on the risk, whether any other carrier may share responsibility for the claim, whether the insurer owes a duty to any other party to provide a defense as an additional insured or to pay for fees and costs under a contractual indemnification provision are also significant to the adjuster and the carrier, and establish the basis for an acceptable settlement range for the adjuster to bring to the mediation.

Often plaintiffs fail to communicate a demand or allocation to the general contractor, leading to no flow-down demands being made between defendants and third party or cross defendants. This failure impedes the evaluative process set forth above and can easily hamstring a mediation.

Another problem encountered in complex construction defect mediations is the failure of carriers to communicate with each other in advance of mediation day. As noted in the prior sections, a number of inter-carrier issues may exist, any one of which can adversely affect the ability to settle a case at mediation.

D. Gaps in Participant Understanding of Coverage Issues

The mediator is a neutral party whose job is to facilitate the dispute resolution process. A vital function of the mediator is to manage party expectations, which the mediator is permitted to do by, among other things, suggesting possible outcomes, raising issues, and providing certain information based upon his or her experience and substantive knowledge of construction and insurance law. In order to manage expectations in a process that is largely driven by insurance, it is critical that the mediator have a firm grasp and understanding of coverage issues. All too often, parties to a construction defect dispute select a mediator who does not understand coverage, which can present a real barrier to mediation success.

Usually, construction lawyers have a fairly good understanding of the most important insurance coverage basics, as well as many of the obscure nuances of coverage disputes. The same is not always true on the plaintiff side. A very common problem in construction defect cases is the failure of the plaintiff—frequently a homeowner or condominium association board comprised of laypeople—to understand, not only coverage, but the entire mediation and litigation process. These misunderstandings lead to unrealistic expectations that erode any hope of settlement.

Misunderstandings and confusion about contractual indemnity and additional insured coverage is not uncommon. Oddly, subcontractor carriers sometimes seem to forget that just because they may not owe additional insured coverage, they may still be obligated to pay an upstream contractor's defense and other costs under their contractual liability coverage.

IV. STRATEGIES FOR MEDIATION SUCCESS

A. Select an experienced mediator who understands both insurance coverage and construction law and give the mediator the access and the information necessary to get the case resolved. Complex construction defect claims usually require multiple mediations, so if the

initial mediator turns out not to possess the appropriate skill set, do not be afraid to change mediators.

B. General contractor's counsel should provide the mediator with a comprehensive insurance matrix identifying all potential carriers (and coverage levels) for each party, including single and aggregate limits, tender (additional insured and contractual indemnity) dates and responses, coverage issues raised, any large SIRs or deductibles, together with policies and reservation of rights/disclaimer correspondence.

C. If possible, the mediator should meet with the plaintiff (typically a condominium or homeowner board) to afford the board the opportunity to establish an understanding of the process and the mediator's role and to establish a relationship of trust in advance of the mediation. This also gives the mediator in conjunction with plaintiff's counsel the opportunity to manage expectations by clarifying for the plaintiff how insurance companies make decisions, and why not all of their losses may be covered. In addition, plaintiffs should have an understanding of what the trial will involve, as well as the potential for, and risks of, post-verdict litigation, including appeals, coverage actions, and supplemental collection proceedings.

D. Plaintiffs should make allocated demands well in advance of the mediation. General contractors, in turn, should make downstream, allocated demands on lower tier contractors and suppliers, giving ample time in advance of the mediation—at least 30 to 90 days, depending on the size of the case—for defense counsel to report to their carrier(s) and for the carriers to complete their evaluations of the case. The allocated demands should include indemnity or additional insured claims for defense costs as appropriate.

E. In some instances, it may be useful to have "coverage" mediations in advance of "construction" mediations. Similarly, it may be useful at times to have multiple "mini" mediations that are limited to specific trades.

F. If global resolution is not possible, consider alternatives, which could include carve-outs, assignments, non-binding arbitration, or consent judgments against non-defended parties.