



2021 Annual Conference
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Atlanta, GA

I Built a Monument to Myself and You Ruined It! Resolving High-End Home Construction Litigation

I. General and Legal Issues

Understanding High-End Single-Family Litigation

While these are surprisingly common situations, the intricacies of a large single family home claim go beyond the usual issues associated with a construction defect claim. There is an overlay of emotion that is, for the most part, not present in a typical claim. They are more of a relationship between the owner and the builder. They are oral promises made, or thought to be made, and broken. There are usually payment issues and unfinished work, or work that is not up to the sometimes unreasonable expectations of the owner. Integrating these issues into the usual coverage issues, the desire for punishment, and the emotional ties of the parties makes these claims particularly difficult.

Overcoming Common Legal Issues

Take a typical claim with heightened expectations of performance, mix with a feeling of personal betrayal, add that many of the items are not within the coverage of insurance policies, and you end up with the makings for a case that will go to trial even though it should not. So, how do you resolve construction litigation when the plaintiff has functionally unlimited resources and what they care about most is the suffering of their opponent? You must break down the claims to figure out what actual issues are at hand. Some of the common legal issues these cases, that consist of a hybrid of construction defect litigation and more traditional construction claims, include negligence, non-payment, contracts, licensing, delays, and cost over-runs.

II. Investigation

Encountering Obstacles

Construction is often a messy business. It's like being back in the kitchen at your favorite restaurant; it's often better to not know how your sausage was made! Problems leading to litigation between wealthy owners and contractors often occur when the owners have been deeply involved in the process, and their expectations are not being met. Some people, including contractors, have difficulty in communicating realistic expectation to unrealistic clients. Nordstrom has done lots of business people a terrible disservice: The customer is NOT always right! In fact, the customer is often wrong... And awful!!

Key Components

When wealthy owners realize they are not going to get what they expected from their 7-figure residential construction project, the issues we need to sort out often begin with cost over-runs, allegations of over-billing, and delayed project completion. The owners hire attorneys and experts and we end up with allegations like construction defects including leaks, cracks, and premature deterioration. We often have to sort out poor contracting practices including no written contracts at all, no additional insured endorsements, no indemnity clauses, and strange agreements with peculiar clauses. At some point in the process the owner stops paying the general contractor, so the general contractor stops paying the subcontractors, and we end up with a complex tangle of liens on the property, which makes the owners go absolutely crazy! Once we are deep into the weeds of an analysis we often realize we are dealing with contractor's license issues, including disgorgement.

A Successful Investigation

Experts need to conduct professional investigations so that attorneys and insurance professionals can make smart decisions. This should begin with collecting, organizing, and analyzing key project documents including plans, contracts, and invoices. Meetings and interviews with key people can be even more important, because many project like this are lacking the professional documentation of 7-figure commercial construction. Onsite investigations should be well planned and as exhaustive as possible. Realistic analysis of the good, the bad, and the ugly, early in the process is helpful, and over-optimism (well... it's not SO bad) causes harm. On some projects performance testing or invasive investigation is necessary, especially if we want to blame other parties and allocate a portion of the responsibility to them. Most projects need a scope of repair and cost estimate. If testimony is going to happen, the experts may need to write reports.

III. Insurance

What about Bonds?

Surety bonds financially compensate the client if the contractor does not fulfill his contractual obligation. A surety bond is a promise to be liable for the debt, default, or failure of another. It is a three-party contract by which one party (the surety) guarantees the performance or obligations of a second party (the principal) to a third party (the obligee). If the surety company pays out any claims made on the bond, the principal must reimburse the surety. Most federal, state and, municipal contracts require independent contractors to obtain a bond as part of a project agreement. Some states request a bond as part of the professional licensing process. In rare cases, a residential property owner under a custom contract may require a Performance Bond to guarantee that the job will be completed according to the terms of the contract. This is more common in commercial construction. Since it is rare for a performance bond to be procured, generally if there is a bond implicated it will be a license bond for a minimal amount mandated by state licensing requirements. Challenging issues presented are the potential lack of sufficient bond limits for performance failure claims. and who pays for the defense of the bond company in the event of a suit.

The Role of Coverage for General Contractors and Sub-Contractors

The General Liability policy protects the builder against certain claims and lawsuits alleging the builder's negligence resulting in bodily injury, property damage, or personal and advertising injury to a third party. The policy generally pays for the costs of legal defense, settlements, and adverse jury verdicts subject to any policy provisions and restrictions. The main difference between liability insurance and surety bonds is which party gets financially restored... Insurance protects the business itself from losses, whereas bonds protect the person the company is working for. It is a default or failure to perform vs an accident. We will discuss the interaction between the bond and the commercial general liability policy in our presentation.

In custom home construction, Subcontractors can be underinsured or uninsured for the work they are performing. The builder can experience issues with transient companies, transient labor forces, and a lack of project management best practices. We will discuss how all of these issues impact resolution in the event of a loss.

Sometimes, It Isn't Enough

In custom home construction, Builders can have restrictive policies, lack of sufficient limits to cover the losses (including nonexistent or insufficient excess coverage), lack of financial assets to cover losses, a lack of sophistication in drafting contractual documentation, and a lack of best practices with respect to document control and risk transfer. We will discuss how all of these items can impact the resolution of a dispute.

The Ethics Behind the Claims

Disputes relating to custom home building construction tend to be loaded with performance failures versus resultant property damage issues. Emotional and personal issues

in the ensuing battle between the Builder and the homeowner can escalate the dispute and make it even more difficult and expensive to resolve. Potential payment by an insured for a lack of covered damages can potentially devastate a small to mid-sized company, even a successful one. We will discuss how these issues interplay with the resolution of custom home construction disputes and the ethical obligations of an insurance carrier in these instances.

IV. Risk Transfer and Mediation

Don't Forget the Contracts!

In mediating a large custom home case, one needs to have as many defendants as possible to contribute to the settlement fund. This is problematic, however, in these cases because the general contractor is usually unsophisticated in achieving risk transfer to its subcontractors. In large commercial construction cases, general contractors are exceptionally good at passing the risk of faulty construction to the subcontractors through sophisticated and lengthy subcontracts. These subcontracts contain Type 1 contractual indemnity as well as the requirement that the general contractor be named as an additional insured on the subcontractors' completed operations coverage. In the large custom home cases, however, the general contractor often does not use subcontracts at all, or, if they do, the subcontracts do not have indemnity or additional insured provisions. This makes it more difficult for the mediator to raise funds from the subcontractors, thus making the cases harder to settle.

The Devil is in the Details

In addition, oftentimes the general contractor uses unlicensed subcontractors and day laborers. The general contractor also often self performs a lot of the work. This makes it harder to avoid the application of the subcontractor exception to the "work performed" exclusion of the general contractor's policy, thereby making it more difficult for the mediator to obtain contribution from the general contractor's carriers.