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High Rise Cases Just Keep Getting Higher:
What Can Be Done to Contain the Plaintiff and Manage the Risk?

With available raw land for sprawling suburban developments limited and municipalities seeking to develop urban cores where there is access to mass transit, the move in California to high-rise residential construction is on. Many of these buildings are tens of stories high and are designed and marketed as luxury residences. The construction process typically requires an army of contractors who must integrate complex systems dreamed up by owners and designers to make each building stand out from its peers. The scope and scale of these buildings, and the large insurance policies usually purchased to manage the risk of their construction, have not gone unnoticed by the plaintiff's bar and these buildings are quickly becoming ground zero of construction defect litigation in California.

I. The OCIP Players

1. Conflicting Interests for Coverage: One Size Does Not Fit All

a. Single Purpose Entities Have Conflicting Interests with Contractors and Other OCIP Enrollees

The majority of high rise buildings are developed by limited liability companies or corporations organized for the single purpose of developing the building and selling the individual units. By their nature, these entities have a very finite and limited life span and their only asset typically is the building being constructed. Years later, when a construction defect suit is initiated, the developer is typically long since dissolved and/or is largely disinterested in ensuing litigation because it has limited or no resources at risk. However, these single-purpose entities also serve a very important function in obtaining the insurance for the project. In contrast, the general contractors and subcontractors usually are larger entities with the scale to construct such buildings and are often still in operation when the litigation begins. It is the owner of the project who is responsible for securing the "wrap" insurance coverage intended to protect all of the parties involved in the construction of the building.

A natural tension exists between the owners and contractors regarding the scope and breadth of this coverage. While the insurance costs are usually charged back to the general contractor and subcontractors in their respective contracts, the contractors raise their contract prices accordingly.

Thus, these owners have an interest in keeping the insurance costs as low as possible as a means for driving down the overall project costs and maximizing profits. How much insurance coverage is enough insurance coverage is among the most important decisions to be made during the preliminary project planning and one which can have far-reaching effects long after construction is completed.

b. Who Should Be Included in the OCIP

In addition to determining how much coverage is necessary, decisions need to be made as to who will be covered under the policy. The owner, general contractor, and subcontractors are ostensibly all participants in the Owner Controlled Insurance Program. While such coverage extends to the major players, the OCIP can omit a number of key participants in the construction process, such as the architect, mechanical engineer, structural engineer, and other members of the design team. Additionally, these projects often feature sub-subcontractors who have focused scopes of work which cross over multiples trades, such as caulking. Coverage for their work should be reflected in the aggregate amount. Likewise, suppliers are typically not covered in the OCIP. While such a decision is likely one of necessity given each subcontractor has a multitude of suppliers, the intricate nature of the construction of these buildings can often require reliance on specialized systems or material, the failure of which can create potential significant liability for the contractors. Deciding who to include and who to exclude will necessarily influence the coverage available to the OCIP participants and can be a factor in testing the limits of insurance.

2. Coverage Considerations for The OCIP Participants

a. How High Does the Coverage Tower Go?

Weighing who should be included in a wrap is not the only consideration in determining the limits of coverage. As the coverage tower for these residential towers increase, multiple insurance policies, often from different insurance companies, are stacked one on top of another. While ideally, these polices are to work together with one another to provide a blanket of coverage for OCIP participants, unforeseen issues can arise. Varying language from policy to policy, insolvency, exclusions, choice of law provisions, and different coverage grants can combine, or operate independently, to prevent seamless application from policy to policy. These tensions between policies can ostensibly modify the available insurance or the application of the insurance to the claims.

b. How Much Coverage Is Enough?

When the litigation starts, all the OCIP stakeholders need to make understanding the parameters of the OCIP coverage a priority.

As high-rise construction and claims associated with the construction become more common, the limits of insurance have increased. So, have the dollar amount of the homeowner claims.

Determining at the outset of litigation whether the defense is or is not within the limits of insurance, who is enrolled in the OCIP and who is not, and what coverage exists outside of the wrap policy must all be a priority. The allocation of deductibles or self-insured retentions among the participants must also be clearly understood by the contractors and the wrap administrator, as this is a common source of friction among participants once the claims arise.

The owner, general contractor, and subcontractors likely also enter into indemnity agreements. Most often, these agreements require indemnity to run uphill, with the owner receiving indemnity from the general contractor and subcontractors, and the subcontractors also indemnifying the general contractor. How these indemnity agreements are read in light of the existence of an OCIP intended to cover all of the claims for a project deserve consideration by the insurer and the insureds. Moreover, there were important statutory changes made to California law for wraps which were entered into after January 1, 2009 which makes such indemnity provisions void against public policy:

> 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. (California Civil Code §2782.9)

The bar on such indemnity agreements cannot be waived by contract. (Id.) To the extent a contractual indemnification clause is deemed unenforceable, the statute allows parties to the wrap-up to pursue claims for equitable indemnity against one another, unless there is coverage for such claims under the wrap. (Id.) The statute also allows for collection by the owner or general contractor of any self-insured retention for the policy, however the amount collected must be proportional to the alleged liability. (Id.) Finally, nothing in the statute operates to prevent an owner or a general contractor from being named as an additional insured on a policy issued to a subcontractor and pursuing such coverage although the sub is enrolled in the wrap-up. On occasion a CGL carrier may neglect to include a wrap exclusion or you may find that the wrap exclusion is not worded carefully enough to prevent a trigger in the event of certain conditions, such as exhaustion of the wrap or off-site activities by the subcontractor that forms the basis for one of the plaintiff's claims.

II. The Claim

1. Assessing the Claims and Building a Defense Roadmap

a. The Differing Considerations When the Claim Is Made by The HOA And Not the Individual Unit Owners

Defending a modern era condominium high-rise construction defect claim involves the analysis of a number of factual and legal issues that did not exist in the common law era.

Right to Repair laws, other changes in statutes affecting homeowner association rights and obligations, and changes in the condominium formational documents present a myriad of issues that the defense team must confront from the outset of the case. Waiting until pretrial motions to decide how to deal with these issues will lead to missed opportunities to drive down the value of the HOA's case.

For example, it has become common practice for lawyers drafting HOA formational documents to require the Board of Directors for the HOA to obtain majority approval of members at large to file a lawsuit for construction defects. In California, trial courts have been willing to enforce these provisions based on the holding in *Pinnacle Museum Tower Assn. v. Pinnacle Market Development (US), LLC* (2012) 55 Cal. 4th 223 in which the Supreme Court upheld the enforceability of an arbitration provision in the CC&R's. Applying the logic of this decision, trial courts have enforced the majority vote requirement as well. Discovery should be conducted on this issue to determine if the board followed this requirement and obtained majority approval, to set up dispositive motions.

Relocation expenses are another area where the defense can make life difficult for the HOA. In California there currently exists a conflict in Right to Repair law and other portions of the Civil Code dealing with the obligation of an HOA to pay for relocation expenses in the event of repairs to the common areas. The Right to Repair Act states that the HOA is entitled to damages for reasonable relocation and storage expenses. On the other hand, Civil Code Section 4775(b) states that the costs of temporary relocation during the repair and maintenance of common areas shall be borne by the owner of the separate interest affected. No reported cases have yet dealt with this apparent conflict, but some trial judges have issued tentative rulings on motions in limine that favor the defense.

Most new high-rise condominium developments contain mixed uses, including commercial space. Commercial spaces are often built out after the project is completed, and the build out can affect the common area systems. For example, the drain, waste and vent systems for restaurants in commercial use zones of the development will share the main trunk lines in the common areas, and heavy, greasy waste from a restaurant can have a deleterious effect on the cast iron lines.

b. To Repair or Not to Repair?

A number of practical, real world factors suggest that making repairs can help reduce the risk that the HOA will file suit or reduce exposure once suit is filed. One of the most common reasons for filing a lawsuit, as stated by board members in deposition years later, is the failure of the developer to undertake repairs voluntarily. The importance of good customer service can not be understated. Most homeowners and board members need to feel like their concerns are being taken seriously by the developer, and once they feel that they are being disrespected, they will turn the matter over to an attorney.

Contract considerations must also be addressed. Warranties are often included in purchase and sale contracts, and are often pled as a basis for claims, in addition to Right to Repair claims, less so following *McMillin Albany, LLC v Superior Co*urt (2018) 4 Cal. 5th 241. Regardless, the defense should be aware that jurors will not react favorably if the developer has not honored a warranty claim. Warranties are part of the deal and if the developer does not honor the deal, the developer risks an adverse ruling on a contract/warranty claim. Conversely, if the developer does "the right thing" the defense can make the case that the board is overreaching. Overreaching by the board is one of the most successful themes for defending a large construction defect case.

Repairs can also be an effective means of taking away the plaintiff's strongest claims. If the developer has addressed all complaints identified by the board, why was the suit filed in the first place? Another common response by board members when asked why the HOA filed suit is that their expert told them that something was wrong with their building. And who hired that expert? The Board's attorney! The overreaching theme comes through again with this type of testimony.

Insurance coverage for repairs can be a sticky situation. What happens if there is no consequential damage at that point? Developers should notify carriers of claims and work with their insurance carriers to explore how to fund repairs to the mutual long-term benefit of both stakeholders.

c. Special Considerations If the OCIP Has Burning Limits

Most OCIP's have burning limits, so the question is not if, it's when. Everyone has an interest in the handling of claims under a wrap. Careful documentation of claims handling pre and post litigation is paramount. With multiple insureds on a single policy, the defense team needs to consider how each, and every decision reduces the exposure on the claim and advances the interests of the policy holders. Defense counsel need to carefully consider the potential for real conflicts of interest to arise among enrollees and plan how to address these issues (who keeps the original defense counsel being a key question), and seek to minimize conflicts if possible, to avoid unnecessary and duplicative defense charges.

2. Defending the Claims

a. The Growth of Hidden Defects

Leaking roofs and windows in single family homes and wood frame construction were easy to spot. However, things are not that simple in a high-rise, which essentially employs commercial construction with complex roofing, window, waterproofing, mechanical and electrical systems.

Water can run from one floor to the next manifesting itself in multiple units. Specialized experts with experience in window wall and curtain wall design and construction need to be part of the defense team.

With the advent of Right to Repair performance standards that do not always require physical damage to other components of the building, claims can exist in places that can only be seen through destructive testing. Cast iron drain, waste and vent lines are a favorite of plaintiff's counsel because of the extensive amount of repair work that needs to be conducted inside living units just to gain access to remove and replace the piping. Cast iron corrodes—it's a fact of life. How much is too much is the question, and this requires an extensive analysis of multiple samples of the DWV piping by a metallurgist, design analysis by a mechanical engineer, a thorough review of the HOA documents to discover the nature and extent of problems that have been reported by the occupants.

Fire-safety issues are of major concern in high-rises. It was not that long ago that we all saw the spectacular fires in the high-rise apartment building in London.

To defend against claims that fire-stopping is deficient the defense should consider an aggressive defense against the use of extrapolation by carefully planned destructive testing to disprove repetition and making it difficult for the plaintiff to argue that its testing was representative of the pool. (More about extrapolation below.) We are also aware of numerous suits in Florida seeking damages related to certain types of piping used in fire sprinkler systems. These suits have not yet been concluded, but it's safe to say that fire protection systems and fire stopping elements are very important life safety features of a modern high rise.

Coverage always plays a role when considering claims of this nature. To the extent that the claimed damages seem to arise out of product incompatibilities or deficiencies in the manufacturing process, those defendants will typically be outside of the wrap program. The claims will often arise when the resident's first party carrier responds to a water leak claim, discovers that there was a product defect, and then pursues the contractors in subrogation. The wrap carrier is likely to look to defense counsel to bring the product manufacturers into the case, along with design professionals if appropriate. This gets more complicated when the project has design-build elements; to the extent that the defects are alleged to result from deficiencies in the installation, the contractors may be covered under the wrap, but if the alleged problems are based on the design of the project, the interaction between two products used in tandem, or a manufacturing defect in a batch of goods, that portion of the claim might not be covered by the wrap policy.

b. Extrapolation, More or Less

There seems to be a trend toward more extrapolation with less evidence. Extrapolation is common in everyday life. Jurors are used to hearing the results of political and opinion polls, especially during an election cycle, so the defense should expect jurors to accept extrapolation as a means of measuring the extent of a problem.

In *Duran v U.S. Bank Nat. Assn.* (2014) 59 Cal.4th 1, the California Supreme Court rejected the trial court decision to permit the use of "statistical sampling" to establish liability and damages in a wage and hour class action.

The Court identified three material considerations to evaluate the reliability of statistical sampling, the considerations set forth by the Court are summarized below for reference: (1) whether the sample size is large enough to reflect the greater population; (2) whether the sample taken meets the threshold requirement that it be truly "random" and not subject to "bias"; and (3) whether the ultimate margin of error presented by the sampling is too large to reliably and fairly extrapolate the results. The challenge for the defense is to gather evidence to demonstrate that these conditions do not exist so that the court, upon motion, will not allow Plaintiff to extrapolate. There is usually one key Board member or one person from the HOA management company that serves as a liason between the attorney and expert on the one hand and the HOA on the other hand. That individual should be deposed and questioned on the manner and means of selecting the units where testing was performed by the HOA experts. Unit owners can be extremely uncooperative with management, and as a result, management sometimes takes the easy way out by conducting testing at units owned by friendly occupants. That fits the definition of bias perfectly.

c. Where Does Design End and Construction Begin

A common means of reducing the cost of construction is the use of design-build subcontractors in a project that is otherwise design-bid-build. Design-build subs often include plumbing, mechanical and electrical, but some aspects of design can also be found in curtain wall contractors who are asked to prepare shop drawings for the architect's design. While this is not supposed to involve design, it often does. Hence, a claim regarding the skin of a high-rise will involve tension between the Architect of Record and the subcontractor that is involved with the implementation of that design. Assuming a problem has in fact been identified by the HOA, the answer to who is at fault lies in the contract documents, project meeting minutes, emails and shop drawings.

Consideration should be given early on to determine if other policies exist for the design build contractors and subcontractors that might address the claims not covered by the OCIP. These policies are typically claims-made and reported, so timing is extremely important. One needs to be wary of a blanket notice to subcontractors under Right to Repair laws. If a subcontractor receives notice under a Right to Repair statute and then fails to timely notify its E&O carrier on the risk at the time it receives notice, the subcontractor may find itself facing a denial by the E&O carrier. Differing amounts of coverage for different years will also affect timing of the claims on an E&O policy, although one does not always know in advance the amounts available to the subcontractor on the different years.

d. Third Party Inspectors: Friend or Foe

Third party inspectors are intended as a safeguard against defects and are often mandated by the OCIP provider. Having a second set of eyes on the job is a good thing, but the defense must be wary of the use of the inspector's records by the Plaintiff as the key that unlocks the skeletons in the closet.

Every construction project experiences problems, and 99 percent of the time the problems are solved, and the matter is closed. But plaintiffs will use the records of the difficulties encountered during construction as a roadmap for testing the integrity of the building. If they can create a problem using accepted testing protocol, Plaintiff will then argue that the developer, general contractor and subcontractors were guilty of burying the problem, not solving it. Review these records early and talk to the stakeholders from construction about the resolution of these construction issues. Check statutes as well, as in California third party inspection records are inadmissible if certain criteria are met. See Civil Code Section 43.99(b).

III. Special Considerations

1. Strategies for Protecting Your Insured/Client from An Excess Judgment When the OCIP Is Depleted

The best preparation on this topic takes place long before there is a claim. While many projects are developed by LLC's, the general contractor and trades do not have that luxury. In house counsel for the general contractor should work with its CGL and excess carriers to remove any wrap or residential work exclusions so that in the event the wrap is not sufficient, the general contractor has another potential avenue to cover the claim.

The general contractor can also work with the major subcontractors on projects involving wraps to assist them in determining what coverage they have in their insurance program, and can assist them in getting wrap exclusions removed, if possible. Counsel for the general contractor can also work closely with the owner, giving them assistance in determining levels of coverage appropriate for the risk. Many times, an owner will become too focused on the overall job cost and try to save money by getting minimum amounts of coverage on the OCIP.

During construction on projects with an OCIP, an effort should be made by the Owner or the general contractor to make sure they capture any second- or third-tier subcontractors and get them enrolled in the OCIP. In addition, regular meetings with the broker should be conducted to make sure everything is in order and to consider whether additional layers of excess coverage can be placed on the project during construction.

Once the claim is reported and a wrap carrier's adjuster assigned, the insured or its coverage counsel should request an aggregate report to find out if there are any previous claims that have impaired the limit. Review any coverage correspondence from the carrier carefully and make sure everyone is on the same page about the way the coverage applies: Does defense erode the limit? How many occurrences does the claim represent? Do all the claims being asserted in the case relate to the products/completed operations coverage or are there some aspects of the claim that are properly considered ongoing operations claims (for instance, claims that the owner or management company improperly managed the building, failed to maintain it, or failed to properly operate system controls). In addition, arrangements need to be made to obtain complete copies of all other insurance issued to the wrap participants from the time construction began until the present.

These policies need to be thoroughly reviewed, preferably by coverage counsel for the developer/general contractor, to identify any available insurance outside the OCIP. The case management order will usually provide that all such policies be made available, but practically speaking the policies should be subpoenaed to avoid delay and to insure cooperation.

2. Looking for Other Sources for Settlement Contributions

Property owners are sometimes resistant to putting their first party carriers on notice of potential claims, because they don't want to pay the deductible or SIR for that policy. However, if there is a life safety issue and immediate funding for repairs is needed, getting the first party carriers involved early is an important strategy that should not be overlooked, for the following reasons. The first party carrier may have broader coverage available than the third-party liability carrier. For instance, in some states it is common for the contract between the owner and the general contractor to preclude indemnification for consequential damages. Second, the first party carrier may have in-house experts or negotiated rates for expert investigators, so that the investigative expense is carefully managed early on.

Performance bonds guaranteed by the principals of the subcontractors can also be used to help settlements of an underinsured project. Depending on the language of the bond and the contractual obligations in the subcontract, and the nature of the claims by the HOA, a performance bond may apply to cover a construction defect claim. The potential personal liability of the principal of a subcontractor on a bond is strong motivation, for example, for that principal to push hard on his/her CGL carrier that may have denied the claim due to questionable exclusions.

Construction product manufacturers may share liability for product defect issues, and that liability would be outside the wrap limits. Product manufacturers, however, are not subject to strict liability under California's Right to Repair law. In *Acqua Vista Homeowners Assn. v. MWI, Inc.* (2017) 7 Cal.App.5th 1129, the California Supreme Court ruled that Civil Code section 936 requires proof of negligence or breach of contract in a claim under the Right to Repair Act against a product manufacturer. Therefore, counsel needs to consider when deciding whether to name and serve product manufacturers if standard of care evidence will be available to prosecute this claim, and whether it is in the best interests of the defense to make such a claim at all. Making a product claim against a manufacturer can backfire on the defense.

To this end, when analyzing a claim involving corroded cast iron pipe, the defense might also consider the possibility of methane gas drifting from the main trunk lines in the public right of way through the sewer laterals into the drain, waste and vent system of the project. If the lateral connection, which is often made by the public agency, is not fully submerged, gas can drift into the drain, waste and vent system of the project and greatly accelerate what would otherwise be a slow, gradual deterioration of the cast iron pipe. Running P-traps in laterals are not allowed by some jurisdictions, so methane gas can drift into the cast iron drain, waste and vent lines through the lateral. Public agencies can be held accountable for this significant contributing factor.

Finally, remember that each case is unique. Hi-rise cases do not fit a mold. The exposure is higher than historical norms and the more insurance available, the higher the claim. All the more reason for all members of the team to hurdle early and often.