



The Insured Defense Against Construction Defect Claims

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It is well-settled that insurance defense counsel cannot be involved in any insurance coverage dispute between their insured client and their insurer client. It is also generally accepted that insurance defense counsel can do nothing in the conduct of the defense that harms the primary insured client's coverage position. These twin ethical obligations of nonparticipation in the coverage dispute and preservation of the insured client's coverage are seen by some as paradoxical: insurance defense counsel must scrupulously avoid coverage just as they must sufficiently immerse themselves in it to avoid prejudicing the insured's coverage rights. The paradox is more perceived than real, however, for neutrality and awareness are not incompatible obligations. Insurance defense counsel can studiously avoid the coverage dispute while at the same time understand it as a means to crafting the right defense. This article explores a few examples.

Perhaps the most difficult consideration for defense counsel is when, or more importantly, when not to file a motion against the complaint. In non-insurance situations, a reduction in claims generally lowers the risk to the defendant. That is not always the case with insured clients. Defense counsel must be careful not to knock out the very claim that has triggered the insurer's obligation to defend. For instance, successfully moving against all claims except fraud may



help the liability picture, but if the insurer pulls coverage as a result, the insured will be prejudiced. Defense counsel may reason that the overall liability was reduced from \$500,000 to \$100,000 as a result of the motions, and the insured is therefore better off. However, the insured would likely prefer to have \$500,000 in covered liability than \$100,000 in uncovered liability. If dispositive motions will ultimately benefit both the insurer and the insured, the insurer may be willing to withdraw its reservation of rights in order to reduce the overall exposure. This, however, is the exception, not the rule. Without such an agreement, defense counsel should consider the effect of the motions on the insured before filing.

Defense counsel should also be wary of requesting increased specificity of dates alleged in the complaint. With respect to the duty to defend, if a claim is

potentially covered by the policy, there is a duty to defend. Without specific dates, the insured may have additional leeway in arguing that its carriers must provide a defense. The carriers usually press for a specific project completion date to determine whether they can deny coverage for "ongoing operations." If the plaintiff is required to plead exact dates, the insured may lose the defense of one or more carriers.

Certainly, this article is not meant to suggest that motions have no place in defending an insured. However, defense counsel should carefully weigh the pros and cons of filing any motion. If the motion will significantly reduce the potential liability, the motion may be warranted. If the plaintiff will have fewer claims, but the same prayer for damages, the motion may accomplish little more than potentially jeopardizing coverage.

Motion practice is not the only problematic area driven by coverage issues. Certain coverage issues may influence deposition strategy, trial preparation, and trial presentation. For instance, a policy may contain a "known loss" provision or a provision restricting coverage to property damage that commenced during the policy period. Normally, defense counsel would exhaustively depose plaintiff's fact witnesses to establish plaintiff's timeline. With the above insurance provisions at play, defense counsel may have to avoid pressing fact witnesses to establish when they first learned of any property damage and/or when they first notified the

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client. Likewise, defense counsel may have to avoid pressing facts at trial that are good for liability but bad for coverage. For instance, plaintiff's notice to the insured client may establish that a portion of plaintiff's damages are barred by the applicable statute of limitations. However, that same information may establish that the insured client knew of the property damage prior to the policy period thereby negating coverage. The result may be a partial liability victory that defeats all coverage.

Other exclusions/provisions create similar tensions. It may be beneficial for defense counsel representing a general contractor to argue that liability for construction defects is solely the fault of an EIFS installer. While that strategy may be beneficial for liability purposes, it may negate coverage for the general contractor under its own policy due to the existence of an EIFS exclusion. The "expected injury" exclusion may also be problematic. A contractor, for instance, may inform the general contractor that proposed construction or a proposed repair will be insufficient. If the contractor is instructed to perform the work anyway, the contractor's carrier may argue that the contractor expected the damage and there is therefore no coverage.

The use of experts may also be altered by particular coverage issues. It is not uncommon for defense counsel to solicit an expert opinion that there are construction defects, but no resulting property damage. Insurers are quick to argue that liability policies cover property damage, not defective work. If the expert testimony reduces the liability exposure but negates the carrier's indemnity obligation, it may cause more harm than good.

The above issues relate specifically to defense counsel's involvement in the coverage issues affecting the insured cli-

ent. Other issues, while not necessarily relating to the coverage dispute between the two clients, should be noted by defense counsel to avoid potential pitfalls. While defense counsel is prohibited from involvement in coverage issues between the two clients, there is no prohibition against involvement on behalf of the insured with other carriers who either are not defending the insured at all or who are defending through another firm. Ensuring that necessary tenders are made is often problematic. The insured client should be able to identify its own insurance policies. It is not uncommon, however, for the insured to provide only the policies that obviously relate to the litigation. Sometimes umbrella policies, older policies, or "less than obvious" policies (e.g. builders risk or property policies) are not provided. Defense counsel should confirm that all policies are provided by the client regardless of whether the client believes they apply. If necessary, defense counsel should contact the client's insurance agent or broker to ensure that all of the policies have been identified.

Confusion can arise with respect to policies that were not purchased by the client. For instance, in the condominium construction context, representatives of the developer often serve on the homeowners association (HOA) board of directors. The bylaws usually require the HOA to insure the board members. These policies may provide a defense and/or indemnity for the client and/or its representatives.

Ensuring that all of the policies are obtained avoids a major trap for defense counsel, the existence of "claims made" coverage. Policies that relate to professional liability, directors and officers coverage, and other similar policies are often "claims made," meaning that the policy in place at the time the lawsuit is commenced is the one that provides cov-

erage. When defense counsel is retained, there may be a very short window to trigger coverage under an applicable claims made policy. If the window closes, the insured client may be saddled with uncovered liability.

Defense counsel should bother, cajole, remind, and badger the client until convinced that all potential sources of coverage have been identified. Defense counsel should arrange for client documents to be reviewed as soon as possible to determine if there are additional sources of coverage. Defense counsel should contact potential third parties, including brokers and even plaintiff's counsel, for insurance information. If there is even a slight chance of coverage under a claims made policy, the best course is to request authorization from the insured client to tender immediately. When determining whether additional tenders are beneficial, however, defense counsel should be wary of an exclusion used by some carriers negating coverage if the defense of the lawsuit is tendered to any other carrier.

While defense counsel cannot become "involved" in the coverage issues between the insured client and the carrier, a working knowledge of the coverage issues will protect both the insured client and defense counsel. Defense counsel should carefully read the reservation of rights issued to the insured client to understand what issues need to be avoided or what actions need to be curtailed. It may also be necessary to establish with the carrier how defense counsel's reports will be used. If the information can be used in a coverage dispute, defense counsel may need to filter the information to the carrier. While understanding the coverage issues does not guarantee a risk free defense, it at least identifies some of the land mines for defense counsel to avoid. ☺