THE TEN MOST IMPORTANT INSURANCE COVERAGE ISSUES FOR A MEDIATOR TO KNOW, UNDERSTAND, AND FOCUS ON IN RESOLVING A CONSTRUCTION DISPUTE

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"Resolution of Construction Liability Issues"

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I.

INTRODUCTION

One of the least understood aspects of successfully mediating construction cases is the availability of insurance coverage. Boldly stated, often the settlement turns on the ability to bring into the case OPM (Other People's Money) to help settle the case.

In those cases where insurance money is potentially available to help settle a case, the Mediator needs to not only be well-versed in the law relative to insurance coverage but well-versed in how insurance money is used in settling cases in the real world.

The purpose of this Article and presentation is to provide lawyers, parties, and mediators a better understanding of what I perceive to be the ten most important insurance coverage issues for a Mediator to know, understand, and focus on in order to increase the chances of successfully resolving a complex construction dispute.

II.

THE TOP TEN

1. What affirmative claims have the potential to trigger insurance coverage? Have the parties/counsel thought of the potential for insurance coverage of the claims in which the party/counsel is involved?

The first thing I like to do is to create a flow chart that contains all the affirmative claims being asserted in the case. The flow chart should indicate what claim is being made, by which party, and who the claim is

against. I also like to use "handles" for the major claims so they are easier to remember.

Once I have all the claims flowcharted, then I examine the nature of the claim and ask if there is any potential that this claim might be covered by insurance. I note the type of coverage that would be involved—primarily CGL and E&O, but also Builder's Risk and Products Liability.

Then I initiate a conversation with the applicable party/counsel on the insurance issue. Sometimes there is a carrier already involved. If that is the case, I get the name of the carrier and adjuster—as well as their contact information. Of course, it also is important to learn the amount of the coverage, the deductible or SIR, and whether it is a burning limits policy.

My goal is to develop a chart that shows all the affirmative claims and the applicable situation re insurance coverage—whether a carrier is already defending or if there is just the potential of bringing in a carrier.

Then I regularly update this chart/flowchart.

2. Are there any claims that have the potential of triggering a performance bond?

An often overlooked potential for "insurance-like" assistance is the existence of a performance bond. Of course, bonds are most common on public works projects—but I have seen them on large private projects as well.

If that is the case, the Mediator needs to look at the chart discussed above and ask the same questions with respect to the applicability of a performance bond. The potential for a bond being available for financial contribution typically is increased the closer the project is to being recently-finished.

If I have any doubt, I informally turn to my friends who are more knowledgeable about bond claims than I am. So it would not be unusual for me to contact someone like Marilyn Klinger and get her opinion on the propriety of making a performance bond claim with respect to a particular

affirmative claim.

3. Have the applicable parties and counsel taken the steps necessary to trigger potential insurance coverage?

There are two "dark secrets" in this area that need to be recognized and understood by the Mediator.

First, sometimes a party is represented by counsel who is not familiar with insurance coverage—and therefore has done nothing to pursue the potential for coverage. In those cases I offer quiet, diplomatic assistance to that party/counsel on how best to pursue the potential for insurance coverage.

The second "dark secret" is that parties being defended by an insurance carrier are often unaware of the inherent conflict of interest in the insurance defense carrier representing them—i.e. that the defense lawyer is being paid by the insurance carrier. This dynamic can result in a failure to pursue the potential for *Cumis* counsel—when having *Cumis* counsel could dramatically increase the chances for settlement.

In those cases I offer quiet, diplomatic assistance to the party seeking to obtain its own (independent) insurance coverage counsel. I always first clear providing such help with insurance defense counsel. Defense counsel typically readily agree because they do not want to be in a position where the insured can later contend the insurance defense counsel represented the interests of the insurance carrier over the interests of its client.

For example, I was involved in a large, complex case on a public works project. The project was intended to turn agricultural waste into electricity. The problem was that a lot of the waste was so "toxic" that is caused painted surfaces to peel and damaged the metal parts in the system that combined and then burned the agricultural waste to create the heat necessary to generate electricity.

I recommended that two of the contractors with seeming divergent interests together hire a nationally-known expert on insurance coverage in construction disputes. They agreed. The expert then wrote a seventeen page

letter about why both contractors had coverage under their CGL policies. The carriers then agreed to defend under a reservation of rights. But they were looking at potentially hundreds of thousands in legal fees and costs. They ended up making sizable contributions and we were able to settle the case.

4. Are there any parties/counsel who need assistance in taking action to potentially trigger insurance coverage?

It is common to have some of the smaller parties in a case represented by a lawyer who has represented them for years. This situation is typical in the case of smaller subcontractors and suppliers. The party may never have even been sued before. So they are very much like a deer in the headlights. Their lawyer may be a trusted, long-time friend but not be a construction lawyer let alone a lawyer who knows the law about insurance coverage of construction disputes.

In this type of instance, I again endeavor to diplomatically and quietly assist the lawyer and the party. On the low end of the scale, I help them understand their policies and write tender letters to their carriers. On the high end, I refer them to one of my cadre of what I call my "fire-breathing coverage lawyers." That is, I recommend that they hire a coverage lawyer to assist them. Of course, whether to take such an action depends on the amount of the exposure of the smaller party in the case.

I recall one case which helps to illustrate this issue. It was a large residential CD case involving a Hollywood celebrity—a very big Hollywood celebrity. The small party involved specialized in doing high-end exterior plastering work. His company was known virtually as "an artist" when it came to exterior plaster finishes on high-end residences in Bel Air and Beverly Hills. This plastering subcontractor had never been sued in working in Southern California for something close to 20 years.

He was being defended by his carrier but under a strong reservation of rights. During one of the Mediation Sessions the adjuster got up, declared the carrier had determined there, in fact, was no coverage and, therefore, that the carrier was no longer defending the plastering subcontractor, and walked out of the Mediation Session. The subcontractor sat there dumbfounded in

my conference room, with plaster on his shirt, pants, and boots. He asked me something like: "What the h…. just happened?" The insurance defense lawyer apologized and slowly backed out of the conference room as well.

I immediately called one member of my cadre of insurance coverage lawyers. As a favor, my friend came into the case immediately. The next day he filed a declaratory relief and bad faith action against the carrier. The next day the carrier, the defense lawyer, and the adjuster all were back participating in the case.

5. If any parties/counsel have triggered insurance coverage, what type of coverage is involved, who is the carrier, and has the carrier assigned an adjuster? Is there the potential that more than one policy is triggered? Is there the potential for appointment of *Cumis* counsel?

It always is important to know what type of coverage has been triggered, the name of the carrier, and the name of the adjuster. I want all of this information so that I know what I am dealing with coverage-wise. Also, I want to include this information on my master flowchart.

Also, it is important to know if there is the potential of more than one policy being triggered. This situation typically occurs when there has been a situation of "continuous loss" such as water intrusion. Smaller contractors (and even some large contractors) change carriers often—sometimes every year.

There is a special situation that can develop once a reluctant carrier is "forced" into participating in the case. A carrier can fight like a hurricane in "denying coverage" but once that carrier is successfully brought into a case the first thing that carrier does is look around for other carriers who also might be "on the hook" for the same risk. In the industry, this approach is known as "spreading the pain." That is, once a carrier is on the hook in a case it wants to find other carriers who can come in to share the pain (cost).

In this instance, the interests of the insured and the first insurer align. Being able to bring in one or more additional carrier(s) spreads the pain for

the first carrier and gives the insured more pockets out of which settlement contributions might be made.

Finally there is is the issue of *Cumis* counsel. If a carrier is defending under a reservation of rights, generally the insured is entitled to retain its own separate counsel as well—but at the expense of the carrier. Thus, the party's regular counsel may be able to be involved to protect the interests of the insured and be able to function as the counsel who "beats on the table" for the carrier or carriers to accept an offer within policy limits and thereby remove the insured (his or her client) from "harm's way."

An excellent article on the fundamentals of the use of *Cumis* counsel is "A Brief Primer on Insureds' Rights to Insurer-Paid, Independent ("Cumis") Counsel by Mark L. Sherman, Esq. of the San Francisco office of Smith, Currie & Hancock (2013).

6. Make a table showing all affirmative claims by party, who the claim is against, and the applicable actual insurance company and the adjuster. Also include potential insurance companies in the table. Mark the actual and potential insurance carriers in the case.

I cannot over-emphasize the importance of developing this chart. If at all possible it should be on one page of paper—even if it is a larger size sheet.

By having all the claims and all the potential insurance coverage (including amounts) in one place enables the Mediator to see the "big picture" of the case vis-à-vis settlement. It also enables the Mediator to see where there could be problem areas and, therefore, where energy needs to be invested to help the case to settle.

It also will show which carriers are not yet on board with participating in the case. So the chart shows specifically where pressure needs to be brought to bear, if appropriate, to make a specific party in the case more likely to participate in a global settlement.

7. Develop a personal relationship/connection with any designated insurance adjuster.

Having done construction mediations for a number of years, I already have relationships with a number of the important adjusters who handle construction cases here in California.

But if I do not know a particular adjuster I go out of my way to speak with that adjuster and develop a personal rapport with that adjuster. I am going to need that adjuster to have a sense of "good will" toward me and, most importantly, toward settling the case.

I want the adjuster to know that I am on his or her side—and, specifically, that I know they have their own pressures within their company and that I will do everything I can to make sure that, when the time comes, they can write a truthful and enthusiastic memo to his or her boss recommending settlement. As I have stated, I want the adjuster to feel that they can write a memo to his or her boss that makes them (the adjuster) look like a hero when it comes to the interests of the carrier.

8. If a party is being defended by its insurance carrier always remember that while defense counsel may represent the insured party, defense counsel is being paid by the carrier. Do not be afraid to diplomatically counsel a party directly on the realities of being defended by a carrier.

Inexperienced parties who are being defended by insurance defense counsel often think of the defense lawyer as "their lawyer" in that they believe that the lawyer is 100% dedicated to their interests.

I have had success in convincing insurance defense counsel to let me talk privately with their insured. In this meeting I can find out what is really happening on the defense. More importantly, I can counsel the insured to be more aggressive toward the carrier about paying in order to get them settled out of the case.

Sometimes this private counseling results in just a more aggressive insured. Sometimes it results in the appointment of *Cumis* Counsel.

9. When warranted, assist the parties/counsel in the use of policy limits demands.

As the case progresses, it can become more clear what path a case needs to go down in order for it to settle. In these instances I have found it very important, as justifiable, for the claimant (with the support of the insured) to make a policy limits demand on the carrier.

Of course, failure to accept a reasonable settlement offer within policy limits can constitute bad faith on the part of the carrier (thereby potentially blowing the policy limits under the policy).

I have gone so far as to provide the insured a template letter to use in making a policy limits demand. Depending on the circumstances, sometimes this letter goes directly to the insured; sometimes it goes to Cumis Counsel or separate coverage counsel.

10. Are there any claims that have the potential of triggering a performance bond? Always remember that the goal is to create a narrative that not only triggers coverage but that when communicated to the adjuster makes them "look like a hero" in recommending the amount you need as the Mediator from that party in order to settle the case. In short, walk in the shoes of defense counsel and the adjusters so that they look like they did a masterful job in representing the financial interests of the carrier.

The heart and soul of successfully mediating a dispute is having the ability to see the case from the shoes of each party—as well as their counsel.

Settling a case is about satisfying "needs" so that those who are contributing to a settlement have "political cover" in making their recommendation re settlement. Again, so I like to say that my goal is to develop the argument on insurance coverage to the point where, when made to upper management, the author (defense counsel and/or adjuster) will look like "heroes" to management of the carrier.

As such, it is critical to stress and articulate in great detail the potential downside for the insured and the carrier should trial of the case go

south. By persuasively detailing the "worst case scenario" it creates a record in the carrier's file of what the Mediator said could happen if the case unravels at trial. It is this type of memo in the file that can get defense counsel and adjusters in big-time trouble with a carrier. The after-the-fact question by upper management is something like this: "Given these facts and what you knew was the law, why on earth did you not settle this case?"

I will end with one story that illustrates this point. I was mediating a large CD case. There were something like 15-20 parties. I had settled out all the parties except the architect—whose counsel had resisted settlement throughout the mediation. This architect and its defense counsel had been riding the coattails of the general contractor and larger subcontractors and suppliers with respect to experts. That is, to save money the architect had not retained any of its own experts.

The owner, being represented by a smart and experienced construction lawyer, had been having the expert for each party "assigned" to the owner as part of each settlement. The owner and the architect were required to go to arbitration. When all the parties had settled but the architect, the owner had control of all the experts of every party who had settled.

I wrote a Mediator's Proposal to settle these last remaining claims (Owner/Architect). I recommended a number (around $650,000) that was within the amount still in the architect's E&O policy (which was, of course, a burning policy). I calculated the exposure of the architect if the arbitration went south to be in the area of $4,000.000. I expected the architect to accept the Mediator's Proposal and the owner (who, at best, can be described as mercurial) to say no.

Instead, they flipped on me. The owner said yes to the $650,000. The architect say no. So there was no deal.

The case then went to arbitration. The architect having designated no experts could not call an expert in the evidentiary hearings. The Award was approximately $4,000,000 against the Architect—well in excess of its $1,000,000 policy. To pay the Award would have bankrupted the Architect. Instead, the Architect sued its insurance defense counsel for malpractice for

not recommending to the architect that it accept the Mediator's Proposal within the remaining policy limits.

A lesson to the wise. Only in the most clear of clear circumstances turn down a Mediator's Proposal with thoughtful and reasonable analysis if that Mediator's Proposal is within policy limits.

III.

CONCLUSION

If a construction case involves insurance coverage issues, legal knowledge and expertise on insurance coverage issues are essential for a Mediator to successfully lead settlement of that case. In addition, the Mediator must have "real world" knowledge of how insurance coverage works and how to work with insurance professionals.

Hopefully this Article has provided some guidelines that will contribute to improving the chances of settling your next complex construction case in which insurance coverage is a key issue.