

***CONSTRUCTION
LITIGATION
DEFECTS:***

***DEFENSE & COVERAGE CONSIDERATIONS
IN CONSTRUCTION MOLD CASES***

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I. INTRODUCTION:

Historically, construction claims have been some of the more complex matters handled by the insurance industry. Issues such as the number of potential parties, the various contractual relationships between the parties, and a determination of whether the loss is actually covered, all necessitate that these cases receive an early and detailed defense and coverage analysis.

The past few years have now added yet an additional dynamic to this already complex analysis. Long threatened "sick building" litigation is finally gathering momentum by the more and more common claim that a building's indoor air quality is somehow impacting the occupant's health or the building's value. The majority of these claims arise in construction settings where mold and other indoor air contaminants are allegedly present in buildings because of various new or remodeling construction defects.

While these claims seem to create a new set of questions to answer, the insurance professional should not abandon the tools already honed in past construction and latent injury cases to answer these new questions. Therefore, this presentation will focus on construction defect issues, and how some of these issues are impacted by the indoor air quality claim. Our discussion centers on a relatively common fact pattern involving water infiltration into a commercial building which causes mold growth in construction and non-construction areas of the structure.

We do not intend this talk as a defense or coverage issue checklist for water infiltration/mold construction cases. Instead, our comments intend to raise some of the "red flags" which will likely need to be addressed in these cases, and which will also likely raise additional defense or coverage questions as the claim handling proceeds beyond these initial considerations.

II. CASE PATTERN:

Large commercial buildings are at risk for water infiltration at the time of construction, once construction is completed, and during times when the building is undergoing significant repairs or remodeling. Here, a large commercial structure is leased to various office tenants. The building's Owner contracts with an Architect to design an addition, and to oversee a re-roofing of the present building. The Owner contracts with a General Contractor to build the addition, and to replace the present roof. The General Contractor hires various Subcontractors to perform some of the work called for in the Owner/General Contractor Contract, including the roof replacement. Typical American Institute of Architects ("AIA") or Associated General Contractor ("AGC") Contracts are utilized between the Owner and the Architect, the Owner and the General Contractor, and between the General Contractor and the Roofing Subcontractor.

During the roof replacement portion of the Project, water infiltrates into both the original building and the building addition over a three week time period. The infiltration is ultimately discovered following a heavy weekend downpour which has caused additional amounts of water to enter the present building and addition. While some of the damage is readily apparent, other damage is latent in that water entering the building in the three weeks before the downpour has infiltrated into closed areas of the structure and addition, and, even prior to the weekend downpour, caused mold to grow in these areas.

Prior to the Project's commencement, the structure was covered by the Owner's first-party "all risk" policy. No additional first-party coverage, whether by separate coverage or by endorsement, was procured as part of the Project. The Owner holds a standard Commercial General

Liability ("CGL") policy to cover tort losses. The General Contractor also holds a standard CGL policy to which the Contractor adds the Owner as an additional named insured. In addition, the General Contractor purchased an Owners & Contractor's Protective Liability (OCP) Policy naming the Owner as the named insured. The Roofing Subcontractor also holds a CGL policy which does not include any other entities as additional insureds. Each of the Owner's, the General Contractor's, and the Roofing Subcontractor's CGL coverages include contractual liability coverage for "insured contracts."

The Owner discovers the water infiltration on a Monday morning following the heavy weekend rainfall. However, it is ultimately determined that the majority of the resulting mold arose from water infiltration prior to the heavy rain weekend. The Owner does not report the loss to its first-party property damage carrier until approximately ten days after the discovery, but immediately informs the General Contractor of the infiltration.

III. DEFENSE CONSIDERATIONS:

A. PRO-ACTIVE APPROACH:

Regardless of the entity insured, a prompt and early response to the Notice will provide a greater opportunity to identify:

- how the infiltration occurred;
- the moisture's infiltration pathways;
- the amount of mold caused by the latent infiltration vs. the heavy rain event;
- the scope of response, and therefore the amount of damage, potentially involved; and

- whether any entity is at fault.

B. IDENTIFY THE INSURED’S RESPONSIBILITIES AT POINT OF LOSS:

1. Identify Contractual Responsibilities in Event of Loss:

- Key: Obtain all Contracts: Construction, Insurance or otherwise!

a. To Insurers:

i. First Party Insurer:

- Notify and/or tender the matter:
 - The Insured’s own First Party Carrier;
 - To other First Party Insurers who may have applicable coverage for the loss;
- Mitigation of damages.

ii. Liability Insurer:

- Notify and/or tender the matter:
 - The Insured’s own Liability Carrier;
 - To other Liability Insurers who may have applicable coverage for the loss.

iii. Surety or other Insurer:

- Notify the Insured’s own Surety Carrier.

b. To Third Parties:

- Notify and/or tender the matter to other entities involved in the Project.

c. To Governmental Entities:

- Any applicable Municipal, County, State or Federal entity which might be impacted by the damage.

2. Control Over Site:

- Determine which entity had the contractual and/or common law duty to exercise control over the Site at the time of the water infiltration:
 - If not the Insured, be sure the entity is placed on Notice of the damage, and that the Insured understands that the damage may have arisen because of a failure of that entity to exercise the requisite control over the Site.
- Determine which entity has the contractual and/or common law duty to exercise control over the Site *after* the Loss:
 - If not the Insured, be sure the entity is placed on notice of the event, that the other entity has confirmed it will or has taken control of the Site, and that the other entity is aware that it is required to employ efforts to mitigate damages if at all possible.

B. PRESERVE EVIDENCE:

- While related to control over the Site, the insured is required to preserve evidence or face possible spoliation of evidence claims.

C. INVOLVE THE RIGHT EXPERTS EARLY ON:

- More Than One Sub-Speciality is Likely Required:
 - Remediation/Repairing Contractors;
 - Structural Engineers;
 - Architects;
 - Design Engineers;
 - General Contractor;
 - Indoor Air Quality Experts;
 - Attorneys.

D. LOOK IMMEDIATELY AT TRANSFERRING ULTIMATE LIABILITY:

1. Tort Liability of Third Parties:

- What entity was charged with the common law responsibility to prohibit the damage at issue:
 - General Contractor;
 - Roofing Subcontractor;
 - Other entities.

2. Contractual Liability of Third Parties

- AIA and AGC Contract forms typically employ indemnification provisions to prospectively shift the risk of loss in the event of an occurrence. For example:
 - AIA Form 201 Section 3.18.
- The scope of construction contract indemnification agreements are limited by Minn. Stat. Ch. 337:
 - Indemnification agreements between construction professionals which seek to have the Indemnitee's fault assumed by Indemnitor are unenforceable; however, recovery may be available against the Indemnitor for breach of contract if the Indemnitor fails to procure insurance to cover the indemnification agreement. Minn. Stat. § 337.02, 337.05, subd. 1

IV. COVERAGE CONSIDERATIONS:

A. IDENTIFY ALL OF THE INSURED'S COVERAGES:

1. First Party:

i. General Property Coverage:

- Use of the pre-existing property coverage may cut off an Owner's First-Party Carrier's subrogation rights against liable Third Parties.

ii. Specific Coverages such as Additional Property Damage Endorsements, Fire, or Builder's Risk:

- Procuring additional First-Party coverages may allow the additional specific First-Party coverage to subrogate against potentially liable tortfeasors, providing the subrogation is not in violation of any applicable "anti-subrogation" rule.
- When does the coverage end as to what parts of the Project?

iii. Other Insurance That Expressly or by Category Names the Insured as an Additional Named Insured:

- It is possible that the General Contractor (and all Sub-contractors?) may have been endorsed onto the Owner's pre-existing First-Party property coverage or additionally procured First-Party coverage as an additional named insured.
- If the Insured is covered under more than one policy, even if the policies are different types of coverage (i.e. first-party and third-party), a "closest to the risk" Other Insurance analysis may be applicable.

iv. Is There Coverage Under the First-Party Policy?

- Specified Coverages or "All-Risk;"
- Potentially Applicable Exclusions:
 - Defective Workmanship or Construction;

- exclusion's exception may provide coverage to loss *resulting from* faulty workmanship;
- Latent Defect Exclusion:
 - while language excludes damages caused directly or indirectly from, among other conditions, "mold," some Courts limit the exclusion's effect, whether by use of an exclusion's exception or focus on the fact pattern;
- Concurrent Cause Issues:
 - What is the level of "exclusion language" available under each of the sections of exclusions?
 - wholly excludes coverage even if the excluded cause is remote? (Exclusions which do not cover damage "caused directly or indirectly by");
 - wholly excludes coverage only if the excluded cause is predominant? ("Overriding Cause");
 - partially excludes coverage for the portion of the loss caused by the excluded cause?

2. Coverage Under Third Party Liability Policies:

i. The Insured's Own Liability Coverage:

- Prima Facie Coverage Issues:
 - "Trigger:" "Property Damage" or "Bodily Injury"
Within the Policy Period;
 - "Loss of Use."
- Potential Applicable Exclusions:
 - "Absolute" Pollution Exclusion;
 - "Business Risk" Exclusions: Is there "Damage to
Other Property?"
 - "Your Product;"
 - "Your Work" and the "Subcontractor"
Exception;
 - "Impaired Property;"
 - Care, Custody or Control Exclusion;
 - Joint Venture;
 - Contractual Liability Exclusion.
 - Does an "Insured Contract" include a breach
of a duty to procure insurance?

**ii. Other Third Party Coverages that expressly or by category name
the Insured as an additional named Insured:**

- Example: the Owner's additional named insured status on the General Contractor's liability policy.

B. IDENTIFY ALL OF THE INSURED'S CONTRACTUAL RELATIONSHIPS:

1. "Coverages" May Be Available to the Insured Through its Contractual Relationships with a Third Party:

- An Indemnification Clause may be enforceable if coverage was procured to insure the obligation.

2. Coverage May Not be Available to Some of the Insured's Contractual Promises:

- Does one of the construction contracts signed by the Insured require it to procure coverage to insure an indemnity obligation? If so, and if coverage was not procured, Minn. Stat. Ch. 337 allows the prospective Indemnitee to assert a breach of contract claim against the Insured for failing to procure the coverage to insure an indemnity obligation. However, such an obligation to procure insurance, because it is not an indemnification agreement, may not be an "insured contract" for the purposes of the exception to the contractual liability exclusion.

2. Confirm Whether Subrogation or Other Recovery Rights are Viable:

i. Is There a Waiver of Subrogation Provision?

- AIA Form 201 Section 11.4.7 contains a "Waivers of Subrogation" provision which may limit the extent of subrogation to that involving the "Work."

ii. Is the Liable Third Party:

- **Solvent?**
- **Insured?**
- Be Sure to Obtain the Policies Insuring the Liable Third Party.

V. CONCLUSION:

Even if the insured's liability in a construction claim is small, such claims are rarely inexpensive to adjust or litigate. Early investigation and analysis of 1) the contractual and insurance relationships between the parties and 2) the building's condition, provides the claims professional with the best opportunity to estimate the Insured's potential exposure, or the Insurer's coverage risk and potential subrogation avenues, especially in construction defect cases impacting a building's indoor air quality.

Seminar Materials (267783).wpd