

Strategies & Solutions for Success



Prepared for:
State of Oregon
Construction Claims Task Force

Presented by:
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C-Risk, Inc. – Profile

C-Risk, Inc.

- Nationwide Construction Risk Management Consultancy
 - ✓ Founded in Chicago & Incorporated in Delaware 1999.
 - ✓ Principal Office located in Portland, Oregon.
 - ✓ Provides Services Exclusively to Construction Industry.
 - ✓ Collaborative Network of Independent Construction, Insurance and Risk Management Professionals.
 - ✓ Specialist in Design & Formation of Wrap-Up Programs,
 - ✓ Construction Defect Mitigation Program Frameworks,
 - ✓ Alternative Risk Transfer & Risk Financing Strategies.

David L. Grenier – Biography

David L. Grenier

- 30 Years Experience in Construction & Insurance Industries
 - ✓ Project Management with ENR Top Construction Firms.
 - ✓ Account Executive – Zurich Insurance, Construction SBU.
 - ✓ Sr. Vice President – CNA Insurance, Construction SBU.
 - ✓ B.S., Construction Management, Syracuse University.
 - ✓ M.B.A., Finance, Marketing Management, Policy/Strategy, University of Chicago Graduate School of Business.
 - ✓ Co-Chair CFMA Construction Industry Liaison Committee.
 - ✓ Construction & Insurance Author, Speaker & Facilitator.

Presentation Objective

To accomplish the goal of developing a broad understanding of the residential construction defect dynamic, and focus on two topic areas:

❖ **Construction Defects**

- ✓ CD Problem Areas
- ✓ CD Claims & Litigation Dynamic
- ✓ CD Impact on Availability of Liability Insurance

❖ **Construction Defect Mitigation Program Designed to Manage the CD Liability Exposure**

- ✓ Wrap-Up GGL Construction Policy Coverage
- ✓ Aggressive Quality Control / Quality Assurance
- ✓ Homebuyer's Warranty and Service Agreement

Construction Defect Mitigation Program

Overview of the Residential Construction Defect Dynamic



Definition

An understanding of construction defects requires a definition of the term

What is a Construction Defect?

Construction defect is defined as "failure of the building or any building component to be erected in a reasonably workmanlike manner or to perform in the manner intended by the manufacturer or reasonably expected by the buyer, which proximately causes damage to the structure."

Source: California Jury Instructions

In practical terms, a construction defect is anything that does not meet the reasonable expectations of homebuyers with regard to quality materials, installation or durability and results in damage to the home and possibly its contents and occupants.

Drivers & Root Cause

Four main construction defect drivers result in construction defect claims and lawsuits

Main Drivers & Deficiency Areas

- Design
- Material
- Construction
- Subsurface / Geotechnical Issues

Root Claims & Allegations

- Inadequate Design
- Inferior Building Materials
- Poor Quality / Workmanship
- Incomplete or Insufficient Geotechnical Data

NOTE: It is generally understood by top residential construction experts that addressing the top 10 construction defects will eliminate 90% of associated construction defect claims and litigation costs

CD Claim Types

The Top 10 Construction Defects can be broadly categorized into the following types of claims

Most Common Claims

- ✓ **Water Intrusion or Penetration**
- ✓ **Superstructure (Above Grade) Failures**
- ✓ **Substructure (Below Grade) Failures**
- ✓ **Soil Subsidence**
- ✓ **Noise Intrusion**

Most Recent Problematic Claims

- ✓ **EIFS (Exterior Insulation and Finish Systems)**
- ✓ **Toxic Mold**

Construction Defect Mitigation Program

The residential construction industry has experienced repetitive patterns of construction defects and has learned some very hard financial lessons

Common CD Claims:

Water Intrusion

- Roofing
- Sheet Metal Flashing
- Window & Door Installation
- Exterior Insulation Finishing Systems ("EIFS")

Rough Carpentry

- Lack of Fire Walls
- Absence of Insulation / Sound barriers (attached)

Foundation Problems

- Concrete & Masonry Work
- Subsidence

HVAC

- Inadequate sizing of system components
- System design & Installation Issues

Industry Lessons Learned:

Poor workmanship is the cause of most construction defect claims and lawsuits

Short-cutting quality control during construction costs *more* money in the longer term

Installation processes of components or materials frequently violate manufacturer's specifications

Water Intrusion issues are the number one category of construction defect claims

Homeowner's frequently lack an understanding of basic homeowner maintenance principles and often do not follow through

Plaintiff's attorneys are very creative and successful in turning poor workmanship into massive quasi-class action lawsuits

Adding to the complexity of the problem are the variations among states in how they view and address construction defect claims

- **States apply different standards of liability for Builder-Developers (e.g. California's Strict Products Liability)**
- **Sophistication of courts and the local bar varies considerably, impacting the speed, complexity and cost of resolving claims**
- **Some states have an active and aggressive plaintiff's bar "cottage industry" in residential construction defects (e.g. California, Nevada, Arizona - to name a few)**
- **Complex phenomenon, e.g., Toxic Mold and EIFS, more prevalent and/or problematic in some states (moist climates) than others.**
- **Hold-harmless contractual provisions and additional insured status means multiple insurers on the defendants' side - separate attorneys and experts and not always coordinated**
- **States take differing positions on Alternative Dispute Resolution**

*Understanding problem States is the first step
in managing the construction defect exposure*

States with Prevalent CD Issues:

California

Nevada

Arizona

Texas (Mold)

South Carolina (EIFS)

North Carolina (EIFS)

Colorado (Subsidence)

Florida (after "Andrew")

Oregon (CDs & Mold – TBD)

Washington (CDs & Mold – TBD)

The California Example:

Strict Liability for Builder-
Developers; ***General Negligence***
for Specialty/Sub-contractors

10 year Statue of Repose

A decade of developing CD
lawsuits (and caselaw)

**Strongest and perhaps most
aggressive CD plaintiff's bar**

**Homeowners' Associations sue
Builder-Developers, who then
cross-claim (via hold harmless
and/or additional insured
provisions) *all* specialty/sub-
contractors**

Several studies have broken down the most prevalent Residential Construction Defect Issues by Category

Construction Defect Breakdown by Building Subsystems

Roof Leaks	12%
Building Structure (Foundation, Walls, Masonry, Floors, Roofing, Siding, Decks, Balconies, Termites, Earthquake)	19%
Building Finishes (Paint, Plaster, Stucco, Soundproofing, Wood Rot, Exterior Finishes)	21%
Internal Systems (Electrical, HVAC, Security, Communication, Elevators, Solar Panels, Recreational Equipment & Facilities)	10%
Plumbing, Drainage & Other Leaks	21%
Infrastructure (Roads, Sewers, Driveways, Asphalt, Landscaping, Parking Structures, Lighting, Erosion, Subsidence)	17%

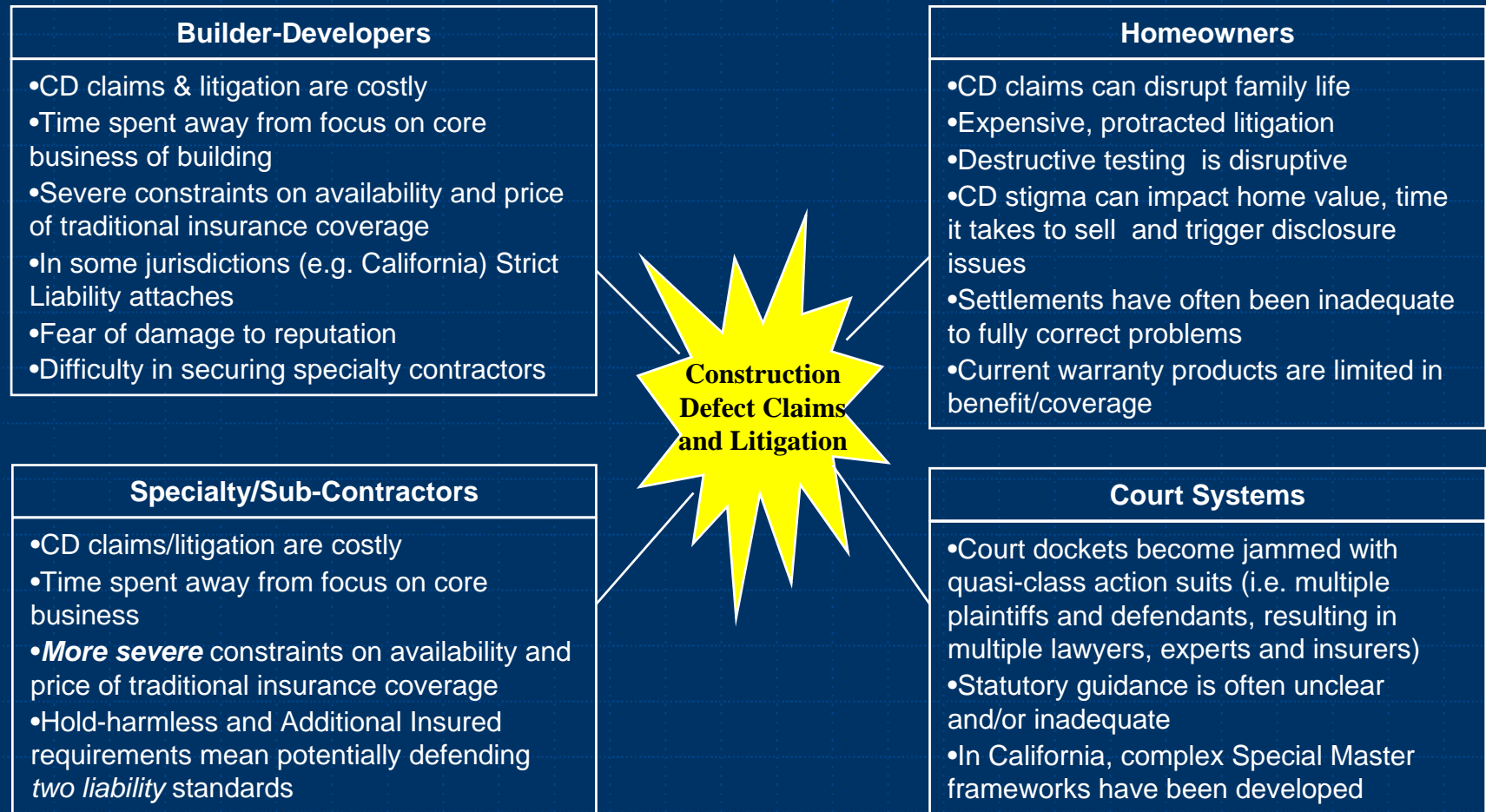
(Percentages based on Barton & Silverman Report, from California Department of Real Estate)

Construction Defect Mitigation Program

Impact of the Residential Construction Defect Dynamic



Construction defects adversely impact everyone touched by this dynamic



... And then there is the impact on the insurers and their responses

Impact / Effects on Insurers:

- Insurers often end-up defending multiple defendants on same project
- In Strict Liability jurisdictions, insurers for specialty/sub-contractors - via Hold Harmless and Indemnification and/or Additional Insured provisions - end up defending two standards of liability
- Duty-to-defend is often more costly than the indemnification of insureds
- Questions of fault are made more difficult with the passage of time (i.e. the older the alleged CD)

Sample Responses:

- Insurers have significantly curtailed coverage to contractors - some ceasing to participate in the residential construction market altogether
- Significant increases in GL premium rates (e.g. 50-200% in the last renewal cycle alone), lower limits of liability, particularly on Excess and Umbrella
- Multiple exclusions are being attached to policies (e.g. EIFS, Mold, subsidence, multi-family-attached and/or any residential construction)
- Vigorous denial / litigation over scope of coverage (i.e. costly coverage disputes)

Generally speaking, the theories or allegations which drive all aspects of Construction Defect Litigation reveals common theories in lawsuits

Types of Legal Theories Used in CD Litigation

- ✓ **Strict Liability (where applicable - 4 jurisdictions)**
- ✓ **Negligence**
- ✓ **Breach of Contract**
- ✓ **Breach of Express Warranty**
- ✓ **Breach of Implied Warranty**
- ✓ **Fraud**
- ✓ **Negligent Misrepresentation**
- ✓ **Breach of Fiduciary Obligation**
- ✓ **Negligent and Intentional Infliction of Emotional Distress**

Construction Defect Mitigation Program

Overview of a New Approach: CDMP



The CDMP is a proactive and holistic risk management approach to managing residential construction defects

- **Identify Top 10 Construction Defects**
- **Determined what it would take to eliminate CDs**
 - **Compiled relevant building codes**
 - **Compared codes to industry standards**
 - **Created quality construction standards to eliminate CDs**
- **Engineer risk management to address liability issues**
 - **Design initial warranty to provide non-insurance CD coverage**
 - **Develop wrap-up program to provide consistent CGL coverage for all contractors**
 - **Determine feasibility of Alternative Risk Financing**
 - **Integrate QA/QC program**
 - **Create new paradigm for CD Claims - warranty administration and extended service**

The Top 10 List

Top 10 Construction Defects

1. Roofing
2. Sheet Metal Flashing
3. Concrete / Masonry Foundations and Walls
4. Waterproofing / Damproofing
5. Rough Carpentry (Floors, Walls & Roofs)
6. Windows and Doors
7. Lath & Plaster (Stucco)
8. Painting (Exterior)
9. Plumbing
10. Soils (Subsidence)

The CDMP Solution is designed to change the way the construction industry manages construction defect exposures

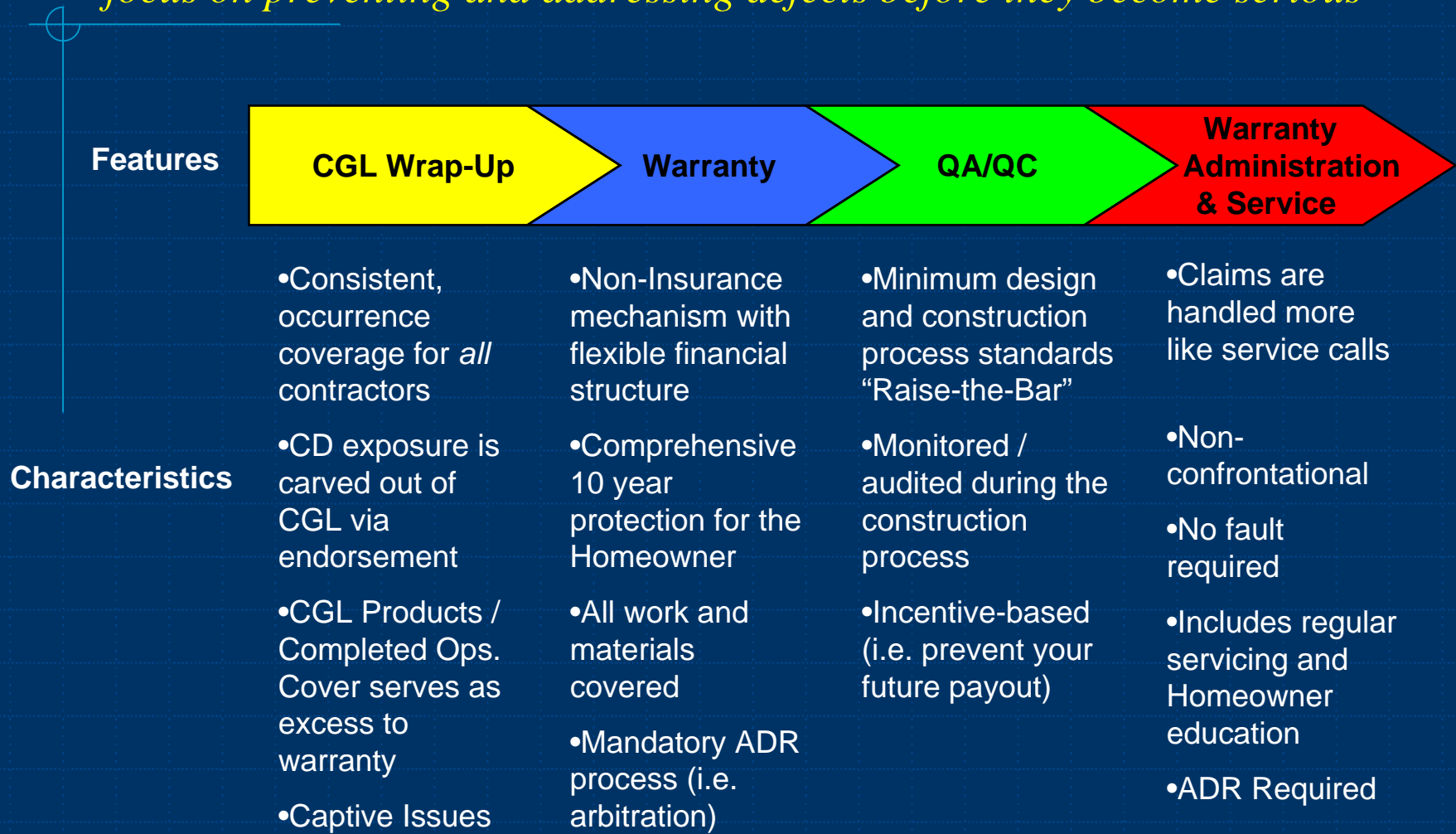
Features:

- ✓ **General Liability Wrap-Up**
- ✓ **10 Year Homeowner Warranty**
- ✓ **Alternative Risk Financing Mechanism**
- ✓ **Integrated QA/QC program during construction**
- ✓ **A full program of Warranty Administration and Servicing**

Note: A CDMP is based on a developed methodology that is flexible. Some elements will need to be tailored to meet each contractor/builder's specific requirements.

Construction Defect Mitigation Program

The Construction Defect dynamic can only be disrupted by an end-to-end focus on preventing and addressing defects before they become serious



Benefits

- **Risk Management Solution for Construction Defects**
- **Innovative Combination of Insurance and Non-Insurance Products and Services structured into a Holistic Program**
- **Reduce Builders' Costs by significantly reducing CDs and the resulting rework and litigation while stabilizing insurance costs; KEY = "Do it Right the First Time"**
- **Increase Builders' Profits; Differentiation, Reputation**
- **Improve Builders' Performance & Productivity**
- **Creates Value for Builder and Homeowner satisfaction**
- **Remove litigation dynamic, i.e., No lawsuits**

The question may arise, why a new approach? The answer is simple!

- **Given the history of residential construction defects, e.g., California, etc., the old paradigm is not working**
- **CGL was never designed to handle CD claims effectively, rendering this form of insurance coverage very inefficient**
- **“Who did what?,” conflicting standards of liability, overcrowded court dockets, too many litigants, attorneys, and experts means solving problem requires a different approach**
- **Current warranty products are inadequate**

Strategies & Solutions for Success

Q & A



C-Risk can help Oregon's CCTF develop an effective CD Mitigation Framework.

Lets talk about YOUR requirements.

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