

Past Trends & Present Challenges in Construction Defect Litigation

WHAT TO EXPECT AND CONSIDER IN CONSTRUCTION DEFECT CLAIMS MANAGEMENT

SUMMARY

The evolution and development of Construction Defect (CD) litigation on the West Coast and the accompanying East Coast have resulted from broad demographic, economic, and litigation trends in the U.S. As people have moved to warmer climates over the last two decades, especially to the Southwest and Southeast states like Florida, the demand for single-family homes has driven residential construction.

Prior to the recession, this building spike spawned litigation in lockstep due to alleged substandard building practices with claims-related property damage caused by reported poor construction. As courts became inundated with filings that required separate CD dockets and separate discovery processes, a cottage industry arose to manage documents, allocate billing, litigate claims, and deploy experts to evaluate damage.

As a result, insurers shifted focus to specialized CD units in an attempt to contain costs. Greater complexity and increased focus on costs will drive industry dynamics and CD resolution over the near term, as insurers continue to amend and tailor coverage to their contractor customers.

Early resolution of valid claims and proper collaborative management of litigation costs will help insurers to maintain market share and drive profits. RiverStone believes that, however your company chooses to manage its CD book, there are three important questions to ask around **approach**, **costs**, and **expertise**.

BUILDING UP TO THE PRESENT

In the last 20 years, the path for residential housing has been growth, collapse, and a slow climb out of the recession. Since the height of the building boom in 2005, when 2,155 new homes were authorized, the number of residential units has decreased by 41% to 1,264 authorized units in 2017. In 2009, at the low point for residential permits, home starts decreased by 80% from the high in 2005. It's also notable that the number of permits issued for buildings with five or more

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The profile and dynamic of new builds is changing, and with it CD claims management and litigation will change too.

residential units has increased by 14%, while they have decreased by 13% for single-family housing starts.¹

With fewer units being built, there have been fewer single-resident homes to litigate. As a result, the CD industry and accompanying litigation have moved on to some extent as well. So what's next?

CONSTRUCTION DEFECT LITIGATION PRACTICES

Typically, there are a number of factors that drive claims and litigation in construction – building types and purposes, the number of homes/units, and the number of stakeholders involved in the building process – all of which result in more complex litigation. An initial lawsuit against a builder is usually followed by multiple third-party lawsuits by the builder against various subcontractors.

As a result, there are numerous individual defendants and their accompanying attorneys. As one might expect, counsel for builders and general contractors direct much of the litigation. This includes managing the builder's defense of the homeowners' cases while prosecuting contract, indemnity, and tort causes of action against the subcontractors. The costs for documents, experts, and court fees only increase litigation spend further. With so many parties involved, it is not uncommon for legal fees to exceed settlement values.

The judicial process has changed significantly in an effort to resolve claims prior to litigation. Many states have enacted Right to Repair statutes to give builders the opportunity to respond to and resolve complaints in order to avoid litigation. Similarly, higher costs and crowded court rooms have led some judicial administrators to create Case Management Orders (CMO) that expedite document exchanges and encourage early resolution. In many cases, such adaptations can be costly, ineffective and have less certain outcomes.

POST-RECESSION CONSTRUCTION DEFECT TRENDS

So what's happening now? Fewer new home builds, with a decrease in single-family dwellings and an increase in multi-family dwellings, along with varied and different judicial processes, are all adding to complexity, litigation time and costs. Insurers are waking up to the real need to find and retain the right people who can tackle such complexity and who understand the risks in dollar terms.

Ultimately, the outcomes for the parties involved in CD litigation depends on costs. Successful parties will be those who are focused on early resolution of valid claims for the right amount to decrease litigation expenses, while others remain

¹ Source: <https://www.census.gov/construction/nrc/index.html>

Did you know.... the cost of experts can often be 50% or higher of the total litigation expense?

Even at a single mediation, as many as 20+ parties and their insurers may appear, which makes resolution even more complex and more costly.

Lawyers for all stakeholders – homeowners, builders, and subcontractors – are engaged across a much smaller number of homes and litigations.

At RiverStone we are very cognizant of our reputation and we protect that reputation...in doing so we protect the reputation of those who are our business partners.

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entrenched in the status quo, with the accompanying longer litigation time and higher costs. To achieve the right balance of time and costs across the spectrum of solutions, parties are now looking to new innovations and approaches.

For example, big-data analysis can help estimate property damage more accurately without the need for in-person reviews. Other data analytics can reveal litigation spend trends that help to devise alternative fee arrangements and reduce costs. Technology and process innovations can enhance discovery and document exchange. This can also improve the timing and opportunity for early resolution as well as reduce wasted resources in the process.

WHAT'S THE STATE OF YOUR CONSTRUCTION DEFECT MANAGEMENT?

Innovation, collaboration and initiative can help push risk-smart resolution to completion in less time and at less cost, which ultimately benefits all stakeholders. For insurers and re-insurers dealing with CD claims, here are three critical questions and considerations:

APPROACH

How willing and able are you to reach across the aisle?

Collaboration among insurers, plaintiffs and litigants can produce better outcomes for everyone. Insurers can work in a non-confrontational way to deliver the right level of transparency at the right time to help all stakeholders get to the right decisions, all of which reduce transaction costs. In our experience, it is self-evident that more litigation does not guarantee better results, nor does it improve the insurer's reputation in the public marketplace.

COSTS

What is the total outcome for any given claim or book?

From more than two decades of work in construction defect at RiverStone, we frequently see cases among insurers and reinsurers where carriers are not clear or correct in their calculation of the real costs of managing CD claims. For insurers to know and calculate their entire costs, they need to combine the cost of settlement with costs of defending and adjusting the claim. Insurers can spend thousands of dollars litigating a single claim and end up spending more in loss than they would if they had settled it early. The right way to measure the total claim exposure is by considering both loss and expense.

At RiverStone, 75% of people that handle our CD claims come directly from industry and half of those have deep experience litigating CD claims.

EXPERTISE

What kind of a claims management team and expertise do you have?

Expertise derives from knowledge, skill and experience. Do your Legal and Actuarial professionals specialize in CD? Are they aware of and experienced in the different laws and legal practices that can vary by state? Do your Actuarial and Claim professionals know where and when to account for loss development factors or over what period of time to account for losses – e.g., there’s a bell curve for such calculations that typically extends over 10-12 years? And then there’s the additional need to stay on top of policy changes, evolving case law, as well as liability and property damage trends. Having the right team with the right knowledge, skills, and experience is paramount.

ABOUT RIVERSTONE

RiverStone is a group of insurance, reinsurance, and service companies specializing in the management of legacy and run-off insurance businesses and portfolios. With nearly 500 professionals with deep industry expertise in claims, customer service, litigation, and financial restructuring, we offer creative and varied deal structures to deliver sustainable outcomes you can count on. We lean forward to develop and deliver innovative exit solutions to help shore up capital and meet board-level mandates to help focus an insurer’s business. We know that reliability, security, and finality all come from an ability to not only assess the risk up front but to execute the deal at the scale and speed required by the business.

For more information, please visit our website at www.trg.com.