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"Big Builder's Reaction to Construction Defect Lawsuits: The Dilemma for Truss & Wall Panel Manufacturers" by Kent J. Pagel

Trends, whether good or bad, invariably develop. Some are sustained. Others are not. One trend that has not only been sustained, but which is feeding on itself, is Construction Defect litigation. In addition to the many lawyers who promote these types of cases, groups such as the National Alliance Against Construction Defects are spawning, providing additional means to perpetuate the filing of these types of lawsuits.

HOW SERIOUS IS THE CONSTRUCTION DEFECT LITIGATION PROBLEM?

Consider that one California law firm advertises successes in more than 60 Construction Defect cases in the past 5 years. The law firm's web site proudly displays a list of settlements and verdicts totaling more than $220 million, an average of more than $3.7 million per case. Using "lawyer math" this equates to a legal fee of approximately $1.5 million per case.

As you might expect, the homebuilders view this trend as "if you build it, they will sue." The California Department of Real Estate has published that one-third of all homeowners had major defects in their original construction, with 10 percent reporting defective roofs. And this phenomenon is NO LONGER limited to California, Arizona and Nevada.

In a typical Construction Defect lawsuit filing, an individual or group of

A WORD ABOUT ENDORSEMENT FORMS

The differences in the endorsement forms may not appear significant, but DO NOT be fooled. Builders have had success at requiring suppliers' insurance companies who issue forms 20-10-11-85 and 20-26-11-85 to defend the builder in Construction Defect cases filed years after the trusses are delivered and installed. Conversely, form 20-10-03-97 which utilizes the language "ongoing operations" has been generally limited to claims that truly arise out of the truss manufacturer's scope of work, (e.g. the design, manufacturing and delivery of the trusses to the customer jobsite).

ISO No. 20-10-11-85: "WHO IS AN INSURED is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of your work for that insured by or for you."

ISO No. 20-26-11-85: "WHO IS AN INSURED is amended to include as an insured the person or organization shown in the Schedule as an insured, but only with respect to liability arising out of your operations or premises owned by or rented to you."

ISO No. 20-10-03-97: "WHO IS AN INSURED is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured."

homeowners will allege a vast number of construction defects. The case will be filed against either the builder only (and in that event the builder will file its own third party action against its various subcontractors and suppliers) or will name the many suppliers and subcontractors involved. The complaints are drafted by savvy lawyers who intend to implicate as many trades and suppliers as possible.

The following language from a production builder master form customer contract that I have reviewed recently, is typical of what you may find:

"All policies of insurance that Supplier is to maintain under this Agreement…shall name Contractor and its affiliated companies as additional insured, using Insurance Services Offices Form B (version CG 20 10 11 85). The additional insured shall be provided the same coverage as provided Supplier…In addition, Commercial General Liability Insurance Coverage, including additional insured coverage for Contractor, shall be maintained in force until expiration of the applicable statute of limitations for claims related to latent defects and construction improvements for real estate."

The cost of defending Construction Defect suits is outrageous. Contributing to the cost are complex legal concepts, broad discovery that is permitted, needed experts, and guaranteed insurance coverage disputes (which by the way are intended by the plaintiffs' lawyers as this scenario encourages settlement over continuing litigation). Once a lawsuit is filed, the insurance industry reports that 40 to 60 percent of all monies expended on the defense of the case pays the defense lawyers and their experts.

When named in a Construction Defect lawsuit, suppliers oftentimes feel cursed, as being in the right usually means very little. But, in the end, so long as they have practiced good risk management and assisted their insurance companies in handling the defense of the case appropriately, suppliers can usually extract themselves from cases at a reasonable cost and chalk up the experience to the cost of doing business.

It is quite different when suppliers and their liability insurance companies are also forced to defend their builder customers (from the claims asserted, for example, by the homeowners) as a result of having issued broadly worded additional insured endorsements. Here, being right almost never matters. The suppliers' problems are exacerbated when their customer contracts require them to issue a specifically described type of additional insured endorsement, only to find out later their insurance policies or insurance carriers do not or will not permit it! DO NOT for a minute think that truss and wall panel manufacturers are immune from this risk or potential.

A BETTER UNDERSTANDING OF ADDITIONAL INSURED ENDORSEMENTS

"Big builder" today believes it has unfairly borne the brunt of Construction Defect litigation. Thus, big builder is growing smarter at managing risk and in using its marketplace strength in the process. Besides demanding very one-sided customer contract terms, big builder is imposing stringent insurance requirements on its suppliers concerning indemnity and additional insured provisions.

Big builder is no longer simply stating "please name [big builder] an additional insured on [supplier's] general liability policy." Big builder knows that smart suppliers have huddled up with

their risk managers and attorneys to craft limiting language to their additional insured endorsements. Thus, with greater frequency, big builder is asking its suppliers "to name [big builder] an additional insured under ISO Endorsement No. 20-10-11-85 or its equivalent." It is important to understand why this is critical to truss and wall panel manufacturers.

ISO is the standard by which most insurance endorsements are written. Almost all insurance policies utilize ISO forms. The first two sets of numbers reflect the type of additional insured endorsement; the last two sets of numbers reflect the month and year the form was implemented. As ISO has updated the form 20-10-11-85 (the most current version is referred to as ISO No. 20-10-03-97), and as some insurance companies will not issue endorsements that are officially out of date, builders who are requesting ISO No. 20-10-11-85 will typically accept ISO No. 20-26-11-85 as an equivalent form.

Those builders requiring the 20-10-11-85 and 20-26-11-85 forms are enjoying success in requiring the insurance companies who have issued such endorsements to at least defend the builders when they are named in Construction Defect cases. Keep in mind that it is not uncommon for a Construction Defect case to be filed 5 to 10 years after completed construction, yet the obligation of the supplier to defend the builder through the additional insured endorsement continues well past the project completion date.

To illustrate, in one reported case decision, three subcontractors completed work for a general contractor on a phased project for a three-year period ending in 1988. A Construction Defect case was filed against the contractor in 1998, almost 10 years after completion. The contractor in turn tendered the defense of the case to the insurance companies of the three subcontractors who had issued additional insured endorsements years after the project in question had been completed.

At first, the insurance companies refused to defend, arguing that the policies incepted well after the construction was completed. An appeals court disagreed, stating that under the 20-10-11-85 Endorsement the contractor was entitled to coverage from the subcontractors' policies even though the work was completed prior to the inception of the subcontractor's insurance policy. The court reasoned that if an insurance company intended otherwise, they should state the limitation within the endorsement. Under this case decision, which may take hold in other states as the opinion is well reasoned, an insurance carrier who issues such endorsements could be signing on for the defense of construction defect claims relating to materials supplied years earlier.

As the typical Construction Defect lawsuit will allege numerous unrelated defects, big builder will require the insurance companies of the suppliers and trades implicated to jointly share in the costs of defending the builder because of the issuance of these endorsements. Once the insurance companies are essentially grouped together to share in the defense of the case, to extricate itself from the suit, big builder will apply the necessary pressure to convince the insurance companies to pool their resources and settle the case. The net outcome results in big builder defending and settling the case with dollars expended by the subcontractors' and suppliers' insurance companies.

Agreeing to issue the 20-10-11-85 and 20-26-11-85 forms greatly increases the supplier's risks and

liability potential for the future (including a great probability of paying much higher insurance premiums). Unfortunately, an even greater risk is developing in that many of the major liability insurance companies are electing not to issue either of these two ISO endorsement forms for their contractor/subcontractor and supplier policy holders. They view the exposure far too great. Instead they will only issue the latest amended version of the ISO version of the 2010 form, ISO No. 20-10-03-97, an endorsement form that they view as more limiting.

TRUSS & WALL PANEL MANUFACTURERS—BEWARE!

More and more builders are requiring the 20-10-11-85 and 20-26-11-85 endorsement forms from their suppliers' insurance companies as an absolute condition to doing business. Additionally, their customer contract forms will routinely provide that the supplier is obligated to continue to provide such endorsements for many years after the trusses are delivered to the customer jobsite (some requiring the supplier to carry such coverage for a period of 10 additional years—often referred to as "tail coverage").

In return, the builders will generally not offer any guarantees that they will buy from such suppliers. On the flip side, more and more of the suppliers' insurance companies will not issue the endorsements that the builders are requesting. And this trend from the insurance company perspective is developing rapidly. Since in many respects big builder's choice of vendor is dependent on who can provide the appropriate additional insured endorsement, you can see that two trends are developing simultaneously with the truss and wall panel manufacturer being squeezed in between. This very well may mean that truss manufacturers are signing contracts where they are agreeing to provide the additional insured endorsement required by their customers. These same contracts are likely requiring the truss manufacturers to provide such endorsements for years to follow. For those who agree to these types of provisions, assuming their insurance carrier will issue such endorsements at the time, they have very little control over whether their liability insurance carriers will continue to provide such endorsements in the future. Furthermore, local or regional underwriters for some insurance carriers may be issuing the 20-10-11-85 or 20-26-11-85 endorsements for suppliers who will later find out that the corporate underwriting departments of such insurance companies disagree with this practice and are refusing to issue such endorsements.

Kent J. Pagel is a senior shareholder of the Houston, Texas firm of Pagel, Davis & Hill, a Professional Corporation. Mr. Pagel serves as the outside general counsel to WTCA.

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