

DEVELOPMENT RISK MANAGEMENT

CLIENT ALERT

OCTOBER 14, 2010

THINK YOU CAN SEND LAWSUITS AGAINST YOUR COMPANY TO YOUR INSURER AND FORGET ABOUT THEM? THINK AGAIN.

It is an unfortunate fact that most builders and developers at one time or another will be served with a lawsuit claiming defects in the homes they build. In states like California, Nevada and Texas, these suits are all too common, and so-called legislative reform has done little to stop the onslaught. Not surprisingly, large (and expensive) liability insurance programs to cover these risks have been a staple in the industry for decades. Project-specific "wrap up" policies, with big retentions and extended "tails" covering defect risks for the duration of the typically long exposure period for such claims, have become a cost of doing business.

Historically, builders and developers assumed that their insurance programs would be there when claims hit. In the "old days," builders paid their deductible and sent the lawsuit to their insurer. The insurer hired a lawyer to defend the suit and, in most instances, builders enjoyed radio silence as the lawyers (for whom their insurer paid) worked to settle the case, using either third party (e.g., subcontractors' and their insurers') money, or money from the builder's own policies. Very few of these cases ever went to trial and builders rarely came out of pocket to settle a case. But in this era of scarce resources and scant investment returns, everyone wants to keep more of their money, for as long as possible. Insurance companies are no exception. This perhaps reasonable response to market conditions in the insurer context, however, is translating into an era of new risk for builders and developers. Insurers are challenging coverage under their policies like never before. In response, builders and developers must rethink how they respond to claims and how they approach their insurance assets.

Scrutinize the Reservation of Rights: Builders must assume that their insurers will reserve rights, in writing, at the outset of the case, and use these reservations against the builder later. The builder's personal risk management or coverage counsel must review the reservation and determine what action is needed in response. Defense counsel hired by the insurer cannot protect the builder's interests here, as they sit in a conflict situation, having duties to the insurer as well as the insured.

Analyze the Claim: The builder and its own counsel also must review the claim or complaint, before the builder's response is required, to evaluate whether the claim or suit includes claims that the policy may not cover. A typical general liability policy, for example, may not cover claims relating to alleged intentional conduct, such as fraud, or statutory violations. If these claims are present, they must be attacked at the pleading stage if possible to remove them from the suit in order to maximize coverage.

Monitor the Case: No longer can builders assume that payment by their insurers of defense costs, or to settle a case, will end the builder's exposure. If the insurer has reserved rights effectively and coverage issues exist, the insurer may well pay defense costs and even fund settlement of the case, and then turn around and sue the builder to get that money back. If the builder fails to evaluate this potential early on, the builder may end up having come out of pocket zero dollars to defend/settle a case, only to find itself facing an exposure for defense and settlement costs incurred by its insurers. And by then, it is too late to attack the insurer's reservation and too late to alter the course of the litigation.

(continued on back)

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Don't Sit Back: Builders and developers must be prepared, if necessary, to play offense. Declaratory relief actions are available to obtain a court ruling on insurer defense and indemnity obligations, among other issues. But waiting may not be prudent, as the law relating to these issues varies from state to state. If the insurer sues first, it may sue in a state where the law favors it, not the builder, and the builder may be unable to extricate itself from a hostile venue.

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