Insurance "Wrap" Policies Are Transforming the Large-Scale Building Enclosure Forensic Evaluation Process

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INTRODUCTION

Like many comparable firms across North America, our company, based in Oakland, CA, not only carries out building enclosure evaluations (for plaintiffs and defendants) of large-scale multifamily and multi-building residential projects, but also designs and administers post-settlement reconstruction of similar projects where our personnel played no role in the litigation process. This wide range of experience affords us the following broad perspectives that may not be as obvious to smaller, more specialized firms.

More and more, we encounter construction defects litigation where the defense team elects not to carry out its own testing and sampling to evaluate the merits of the plaintiff expert's preliminary findings. While in some cases, these decisions likely were based upon expert realization that the results of any such testing would only serve to strengthen the plaintiff's claim, it is also clear that defense unwillingness to investigate is an unintended side effect of increasingly common "wrap" (or "wrap-up") insurance policies.

Specifically, wrap policies eliminate incentives for certain codefendants to help point a spotlight at construction deficiencies and damage caused by fellow codefendants. In our experience, specific unforeseen ramifications of such defense withdrawal from this "blame game" are transforming long-standing forensic (puzzle-solving) and litigation practices.

WHAT ARE INSURANCE WRAP POLICIES?

As reported in the July 2006 issue of *Insurance Journal West Magazine*:[1]

- Owner-controlled insurance programs (OCIPs) or contractor-controlled insurance programs (CCIPs), commonly referred to as "wraps," that have been traditionally used for large, commercial projects with construction costs of $50 million or more, now are being used for all sizes of residential construction projects.

  OCIPs are a relatively new insurance vehicle for residential construction projects. Due to the proliferation of construction defect litigation, those insurance policies are fast becoming the only option for developers, general contractors, and subcontractors who build single-family or multifamily homes in California, Nevada, and other western states.[2]

  Under these policies, the developer, general contractor, and all of the subcontractors become named insureds under a single policy that covers a single construction project, or in some cases, multiple projects. This new insurance model is a drastic departure from the previous insurance model, where each contractor individually purchased and negotiated his or her own policy to protect the company's liability in the event of a claim.

- Under the traditional multi-policy model for residential construction, the limits of each individual policy could be used to satisfy a large claim. Theoretically, 30 policies with a $1 million limit of liability each could produce $30 million of coverage to fund a loss.

  In the new insurance model for residential construction under an OCIP, there is only one commercial liability insurance policy to protect the developer, general contractor, subcontractors, and sub-subcontractors, and the coverage is restricted to the designated project or projects. A mediator no longer has the ability to tap the multiple individual policies of the contractors who worked on the project to build a fund to resolve the dispute in a construction defect case before the parties have to resort to protracted and expensive litigation.

Figure 1 – In 2007, six experts from separate building envelope consulting firms climbed this ladder on behalf of six separate law firms and five separate insurance carriers to document conditions exposed by defense testing.

Figure 2 – In 2017, our destructive sampling at a multi-building condominium complex with 3,200 windows confirmed the material degradation that can occur when incompatible flashing/sealing products are integrated within the building enclosure. Only one defense consultant climbed the ladder to document this project-wide condition.

Due to California's ten-year "statute of repose"[3] for initiating construction defects litigation regarding "latent" (hidden) deficiencies, the long-term effects of these wrap insurance policies are still being realized.

WRAP POLICIES HAVE ECONOMICALLY HARMED SPECIALTY DEFENSE CONSULTANTS

Wrap insurance coverage tends to economically benefit larger, well-staffed defense consulting firms to the detriment of sole-proprietor consultants with specialized expertise (and the small law firms who generally have tended to commission these specialty consultants).

In *Figure 1*, consider the supplemental destructive sampling at a stucco-clad wall and roof scupper carried out in 2007 by a building enclosure consultant working on behalf of a general contractor enmeshed in construction defects litigation involving a large multi-building apartment facility. The six separate experts who climbed that ladder to document these exposed conditions represented the plaintiff owner and multiple defendants, including the general contractor and the stucco, framing, roofing, and sheetmetal subcontractors.

Every one of these defense experts had been hired by a separate law firm and insurance carrier. Each of these consultants strived to identify evidence that would either refute or diminish client-specific findings by the plaintiff's expert or demonstrate that the exposed deficiencies and damage resulted from errors by certain other defendant contractors.

Now, 13 years later, due to modern wrap insurance policies, the once-competing roles of those multiple defense experts often are consolidated into one consultant who has been hired by one law firm on behalf of one large carrier. Further, it has become increasingly common at modern investigations for this sole defense expert to elect to do no supplemental destructive testing. When remediation of all documented

deficiencies likely will be fully funded by your own client (i.e., the wrap insurance carrier), then there is a strong disincentive to take any expert action that could expose additional damage.

Consider *Figure 2*, from our firm's investigation in 2017 at a multi-building condominium complex (with 3,200 similarly installed windows) near San Francisco. Only two consultants—one for the plaintiff and one for the insurance carrier that had issued the project's wrap policy—climbed this ladder to document the material degradation that resulted from installing a self-adhered flashing membrane atop an incompatible sealant.[4]

This single defense expert (who did not initiate any destructive testing) filled the inspection roles that, a decade earlier, would have been taken by separate experts representing the interests of the general contractor, the stucco and fiber-cement lap siding contractors, the framer (window installer), and, potentially, the flashing membrane manufacturer.

THE CORRESPONDING RISE OF GENERALLY UNINFORMED DEFENSE STATISTICAL CONSULTANTS

While the rise of wrap policies during the past decade has economically harmed many specialty defense experts, we have encountered an increase in the use of defense statistical consultants (often, university professors and economists) whose role during the litigation process is to opine that plaintiff's investigative, sampling, and extrapolative processes should never be accepted unless it can be proven that this work was carried out in conformance with the rigidly formulaic (i.e., "frequentist"[5]) statistical random sampling methods that many of us might have encountered in a college "Stat 101" course.

In general, these defense statistical consultants have tended to have very minimal construction knowledge and to have never actually produced any randomized statistical sampling protocol for guiding any building enclosure investigation, whether by the plaintiff or the defense.

Further, these statisticians fully discount the guidance of ASTM E2128, *Standard Guide for Evaluating Water Leakage of Building Walls*, which states, "The protocol in this guide is not based on conventional hypothesis testing and quantitative random sampling....The evaluation of water leakage of building walls is a cognitive process in which technically valid conclusions are reached by the application of knowledge, experience, and a rational methodology..."[6]

In a remarkable example from recent arbitration associated with *Figure 2*, a defense economist sought to reject our forensic team's qualitative findings because the testing had not been carried out in conformance with ASTM E2548, *Standard Guide for Sampling Seized Drugs for Qualitative and Quantitative Analysis*. Clearly, a statistician who considers the recommended process for law enforcement sampling of seized drugs to be superior to ASTM E2128's guidance lacks minimally necessary levels of knowledge and expertise in the means and methods of building enclosure construction and analysis.[7]

> With the elimination of the typical delays and costs associated with the "defense vs. defense" blame game, there is a greater potential for efficient settlements.

IT SOMETIMES MAKES GOOD SENSE FOR THE DEFENSE NOT TO CARRY OUT ADDITIONAL DESTRUCTIVE SAMPLING

While we scoff at the legal gambit of using an inexperienced statistician to attack a plaintiff expert's findings, it does sometimes make good sense for the defense not to carry out additional destructive testing. A decade ago, such supplemental information (no matter how negative it might be) would be needed as the multiple defense parties sought to pin the blame elsewhere. Now, insurance wrap policies have ended such internecine "defense vs. defense" squabbles.

At certain large-scale projects, upon review of the opposing plaintiff expert's initial testing, we have strongly advised our defense clients (commonly, developers and general contractors) that any supplemental destructive sampling almost certainly would not generate beneficial results. Alternately, we have recommended only a narrow search for a few negative cases that could greatly discredit a plaintiff's poorly supported analysis.

Still, if a plaintiff expert's findings fundamentally lack credibility, then why not attack them head-on with intelligently targeted sampling? However, such decisions necessitate the empowerment of defense experts with the skills and ability to differentiate between weak and strong extrapolations and/or dishonest advocacy by the plaintiff consultants. Unfortunately, an effect of wrap insurance policies has been to further encourage such bias at the expense of credible expertise.

WRAP POLICIES TEND TO INCENTIVIZE BIASED ADVOCACY

Rule 702 (Testimony by Expert Witnesses) of the *Federal Rules of Evidence* advises that knowledgeable expert witnesses may testify in trial if their "testimony is based on sufficient facts or data," and "the testimony is the product of reliable principles and methods," and these experts have "reliably applied the principles and methods to the facts of the case."[8]

In short, the opinions expressed by expert witnesses during litigation should be honestly founded upon reliable principles, analysis, and standards. Similarly, ASTM E2128 advises, "The conclusions and findings from an evaluation must be rationally based on the activities and procedures undertaken and the information acquired, if they are to be considered legitimate and substantiated."

In like manner, IIBEC's Code of Ethics well defines the moral and ethical duties of building enclosure experts: "Members and registrants...shall maintain the highest possible standard of professional judgment and conduct. Members and registrants shall conduct their practice honestly and impartially, serving with integrity their clients, employers, and/or the public. Learned and uncompromised professional judgment should take precedence over any other motive."[9]

In short, dishonest advocacy is contrary to the building enclosure expert's legal and

ethical obligations.[10]

However, an effect of wrap insurance policies has been to further incentivize such bias. For example, if defense teams make it a practice not to carry out destructive testing that could disconfirm (or confirm) the true merits of plaintiffs' reported findings, then it should not come as a surprise that certain plaintiff consultants inevitability will seek to game this new system with even greater levels of biased extrapolations that unfortunately may well be used by certain opposing consultants to justify their own increasingly polarized bluster.

To better abate such spiraling cycles of advocacy, we recommend that defense attorneys and their carrier clients should empower those consultants with the proven skills and ability to expertly evaluate the merits of plaintiffs' extrapolated claims. Coverage and litigation decisions should be founded on credible data and analysis, not predetermined puffery and unthinking denial. Otherwise, over time, those plaintiff advocates best positioned to take advantage of defense teams' general unwillingness to investigate will be the ultimate winners.

WRAP POLICIES CAN ALSO INCENTIVIZE UNDERFUNDED SETTLEMENTS

In addition to forensic analyses, our firm also designs and administers post-settlement repairs at projects where our personnel had played no role in the litigation process. At such projects, we increasingly encounter jointly agreed-upon (and already funded) scopes of repair that, upon closer inspection, do not address substantial deficiencies that ideally should have been identified prior to final settlement. While it is not uncommon for various issues to be missed during a typical forensic investigation (thus explaining why contingency fees are a common component of the repair cost-estimating process), we find that the long-term dynamics of wrap policy coverage have exacerbated the magnitude of these omissions at certain projects.

In particular, our personnel have observed an increasing number of cases where plaintiffs' opportunities to gain knowledge of actual conditions within the building enclosure appear to have been sacrificed to extract a relatively quick financial return from defense teams known to commonly do no destructive vetting of plaintiff claims. At some projects, such lack of expert pre-settlement analysis has led to gross underfunding of necessary repairs. Further, failures to carry out this essential work have hindered future buyers' and sellers' efforts to secure bank loans.

SUMMARY DISCUSSION

In affected portions of North America, unexpected effects of insurance wrap policies at large-scale multifamily residential projects are transforming long-established practices of providing plaintiff and defense expertise for construction defects litigation. Certain specialty defense consultants are disappearing from job sites, while often-uninformed defense statisticians are venturing down from their ivory towers.

It is increasingly common for defense teams to elect to do no destructive testing of their own. Certain plaintiff consultants who long relied upon "defense vs. defense" testing to supplement their preliminary findings should consider revamping their sampling protocols.

As defense experts' investigative options increasingly have been constrained by shortsighted calculations made by their carrier clients, and certain plaintiff advocates increasingly are rewarded for bloated extrapolations, these skewed results have promoted even greater advocacy by opposing parties in a manner contrary to federal and state evidence rules and the intent of industry standard ASTM E2128.

Unfortunately, the owners of multifamily residential facilities often fare the worst from these systemic changes in the building enclosure evaluation process. When the nature and extent of the defense's destructive sampling is reduced or eliminated, and plaintiff experts and their attorney clients choose (often for narrow tactical reasons related to expeditiously winning the litigation battle) not to expand their own testing, then the settlement funds can be grossly insufficient to remediate severe hidden damage finally exposed during the repair process.

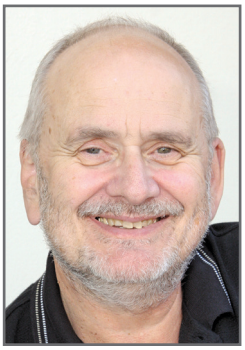
To be fair, instances of insufficient settlement funds (commonly related to high attorney fees) certainly predate the advent of wrap insurance policies. Further, we would agree that some plaintiff investigations appear to have been instigated to extract money from insurance policies with no actual intent to repair discovered damages. In addition, we are not disparaging the potential net value, in time and money, of wrap coverage. With the elimination of the typical delays and costs associated with the defense vs. defense blame game, there is a greater potential for efficient settlements. Our goal for this article simply is to point out certain unexpected effects of these wrap policies on these litigation dynamics.

REFERENCES

1. Robert J. Olson. "The OCIP or Wrap Policy." *Insurance Journal West Magazine*. July 3, 2006. www.insurancejournal.com.
2. Note: Our firm has only encountered wrap policies in relation to large-scale multifamily residential developments.
3. Per Section 337.15 et seq. of the California Code of Civil Procedure, "Actions for latent deficiency in construction or survey of real property or injury arising out of such deficiency" must be commenced within ten years of "substantial completion" of the project but in no event more than ten years after the earliest to occur of the following: i) date of final inspection by the authorized public agency; ii) date of recording of a valid notice of completion; iii) date of use or occupation of the improvement; or iv) one year after cessation or termination of work on the improvement. This statute of repose applies to claims against architects, designers, contractors, subcontractors, surveyors, and others who provide services for construction or improvements to real property.
4. Specifically, off-gassed solvents from the underlying incompatible polyurethane caulk had severely degraded the rubberized bitumen at the self-adhered flashing.
5. For additional discussion of "frequentist" sampling and its general unsuitability for building enclosure investigations, reference L. Haughton, "Bayes' Rule, Bayesian Thinking and the Extrapolation of Destructive Testing Data," in the August 2013 issue of *Interface*, http://iibec.org/wp-content/uploads/2013-08-haughton.pdf.
6. ASTM E2128, *Standard Guide for Evaluating Water Leakage of Building Walls*. ASTM International, West Conshohocken, PA, www.astm.org/Standards/E2128.htm.
7. In this litigation, the arbitrator's ruling accepted the cognitive and

qualitative approach of ASTM E2128 while noting that the defense had not used random statistical sampling to develop its own repair costing analysis: "It should be noted that all experts in this case...have recommended scopes of repair to untested/uninspected locations, based upon evaluations of other components that they consider to be sufficient to form such project-wide opinions. Respondants cannot have it both ways—they cannot credibly criticize Field's opinions regarding the need to repair untested/uninspected locations when their own expert has done the same thing."

8. https://www.rulesofevidence.org/article-vii/rule-702/
9. https://iibec.org/membership/code-of-ethics/
10. L. Haughton and C. Murphy. "Qualitative Sampling of the Building Envelope for Water Leakage." *Journal of ASTM International.* 2007, www.astm.org/DIGITAL_LIBRARY/JOURNALS/JAI/PAGES/JAI100815.htm: "For their findings to be considered substantive, all qualitative researchers, including building envelope professionals, must avoid any biased advocacy that hides, distorts, or selectively interprets the collected data. The mantra of the qualitative researcher must be: 'It is what it is.' In other words, the data tell the story, even if this story differs from the desired or expected findings."



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NYC Hikes Fines on Façade Noncompliance

In the wake of the tragic death of architect Erica Tishman, felled December 17, 2019, by falling debris from a Manhattan building whose façade should already have been repaired (see February 2020 *Interface* at https://iibec.org/architect-killed-by-debris/), New York City's Façade Inspection and Safety Program (FISP), or Local Law 11, now has increased fines for nonconforming buildings. More robust inspection mandates and documentation have also been included in the changes, which took effect February 20.

New penalties include:

- $5,000 fine for failing to file an acceptable inspection report.
- $1,000 per month for filing late.
- $1,000 per month plus a monthly fine for each linear foot of sidewalk shed for failure to correct unsafe conditions.

The city has also issued an emergency declaration demanding that owners fix dangerous building façades and allowing the city to send its own contractors to erect scaffolding and to send the bill to the property owner.

A major change requires close-up physical scaffold examination of exterior walls of buildings of six stories or higher at intervals of 60 ft. along the length of a structure. Drones or other methods of assessing exterior wall conditions cannot be used in place of close-up inspections. There are additional requirements related to experience and responsibilities of Qualified Exterior Wall Inspectors (QEWIs).