Construction Defect Claims – Defining, Comparing and Contrasting the Differing Roles of the Adjuster and Attorney in Protecting the Contractor – *The Attorney's Role*

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****** IMPORTANT NOTE***

When a properly insured contractor is sued, that contractor's defense is handled by 2 different professionals, an adjuster, and an attorney. The roles played by each of these professionals are very different. In this article the role of the attorney is discussed under 3 headings: (A) Who Chooses the Attorney, the Insurance Company or the Contractor?; (B) Ethical Considerations, and Their Importance to the Contractor; and (C) Litigating the Case

(A) Who Chooses the Attorney, the Insurance Company or the Contractor?:

Usually a contractor's insurance policy allows the insurance company to choose the attorney who will defend the contractor. However, insurance companies are often very solicitous of contractors' suggestions regarding attorneys to handle their cases. So long as an attorney suggested by a contractor is qualified to handle the particular case in question, the insurance company will often take the contractor's suggestion, and will retain the suggested attorney to handle the contractor's defense.

In fact, an attorney might not charge his/her contractor clients to tender their cases to their insurance companies if the contractor recommends that the insurance company hire the lawyer to represent the contractor. This way the contractor gets the desired lawyer, and does so without paying the lawyer anything.

As is discussed later in this article, in certain conflict of interests situations an insurance company must pay for an attorney chosen by the contractor.[1]

(B) Ethical Considerations, and Their Importance to the Contractor:

Who is the Attorney's Client? Why that Issue is Important:

When an insurance company is paying a lawyer to represent a contractor, who is the lawyer's client? The insurance company? The contractor? Both? This question is important because typically a lawyer owes whoever the client is numerous duties. For instance, an attorney "must zealously advocate for his/her client;"[2] an attorney owes his/her client a fiduciary duty;[3] an attorney has the duty "maintain . . . at every peril to himself or herself to preserve the secrets, of his or her client;"[4] and an attorney has a duty of loyalty to a client.[5] Also, an attorney has a duty to not represent parties with adverse interests.[6]

Don't insurance companies and their insured contractors sometimes have conflicting interests? For instance, isn't it in the insurer's interest that the facts show that the contractor does not have coverage, and doesn't the contractor have the opposite interest??

The answer to these questions are generally found in what is called the "tripartite relationship", in a 1984 Court of Appeal case,[7] and in the legislature's codification of the concepts announced in that case.[8]

****** Unless otherwise specified, all statements regarding law refer to California law only; the law of other jurisdictions may be different.***

[1] See "*Cumis Counsel*" subheading under "(B) Ethical Considerations, and Their Importance to the Contractor"
[2] In Re Josiah Z. 36 Cal.4th 664 (2005)
[3] Tri-Growth Ctr. City v. Sildorf 216 Cal.App.3d 1139, 1150 (1989)
[4] Business and Professions Code Section 6068(e)
[5] Flatt v. Superior Court 9 Cal.4th 275 (1994)
[6] Rules of Professional Responsibility Rule 3-310(C)
[7] San Diego Federal Credit Union v. Cumis Insurance Society, Inc. 162 Cal.App.3d 358 (1984)
[8] that codification is at Civil Code Section 2860

The tripartite relationship:

Generally when one buys an insurance policy that protects against liability to third parties, one buys 2 pieces of coverage; one such piece is indemnity, that is payment for money that the insured might owe a third party as a result of an insured risk; the other such piece is defense, the insurance company must hire a lawyer to defend the insured when the insured is sued for something for which indemnity might be owed.[9] In such a context the law refers to the relationship between the insurance company, the insured, and the lawyer paid by the insurance company to represent the insured as the "tripartite relationship."[10]

"In California, it is settled that absent a conflict of interest, an attorney retained by an insurance company to defend its insured under the insurer's contractual obligation to do so represents and owes a fiduciary duty to both the insurer and insured."[11] "So long as the interests of the insurer and the insured coincide, they are both the clients of the defense attorney and the defense attorney's fiduciary duty runs to both the insurer and the insured."[12] "It is a well accepted and oft repeated principle that the attorney retained by the insurance company for the purpose of defending the insured under the insurance policy owes the same duties to the insured as if the insured had hired the attorney him or herself."[13] "In . . . [the tripartite relationship] the attorney has two clients whose primary, overlapping and common interest is the speedy and successful resolution of the claim and litigation."[14]

Often the interests of the insurance company and the insured indeed are common, they are the same. But, what about when that is not the case; for instance, the issue of coverage?

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[9] Gray v. Zurich Ins. Co. 65 Cal.2d 263 (1965)
[10] Abramovsky, Aviva "The Enterprise Model of Managing Conflicts of Interest in the Tripartite Insurance Defense Relationship" 27 *Cardozo Law Review* 193, footnote 24
[11] Gafcon, Inc. v. Ponsor & Assocs. 98 Cal.App.4th 1388 (2002)
[12] Gafcon, supra, quoting Lysick v. Walcom 258 Cal.App.2d 136 (1968)
[13] Gafcon, supra, quoting Bogard v. Employers Casualty Co. 164 Cal.App.3d 602 (1985)
[14] Gafcon, supra, quoting American Mutual Liab. Ins. Co. v. Superior Court 38 Cal.App.3d 579 (1974)

"[I]nsurer-appointed defense counsel, owe[] their primary obligations to . . . [the insureds] to provide the same level of competent and ethical representation as if . . . retained . . . personally [by the insureds]."[15] If insurance company-retained defense lawyers have acted as "coverage spies" they have "misbehaved", and could be "exposed to malpractice liability, [and] disciplinary actions [by the State Bar]."[16] Also, an insurance company-retained defense attorney owes a duty not to reveal to the insurance company confidential coverage information obtained from the insured.[17] And, under certain circumstances an insurance company can be held liable for actions of defense counsel that favor the insurance company to the detriment of the insured.[18]

Insurance companies generally each have a "panel" of defense attorneys from which an adjuster can choose a lawyer to defend a contractor's case.

The real-world fear of contractors is that attorneys who are on an insurance company's panel know "on which side their bread is buttered", and that they will favor the insurance company over the contractor. They're not suppose to do that, but that's the fear; and that is why many contractors choose to have their own attorneys represent them at the insurance company's expense.

Cumis Counsel:

The phrase "Cumis counsel" has become commonplace in California law. The phrase is named after a California Court of Appeal case, San Diego Federal Credit Union v. Cumis Insurance Society.[19] Cumis counsel is a lawyer who is independent from the insurance company, is chosen by the insured to defend the insured, is paid by the insurance company, and

[15] Dynamic Concepts v. Truck Ins. Exchange 61 Cal.App.4th 999 (1998) (Internal quotation marks and citation omitted.)
[16] Dynamic Concepts v. Truck Ins. Exchange 61 Cal.App.4th 999 (1998)
[17] American Mutual Liab. Ins. Co. v. Superior Court 38 Cal.App.3d 579 (1974)
[18] Betts v. Allstate 154 Cal.App.3d 688 (1984)
[19] San Diego Federal Credit Union v. Cumis Insurance Society 162 Cal.App.3d 358 (1984)

is retained because of a certain type of conflict of interests . "A conflict of interest [that requires the retention of Cumis counsel] . . . arise[s] if . . . the outcome of the coverage issue can be controlled by counsel first retained by the insurer for the defense of the underlying claim,"[20] and the coverage issue in question has been "reserve[d]" by the insurance company.[21]

The facts of the Cumis case itself are illustrative of the type of situation where Cumis counsel must be retained. The San Diego Federal Credit Union was sued by Magdaline Eisenmann under various theories for compensatory damages and for punitive damages. The credit union demanded that its insurance company, the Cumis Insurance Society, defend and indemnify the credit union. The insurance company wrote the credit union a "Reservation of Rights" letter. In that letter the insurance company said that while it would defend the credit union, it would not pay for punitive damages because those are not covered, and it may not pay for other damages because they may not be covered.

Whether the credit union's actions were intentional would be established in the Eisenmann action. Under the law and the insurance policies there would be no coverage if the credit union's actions were intentional.

The insurance company chose and retained a lawyer to defend the credit union. The credit union sued the insurance company, claiming that the insurance company had to pay for a lawyer chosen by the credit union because the lawyer chosen by the insurance company might well favor the insurance company on issues that would ultimately determine whether the credit union was covered.

In agreeing with the credit union, and in finding that the insurance company had to pay for an independent lawyer to defend the credit union the trial court judge made a wise

[20] Blanchard v. State Farm 2 Cal.App.4th 345, 350 (1991)
[21] Civil Code Section 2860

observation of human nature. He said, "The Carrier [which is what an insurance company is often called] is required to hire independent counsel because an attorney in actual trial would be tempted to develop the facts to help his real client, the Carrier Company, as opposed to the Insured, for whom he will never likely work again. In such a case as this, the Insured is placed in an impossible position; on the one hand the Carrier says it will happily defend him and on the other it says it may dispute paying any judgment, but trust us. . . . Insurance companies hire relatively few lawyers and concentrate their business. A lawyer who does not look out for the Carrier's best interest might soon find himself out of work."[22]

The insurance company appealed the trial court's ruling. The Court of Appeal affirmed, deciding that under the circumstances of the Cumis case the insurance company had to pay for an attorney chosen by its insured, the credit union.

The concepts found in Cumis have been codified into California's statutes.[23] (Some say that in the codification process the legislature modified Cumis somewhat; so, it is important to a detailed understanding of the Cumis concepts that the statute be read.) Unless an insured timely waives the conflict in writing, an insurance company must appoint Cumis counsel if "a possible conflict may arise or does exist."[24] "[A] conflict of interest may exist" "when an insurer reserves its rights on a given [coverage] issue and the outcome of that coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim."[25]

Examples:

Contractors' liability insurance policies generally provide insurance for damages resulting from a contractor's work, but not for the work itself. For instance, if a developer or a

[22] Cumis, supra at 365
[23] Civil Code Section 2860
[24] Civil Code Section 2860(a)
[25] Civil Code Section 2860(b)

group of homeowners sue(s) a framer for improperly installing windows such that water intrudes into the houses when it rains, the insurance probably will not cover the cost of re-installing the windows; however, it probably will cover the cost of interior damage caused by the rain. Insurance companies usually reverse their rights in this area of non-coverage, often called the work product exclusion.

In this situation will the framer's lawyer look for interior damage, thus looking for facts that support insurance coverage or will the lawyer ignore such interior damage, thus giving fuel to the insurance company's argument that there is no coverage?

Contractors' liability insurance policies generally don't provide coverage for breach of most contracts. If a developer or a group of homeowners sue(s) a contractor for breach of a contract (which is not covered) and for other causes of action which are covered, and the contractor's lawyer can file a motion that will destroy the covered causes of action, thus destroying coverage, what will he/she do?

These are the types of situations that lawyers representing contractors face on a daily basis.

Conclusion as to Ethical Considerations:

A contractor can send a lawsuit to the insurance company and accept the lawyer chosen by the insurance company to represent the contractor; or, the contractor can have the contractor's own lawyer tender the case to the insurance company, requesting that the insurance company hire the contractor's lawyer. Very often the insurance company will respect that request, and will pay the contractor's lawyer's fees to represent the contractor.

The relationship between the insurance company, the contractor, and the lawyer is called the tripartite relationship. The rules of the tripartite relationship recognize that generally the

interests of the insurer and the insured coincide, but not always. While a lawyer owes duties to both the insurance company and the contractor, the ethical lawyer should keep in mind that his/her "primary obligations [are] to . . . [the insured] to provide the same level of competent and ethical representation as if . . . retained . . . personally [by the insured]."

When a coverage issue is reserved by the insurance company, and that "coverage issue can be controlled by counsel first retained by the insurer for the defense of the claim," Cumis counsel must be paid by the insurance company.

(C) Litigating the Case:

Trial Guides the Lawyer Throughout the Litigation:

Although lawsuits go through many twists and turns, and it may well be years from the time of the filing of the lawsuit to the trial, the good lawyer has the trial on his or her mind from the moment that the case begins. While it is true that most cases settle before trial, what will happen if there is a trial must be kept at the forefront of the lawyer's mind at all times.

What will those 12 people sitting in the jury box do with this case? That's a question that must guide a lawyer throughout the litigation. If the case goes to trial, then the importance of this question is apparent. But, even if the case does not go to trial, even if the case settles, the settlement will be based on projections as to what a jury would do if the case were to be tried.

At the Beginning of the Case – Don't Act Before Gathering the Relevant Information:

There is a rule of table etiquette that says, "'[A]lways gather information before acting.' Don't salt first, taste first."[26] The same rule applies when a lawyer first encounters a lawsuit. Unstated, but still a part of the rule is the requirement of analyzing the information. (Tasting is fine, but without analysis one cannot know whether salt is needed.)

[26] Jodi Smith, Etiquette Expert, as referenced in "Even as Finals End, More Learning on Their Plate for Brandeis University's International Business School" 05/14/04 Brandeis Press Release

Before taking any action the good lawyer gathers the relevant information available. He/she may call or visit the client, talk to the adjuster, thoroughly read the pleadings, call the opposing lawyer(s), etc. The lawyer analyzes this information under the applicable law, which may need to be researched; the author of this article finds it beneficial to write an initial letter to the insurance company (and to the contractor if that's what the contractor wants). This initial suit analysis becomes the "constitution" of the case; a deep, broad, and detailed document to which the lawyer, the adjuster, and the client can refer as the litigation continues.

Then the lawyer acts. He/she files whatever the appropriate responsive pleading is, thus signaling the contractor's official appearance in the case, and begins the vigorous defense of the contractor.

Gather the relevant information, analyze the relevant information, and *then* act. Sometimes salt is needed, and sometimes pepper is needed; no one knows until the information is gathered and analyzed.

Legal Issues:

Construction defect cases often contain cutting edge legal issues; that's probably because of their complexity; with so many parties, and so many things that went on during the contracting between the homeowners and the developer, and between the developer or general contractor and the sub-contractors, and with so many things that went into the building of the homes or commercial buildings, issues simply arise.

It is the lawyers job to spot these legal issues, to analyze them, and to act appropriately on them. An issue may prompt a particular dispositive motion, or it may become a line of defense that is kept for trial, or it may be used for some other strategic purpose.

Factual Issues:

The facts of any case are of prime importance. This is where a good relationship between the lawyer and the contractor is very important. The lawyer should communicate well with the client; sometimes the phone works, but sometimes there's no substitute for sitting down with the contractor in the contractor's office, where the people and papers involved with the construction are located.

Strategy:

Litigation strategy is born from a lawyer's analysis of the legal and factual issues. In defending a case it is important to try to have two, three, or more lines of defense. For instance, the first line of defense for a subcontractor might be to prove that the general contractor's Responsible Managing Employee did not actually supervise the construction operations, thus invalidating the general contractor's license,[27] thus invalidating the general contractor's contract-based causes of action;[28] the next line of defense might be that the indemnification clause in the subcontract is not enforceable because it violates the statutory prohibition on over-inclusiveness;[29] and the next line of defense might be that the contractor followed the general contractor's plans and specifications, thus alleviating the contractor from resulting problems.[30]

Throughout the litigation the conscientious, good lawyer builds up each of these defense lines, utilizing hard work, and his/her legal, communicatory, research, and analytical tools. At mediation, trial, or at a dispositive motion these lines of defenses are ready; if the first falls, the second is ready to go, and if the second falls the third is fully armored and ready to protect the contractor.

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[27] Buzgheia v. Leasco Sierra Grove 60 Cal.App.4th 374, 434 (1997)
[28] Ranchwood Communities v. Jim Beat Construction 49 Cal.App.4th 1397 (1996)
[29] Civil Code Section 2782
[30] See Mannix v. Tryon 152 Cal. 31, 41 (1907)

Mediation:

Mediation is "the act of a third person in intermediating between two [or more] contending parties with a view to persuading them to adjust or settle their dispute."[31] It is a staple in construction defect litigation. Typically, the court will appoint a mediator who is acceptable to all parties in the lawsuit at the time of the appointment. While a recent case holds that a court cannot order a party to pay for and attend private mediation,[32] trial courts still do what they can to get parties in construction defect cases to mediate their disputes.

A lawyer should be fully prepared with his/her legal strategy when attending the mediation. He/she will often deploy at least some of that strategy at mediation. When a favorable settlement is sought, it may be achieved through the use of the appropriate strategy and well-honed negotiation techniques. It also helps if the lawyer knows and is respected by the mediator and the other lawyers involved.

Case Management Order:

Over the years California's courts have found that a Case Management Order ("CMO") is essential to the management of a case that has numerous parties and/or numerous issues. So, the courts have taken to issuing CMOs as a matter of course is such complex cases. By definition almost every construction defect case is a complex case.[33] A CMO generally appoints a mediator and a discovery referee, governs discovery, governs pleadings to a certain extent, and sets important dates in the litigation.

A CMO benefits the parties and the court because it simplifies matters. For instance, in a case not governed by a CMO there is no limit on the number of Requests for Documents that a

[31] Black's Law Dictionary, Fifth Edition 885
[32] Jeld-Wen v. Superior Court 146 Cal.App.4th 536 (2007)
[33] See Rules of Court Rule 3.400

party can serve.[34] In a case with 300 entities wherein maybe 100 of those entities are all suing each other, the paper flying through the law offices and the contractor's offices would cripple everyone. A well-written CMO generally just orders everyone in the case to deposit all of their "stuff", that is all of their relevant documents in a centralized document depository. (For subcontractors that generally means depositing the job file.)

Experts:

At some point in construction defect litigation most contractors, as well as developers, and homeowners have to retain one or more expert witnesses. An expert witness is someone with "special knowledge, skill, experience, training, or education sufficient to qualify him as an expert on the subject to which his testimony relates."[35]

Although a contractor who is a party in the lawsuit would generally technically qualify as an expert, the designation and use of a party/contractor is nearly always folly to say the least. Imagine the testimony, "Yes, in my opinion I did a wonderful job." Juries consider the source when they evaluate testimony. Of course a person is going to say nice things about him or herself; because of this, a person's self-critique usually has almost zero credibility with a jury.

An expert in a building trade must indeed have specialized knowledge, experience, or education, but that expert should also be viewable by the jury as objective. The expert should be unrelated to the contractor who is in the litigation. The expert should be a good testifier, that is he/she should speak well, and should be able to "teach" the jury.

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[34] Code of Civil Procedure Sections 2031.010, 2019.010; Weil and Brown, The Rutter Group Civil Procedure Before Trial Section 1435.1

[35] Evidence Code Section 720

Trial:

Construction defect trials are generally very lengthy because of the volume of facts and law that need to be litigated. They often take weeks or months to try.

Most lawyers have never tried a construction defect case because so many settle. Only a fortunate few lawyers have tried one or more construction defect case.

Knowledge of what happens at the end, how 12 people sitting in jury box will react, is something that the lawyer should have at the beginning, when the case is new; even if the case settles sometime before trial, that settlement will be based on projections of what will happen if the case goes to trial.

Conclusion as to Litigating a Case:

What will happen if the construction defect case goes to trial is a guide for the construction defect lawyer from the beginning of the case. The lawyer's action at the beginning of the case should be no action at all; the beginning is the gathering information stage. Only after the available relevant information is gathered and analyzed should the lawyer act.

The legal issues involved in a construction defect case are often cutting edge issues; the wise analysis of those issues is critical. The factual issues involved in a construction defect case are very important; their proper gathering and analysis requires good communication between the lawyer and the contractor. In many instances the lawyer should go to the contractor's office, sit down, and personally go over the case.

Litigation defense strategy should involve the building of multiple defenses; if one goes down the next should hold; if it goes down, then the next should hold. The contractor's lawyer should be prepared with these defenses at mediation.

CMOs make construction defect cases manageable. One or more Expert witness should usually be prepared to testify on behalf of the contractor.

Trial is where it all comes to together, on rare occasion with an actual trial, more often with a settlement based on trial projections.

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