CONSTRUCTION MEDIATIONS: MANAGING THE VARIABLES, DEVELOPING EFFECTIVE METHODS & TIPS FROM THE TRENCHES

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I. MANY VARIABLES

Mediators generally consider multi-party construction disputes to be the most difficult cases to mediate and settle. The difficulty, as experienced practitioners know, stems from the many moving parts characteristic of most construction disputes. Consider the following examples:

1. **Numerous Parties.** Construction litigation often involves multiple parties, including the project owner, architects, engineers, other design professionals, the general contractor ("GC"), sometimes a construction management company, and various subcontractors. Given the number of parties and the factual, legal, and insurance-related issues that may impact each party, a number of elements must come together smoothly for the negotiation to be fruitful.

2. **Alignment of Parties.** The manner in which the parties' interests align may be complicated. For example, the project owner may have sued the GC directly and the GC may have sued the subcontractors as third-party defendants. The owner may have jointly sued the GC and all relevant subcontractors. Or, the owner could have sued the GC and several subcontractors, and the GC could have added other subcontractors or professionals as third-parties. The GC may have addressed the owner's concerns and is now suing the subcontractors after making the required repairs. Significant cross-claims for indemnity and contribution can also exist between defendants, further complicating the settlement negotiations. Moreover, depending on the contract language, some types of disputes over the same project may be heard in an arbitral forum and others in litigation, leading to the risk of inconsistent results and a probability that the varying dispute resolution timelines will create additional challenges.

3. **Business Relationships.** As repeat players in the construction industry, the litigants may have long-standing relationships with each other, which can have a substantial impact on the dynamics of the mediation and settlement negotiations. Property owners, property management companies, general contractors, subcontactors, architects and engineers may continue to cross paths long after a

particular dispute is resolved. The desire to preserve valuable, ongoing business relationships can be a significant factor in seeking common ground at mediation. The existence of interconnected relationships may also affect unrelated projects, injecting the settlement process with additional considerations or challenges.

4. **Contract Issues.** Most construction cases involve multiple contracts between the parties involved in the project. Issues that may impact the negotiation process include:

    a. Do all the **subcontracts** follow the same general form or do different provisions apply to different subcontractors?

    b. Is there an **indemnity** provision in the subcontract? Are there issues regarding the "express negligence" doctrine? Does the new Anti-Indemnity Act govern the indemnity clause and, if so, what does it mean relative to enforceability of the clause? Has the GC made a timely demand for indemnity in advance of the mediation?

    c. Is there a contractual requirement to name certain parties as **"additional insureds"** on insurance policies? Has the insurance coverage or defense been requested in advance of mediation and what was the result of that request?

    d. Is there a **mediation requirement** in the contracts that requires an early mediation before suit can be filed?

    e. Are there **arbitration clauses** in any of the contracts that impact some or all of the parties?

5. **Insurance Issues**: A multi-party construction mediation typically comes with insurance-related issues. Common examples include:

    a. **Availability of Insurance**? Are any defendants without insurance? Have any carriers denied coverage? Are some or all carriers defending under a reservation of rights? How significant are the carriers' coverage defenses? Do the insureds understand the limitations on their coverage—for example, that insurance is not a guarantee for defective work? Are the insurance company representatives present for the mediation, and with or without coverage counsel? Do the defendants have coverage counsel present for the mediation to address insurance coverage issues as they arise? Have any of the insurers or policyholder defendants initiated coverage litigation?

b. How are the **defendants' insurance programs structured**? Do some defendants have multiple layers of excess coverage? Are there large self-insured retentions that impact the direction the litigation may take? Does the dispute span multiple policy periods, potentially triggering multiple policies and different insurers? Are there issues to be resolved with respect to the trigger of coverage, allocation between covered and non-covered claims, parties or remedies? Have the defendants and their insurers resolved these issues in advance of mediation so that they are aligned in their efforts to achieve resolution?

c. Is there an "**additional insured**" ("AI") provision in favor of the GC? If so, did all subcontractors obtain the necessary AI coverage or did some fail to honor such provisions, creating potential breach of contract issues (and possible actions against insurance agents/brokers) for failure to add the AI endorsement? Does the AI clause provide coverage only during the course of the project and not with regard to later-discovered construction defects? Did the GC articulate its demand for AI coverage reasonably in advance of the mediation so that the impacted carriers are on notice and have had the opportunity to formulate a position? If the AI issues were not raised in advance of mediation, carriers for subcontractors with AI obligations may appear at mediation focused solely on their named insured's liability and unprepared to consider any AI arguments that arise - while the GC's carrier may come to mediation expecting the AI carriers to foot the bill.

d. Are there different **approaches and attitudes between insurers** regarding the plaintiff's claims, the available defenses, the appropriate defense strategy, insurance coverage (or more predictably a lack thereof), and how to manage the negotiations? This is a virtual certainty – so, how can the parties reconcile the differing insurers' positions?

e. What are the **deductibles** or **self-insured retention levels** applicable to the available insurance? How do they play into who makes the decision at mediation? Are the insured and insurer on the same page relative to liability and settlement dynamics and strategy?

f. Are there any **eroding policies**, where every dollar spent for defense costs erodes the limits of the policy? These are typical in professional liability policies for architects, engineers, and surveyors, among others.

6. **Time Constraints**. Timing is everything. Are the parties ready to mediate? Have the parties had sufficient time to conduct discovery necessary to complete a meaningful evaluation of the claim? It can be difficult to persuade an insurance company to settle a claim before some preliminary discovery has been completed—*i.e.*, unless the file is "papered." Insurers tend to think they need to take a firm defensive posture to most lawsuits in order to avoid the "shake-down" mentality. Put another way, insurers manage more litigation than any other entity, so they don't scare easily. If the plaintiff is not prepared to demonstrate the strength of its case, it can be difficult to get an insurer engaged in the mediation process. The time constraints inherent to a multi-party case present their own challenges because of the number of parties and the time it may take even an efficient mediator to "make the rounds." Preparation can be the key to making the best use of the time allocated to exploring settlement options through mediation.

II. MEDIATION MODELS

Mediators and lawyers who regularly practice in the construction area have developed mediation techniques designed to deal with these competing variables. Creative counsel and mediators will be well-served by a working knowledge of these methods. There is, of course, no single "correct" method or model that always works; the particular variables of each case will determine the approach that gives parties the best chance of settling.

The discussion below assumes a mediation between an owner/plaintiff and various professionals, the GC, and subcontractors as defendants or third-party defendants (for ease of reference, "defendants").

A. Traditional, Global Mediation

The traditional mediation method is familiar and widely used. The mediator negotiates between the project owner, on one hand, and all the defendants on the other, with a continuing trade of numbers that hopefully results in settlement.

> ***Major Advantage*:** All is out in the open, for better or worse. If each defendant has the resources to pay (insurance or otherwise) and is willing to contribute to the settlement pot at a level that all others deem reasonable, the traditional method can work. To be successful, however, this mediation model requires the planets to align perfectly. This typically requires planning and coordination by defense counsel in advance of the mediation, along with a strong GC (and/or counsel for the GC) who is willing to make a significant contribution to the settlement pot,

consistent with the co-defendants' expectations. A GC that is willing to pay its "fair share" is in a position to assist the mediator—almost as a co-mediator—in gathering contributions that everyone perceives to be reasonable from the others, moving the group towards a resolution.

A variation on the traditional "back-and-forth" mediation is that the mediator obtains—early in the day—a "fairly honest" and realistic indication from the owner/plaintiff's counsel regarding the range in which settlement might be feasible. Typically, this approach is effective only with experienced construction counsel. With this number in hand, the mediator then spends most of his/her time with the defendants, building the settlement pot towards the owner's general range.

***Major Disadvantage*:** All is out in the open among the defendants.

a. In a complex multi-party construction case, use of the traditional mediation method often leaves the owner/plaintiff waiting all day for an opening offer from defendants, while the defendants negotiate among themselves.

b. Defendants and carriers generally look at each other to assess the reasonableness of each defendant's contribution level, because the defendants each know what the others are contributing. If a defendant believes that a co-defendant is not offering its fair share towards the pot, that defendant will typically lower its contribution in response. This may create a domino effect with other defendants, as all are driven towards the "lowest common denominator." This mediator's (and litigants') nightmare is extremely common given the dynamics of a complex multi-party construction mediation. An extreme, but very real, example is the situation where Defendants 1 and 2 both state clearly that they will never pay as much as the other (which logically results in a zero dollar offer for those two). When one defendant/carrier takes what other defendants believe to be a "low-ball" position, the possibility of a successful negotiation is jeopardized.

For these reasons, the consensus among legal professionals is that settling a large construction case using the mediation method typically employed in a straightforward two-party case is exceedingly difficult.

B. Various "Blind" Methods

The challenges posed by the numerous variables in play and the fact that each defendant knows what every other defendant is offering typically have a chilling effect on settlement efforts. To address these concerns, a number of "blind" approaches have been developed to mitigate the damage.

1. **The "Single-Blind" Method**. Each defendant provides the mediator with its contribution to the defendants' collective settlement pot for that particular phase in the negotiation. The mediator keeps the separate contributions confidential, but discloses to defendants the total dollar amount before taking the total number to the owner/plaintiff.

> ***Major Advantage*:** No defendant knows the contribution of any other defendant, thus helping avoid the race to zero.
>
> ***Major Disadvantage*:** Each defendant knows its percentage contribution to the total offer, reviving the problems associated with comparing contributions. Many defendants/carriers are able to negotiate "with blinders on," based on an evaluation of their own exposure and without regard to how their contribution compares to the total. Other defendants balk if they believe "they are carrying more than their fair share of the load."

2. **The "Double-Blind" Method.** This approach is similar to the single-blind method, but the mediator also keeps confidential from the defendants the total, combined settlement offer.

> ***Major Advantage*:** This method avoids the "who is paying what" problem by insuring that no defendant/carrier knows how their number relates to the total settlement pot.
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> ***Major Disadvantage*:** This approach is akin to playing chess blindfolded. The defendants are negotiating with the owner/plaintiff with no information in each negotiating round regarding the total number conveyed to the owner. Typically, the defendants do not want the owner/plaintiff to know this method is being used, which creates additional challenges. The owner also may assume, incorrectly, that the defendants know the total number offered. If the number is particularly low, the assumption that the lowball offer was intended as such can kill the negotiating process.

3. **The "Triple-Blind" Method.** This approach modifies the double-blind method with the addition that if a global settlement is achieved, the plaintiff only knows the total number and not the contributions from each defendant.

***Major Advantage*:** Consistent with the concerns above, this method prevents the owner/plaintiff from saying: "Wait a minute! Defendant A is not contributing enough and so I do not agree to the total because defendant A should be paying more and is getting out too easily."

***Major Disadvantage*:** Handling the settlement documents and payments can be tricky. Once a global settlement is achieved, the parties may be content that the matter is resolved and unconcerned with the amount paid by each party. After all, the plaintiff got a total amount that the plaintiff was willing to accept. On occasion, concerns remain that the agreement may fall apart before it closes if the parties obtain information regarding each defendant's contribution. In these situations, the mediator or another third party may have to act as a confidential clearinghouse to receive checks from each defendant and deliver the total sum to the owner/plaintiff. If the case has settled, these are good problems to have, but the mechanics of closing the deal under these circumstances can be challenging.

C. The Mediator Proposal

Some mediators dispense with many of the negotiating steps and spend the day visiting and re-visiting with each party in order to discern the lowest amount the plaintiff might accept and the maximum amount each defendant might pay. A mediator may ask each defendant (without identifying itself) to write on a piece of paper, for example, the first number and the top number it might offer. The reliability of these numbers can be suspect and of limited benefit, but if all counsel and the carriers know and trust the mediator, they may be fairly candid in providing information that can give the mediator a sense of the potential total settlement pot. After a series of negotiating trades, the parties may be unable to close the gap, but the mediator should have a good sense about what each party might be willing to do. Generally with the permission (and sometimes even the urging) of the parties, the mediator proposes a number for each defendant to pay and a total number for the owner/plaintiff to accept.

***Major Advantage*:** If the mediator has the wisdom of Solomon, the case is settled!

***Major Disadvantage*:** To enhance the effectiveness of this resolution strategy, most mediator's proposals are non-negotiable to prevent parties from, predictably, starting a new negotiation with the mediator. A straight "up or down" maximizes the pressure on each party to say "yes" without seeking to negotiate a different number with the mediator. Under this scenario, if one party says "no," the case does not settle. Or the mediator might seek to assist a "no" party by getting a better deal at the expense of others. Some mediators build "fluff" into one or more of the proposed numbers to handle a party that wants to further negotiate

with the mediator by saying "I can't do 9 but I can do 8." As an alternative, the mediator might propose a total number to plaintiff and a total number to defendants and let the defendants work among themselves to see if they can put together the proposed settlement total. In any event, there are many variations on the mediator proposal concept itself, but overall it is often the safest and surest way of getting the case settled.

D. Separate Negotiations

If a global mediation appears unlikely, the mediation may turn to a series of independent negotiations between the owner and/or GC as a claimant and the GC and/or subcontractors as a paying party. Contribution, indemnity, and other matters may prevent such an effort in whole or in part, but it is always a back-up approach if the global effort is not succeeding.

III. TIPS FROM THE TRENCHES: CONSIDERATIONS IN A MULTI-PARTY CONSTRUCTION MEDIATION

(With Special Emphasis on Insurance-Related Planning)

A. Counsel for Plaintiff(s), Third-Party Plaintiff(s) or Cross-Claimant(s)

a. Plead your facts and assert your claims in a way that maximizes coverage and does not limit or destroy coverage.

b. Assert your claims in advance of the mediation so the defendants' carriers have sufficient time to investigate liability and damages before mediation. Payment of significant sums from insurance proceeds may not happen until after vetting of expert reports and depositions.

c. In cases involving both covered and non-covered claims or remedies, tie the alleged damages to the covered claims, if possible, to maximize pressure on the insurer(s).

d. Prepare your client for mediation by explaining the coverage issues, limitations, and exclusions that may impact the insurer's willingness to participate in a settlement, so the client is not surprised at mediation. Clients in the fight for the first time may not appreciate the insurance coverage issues and the impact that coverage limitations may have on the policyholder's obligations. An insured who wants its carriers to "take care of the problem" may have to learn the benefit of falling on its own sword from a liability standpoint, careful nevertheless not to admit liability and void the coverage.

e. Avoid premature mediation efforts, but balance carefully. The mediation should be scheduled late enough in the litigation for the parties to have developed their respective positions, but not so late in the game that any "defense costs" leverage on carriers has been lost. For example, it might be wise to mediate following expert designations/reports, but before incurring the cost of taking expert depositions.

B. Counsel to the GC

a. If the GC has indemnity or AI claims, make demand sufficiently in advance of the mediation so that the carriers have had time to do their due diligence. Although filing summary or declaratory motions on these issues may be an effective tactic, it can also chill discussions until rulings are made.

b. Give careful consideration before filing dispositive motions to remove tort theories based on the economic loss rule that, if granted, may remove insurance coverage and defense for the client.

c. Work to take the lead in coordinating efforts between all defendants or third-party defendants and the carriers as to all issues in conflict in an attempt to come to the mediation as a defendant/carrier group that is organized, coordinated, and has a plan for negotiating with the plaintiff(s). This ideal world certainly might not be possible given the dynamics, but in certain instances this coordination in advance will be the key to a successful mediation.

d. Consider having a defense-only meeting or mediation, in an attempt to work out a collective strategy for negotiations with the plaintiff.

3. Counsel to Insured Defendant or Third-Party Defendant

a. Ensure that all applicable policies have been identified, that the carriers have been notified, that the carriers have had an opportunity to conclude their coverage analysis, and that efforts have been made to address any allocation, other insurance, or priority of payment issues.

b. If an insurer will be represented by coverage counsel at mediation, the policyholder should consider whether it needs coverage counsel at the mediation or on-call to address issues as they may arise. Defense counsel should understand her ethical duties, potential conflicts of interest, and limitations on her ability to provide advice on coverage issues.

c. Coordinate with other defense counsel (all or an aligned group) as outlined above to eliminate impediments to settlement prior to mediation, if possible.

d. If there are significant coverage issues, consider scheduling an extra day of mediation prior to the global mediation to give the defendants and their insurers an opportunity to focus on the insurance issues.

4. Tips for All Counsel

a. Use your submission to the mediator to provide more than just the facts and the law, or a summary judgment-type submission. Help the mediator learn the dynamics of the case and any major impediments to settlement from your perspective. Consider suggesting the mediation method you believe may be most effective.

b. Discuss in advance with other counsel whether an opening session with presentations is necessary, whether it will advance the ball towards a resolution or possibly backfire by causing the parties to become more entrenched in their positions, and seek to develop a consensus.

c. Do not appear at mediation and announce for the first time that your representative with the settlement authority has to catch a plane at noon.

d. If a "bells and whistles" opening session is necessary or desired, consider scheduling a second day of mediation to allow time for the actual negotiation process to work.