

# Mediation of Residential Construction Defect Cases

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## MEDIATION OF RESIDENTIAL CONSTRUCTION DEFECT CASES

Statistics and practice confirm the vast majority of residential construction defect claims settle prior to trial. The key to successful resolution of these cases, therefore, is to achieve ultimate resolution of the claim in the most efficient, least expensive manner. Mediation has proven to be a critical tool toward achieving this result. The lawyer's ability to successfully use the tool of mediation, however, requires a thorough understanding of how best to implement and execute the mediation process.

In order to successfully utilize the tool of mediation, it is critical lawyers understand three basic components. First, lawyers must understand the nature and extent of preparation required before cases are ready for the mediation process. Second, lawyers must understand the unique nature of the mediation process, particularly with regard to residential construction defect claims. Finally, lawyers must understand how to close the mediation process and accurately and thoroughly document any settlement or agreement achieved. This paper addresses each of these three critical issues.

### I. PREPARATION.

The importance of preparation for mediation cannot be overemphasized. Absence of mediation preparation is simply preparing for a failed mediation. The chances of successfully resolving claims through mediation are directly proportionate to the level and extent of preparation by a particular party. Preparation for mediation includes:

- preparation of the substantive claims and defenses;
- research and investigation of potential mediators;
- investigation and analysis of insurance coverage/financial responsibility issues;
- research and understanding of legal framework for claims and defenses;

- preparation of lawyers;
- preparation of clients.

Failure to adequately prepare for mediation in any one of these regards dramatically reduces the chances of a successful mediation.

Lawyers and their clients must prepare for mediation efficiently. Costs of preparation must be taken into account. Similarly, the cost of inadequate preparation must be taken into account. While it may cost more to secure a formal written expert witness report, that report may facilitate settlement at mediation, and avoid the cost of future legal proceedings. The cost of spray tests may be excessive in light of the amount claimed for window installation or manufacturing issues. On the other hand, the spray test may trigger a response from the window manufacturer, installer or general contractor that again facilitates the mediation process. The elements of preparation set forth below are meant to be illustrative, as opposed to exhaustive. There is not check list or formula to be followed in every case. The lawyers, clients, and insurers all need to evaluate each case on its merits to determine what elements of preparation will most efficiently serve the ultimate goal of a successful resolution of the claims. The elements of preparation set forth below, however, are most often found to positively impact the mediation process.

A. Preparation of Factual Support for Claims or Defenses.

Prior to mediation, it is vital that all parties to the mediation have sufficient factual information available to make intelligent decisions regarding claims resolution. In the absence of available information, many lawyers or clients take a very conservative approach, for fear of making erroneous decisions due to the lack of factual information. When information is conveyed, experienced lawyers, insurance claims representatives and clients can review the

information in light of their experience and make a reasoned evaluation of the risks and rewards of ongoing litigation. Where all parties have a solid base of information from which to proceed, the chances of successfully resolving the claim increase. Key factual information required for mediation of residential construction defects include the following elements:

1. Project Documents.

The project documents for a residential construction project typically include the original purchase agreement, any original plans or specifications, subcontracts, invoices, bills or other documents to identify the scope and nature of work performed. Correspondence between the parties regarding any prior history of problems or repairs is critical information. While residential construction projects typically contain far less documentation than commercial projects, efforts to exchange all pertinent documents should be completed prior to the mediation.

2. Onsite Inspection.

Prior to the mediation, all parties should have the opportunity to review the site and alleged defective conditions. Parties should document existing conditions through the use of photographs. Color photographs are most effective at mediation. From the claimant's perspective, photographs should illustrate the claimed defective conditions, the damage arising from the claimed defective conditions and provide context as to the process followed to construct the home. From the defense perspective, photographs should also be taken to illustrate areas where construction was completed in an appropriate fashion, or to illustrate that damage does not exist or is not as severe as indicated.

### 3. Expert Reports/Disclosures.

From the claimant's perspective, one of the most critical pieces of information required for a successful mediation is a thorough and detailed expert witness report. A well documented expert report will set out the factual basis and support for the claims or defenses and identify the witness who will support such position at trial. This documentation or proof is critical for each party to understand and evaluate the risks of proceeding to litigation. The report is more critical from the claimant's side, since most defendants, their lawyers and/or insurers will need support for any recommendation to pay money to resolve claims. From the defense perspective, expert reports are still critical, but the timing and nature of expert reports is subject to many other variables which dictate whether reports should or should not be produced prior to the mediation.

### 4. Repair Bids.

Two essential considerations in any residential construction defect case are the scope of repairs required and the pricing of work for that scope. Detailed construction bids address both of these issues and provide factual support for the pursuit or defense of claims on these issues. The bid should clearly spell out the scope of work required, the cost to complete that scope of work, and at least a general breakdown of costs into categories that allow for discussion and evaluation of the bid. In order to maximize the utility and impact of the bid, the following components are essential:

- use a reputable, experience contractor;
- provide detail regarding the scope of services;
- provide a firm bid, not an estimate;
- provide sufficient detail to allow breakdown of costs;
- provide a timeframe for bid;

- provide “realistic” bids;
- verify number, size and configuration of windows;
- identify all allowances (basis and amount).

Bids must be realistic. Defendants won't pay for the over-the-top bid with regard to pricing or scope. Homeowners will not accept the under-the-bottom lowball bid with respect to incomplete scope or unrealistically low pricing. Contractors with experience, a list of references and prior work, and a willingness to work with homeowners are more likely to contribute toward a successful mediation. Bids that break out in general terms the cost of stucco replacement and removal, cost of removing and resetting windows, cost for sheathing or other structural work, cost for any interior work and identify allowances are more useful at mediation. Finally, since the scope and necessity of window replacement is almost always an issue, parties should know the precise number of windows, size and configuration of windows prior to mediation. This will facilitate negotiations as to damage analysis, cost allocation and possibly allow for replacement of certain windows as an alternative method of negotiation.

The level of actual investigation is again dependent on the nature, size and extend of the claim. A firm factual background, however, dramatically increases the chances of success at mediation.

B. Preparation/Analysis of Insurance Coverage/Financial Responsibility.

As the extent and nature of residential construction defect claims increases, the issue of insurance coverage, financial responsibility and collection becomes critical. Construction companies that previously worked with homeowners to resolve claims may now be overwhelmed with the onslaught of litigation. Insurance companies that previously paid claims may now be examining coverage defenses or creating policies to limit or eliminate coverage. Preexisting

firms may be dissolving statutorily, possibly eliminating future liability. As a claimant and defendant, the exploration of these issues prior to mediation can again increase the chances of success. In particular, prior to mediation the parties should be aware of:

- The insurance coverage or lack thereof of each party;
- The corporate status of each party;
- The ongoing business status of each party;
- The existence of all reservation of rights letters and, if applicable, copies of applicable policies.

In cases where collectibility is a critical issue, defendants should raise that issue with claimants prior to the mediation. If coverage questions are to be addressed, these can best be addressed through the presence of separate claims representatives or insurance coverage attorneys present at the mediation. At the very minimum, these parties must be available by phone. Further, the basis of coverage positions must be disclosed to the plaintiff as early as possible. The chances of an unsuccessful mediation increase geometrically when the issue of collection or coverage is raised for the first time at the mediation session.

C. Preparation of Legal Analysis.

The recent flurry of residential construction defect claims in Minnesota and other states has generated a unique body of law. Legal issues relating to statute of limitations, statute of repose, notice issues for warranty, warranty exposure, subcontractors' exposure to statutory warranties, waiver and limitation of consequential damages or warranties, dissolution of corporations and issues regarding insurance coverage are all rapidly evolving. Prior to the mediation, if legal defenses or related issues exist, they should be identified and raised to the

opposing party. Again, the chances of success at mediation increase geometrically where legal issues are identified and evaluated in advance of the mediation.

The list of premediation preparation set forth above is by no means exhaustive. Each individual case requires individual analysis. These fundamental issues, however, should at least be considered prior to scheduling the mediation.

D. Preparation for Selection of Mediator.

Many factors will go into the selection of your mediator. Prior to selecting a mediator, however, you should obtain information regarding the background and experience of the mediator, the mediator's track record of success or lack of success under similar circumstances and availability. You should consider the personality of the mediator and how that personality will interact with the lawyer or a particular client. In some cases, a kinder, gentler mediator will achieve great success. Other clients may require a father figure or teacher as a mediator to achieve success. Still others require a mediator be aggressive, adversarial and attack vigorously a client's stated position. The lawyer should know and understand his or her client, the opposing parties, and then determine which approach will most effectively create an opportunity for settlement.

Another issue to consider with regard to mediators is the existence of actual or perceived conflicts and preexisting relationships with the parties. Many times mediators will have ongoing relationships with parties or lawyers representing parties. These relationships may be as simple as prior mediations for a particular party or lawyers. The relationship may be more direct as in the mediator previously represented one or more of the parties or a partner of the mediator may have a similar relationship. The mediator's background with regard to litigation and prior clients is a factor to consider. If a mediator has a history of representing general contractors, is that

mediator appropriate in a case where one of the parties is a general contractor? Some believe the prior relationship increases the chances of success while others believe it may establish a bias. Regardless of your view, the key is to know the information. The more information you secure regarding a mediator's background, approach to settlement negotiation and experience, the better you can tailor your selection of a mediator to a particular case.

E. Prepare Your Clients.

Clients are the key players in any mediation. In a litigated case, the claim and defenses are tailored to the legal setting. Lawyers and their clients must persuade a judge or jury in order to achieve a successful resolution of the claim. Mediation is different. In mediation, the arguments must be tailored to persuade not the judge or jury, but instead persuade the other party and its lawyer. Arguments that may have little legal relevance, may be critical to resolving cases at mediation. The emotional aspects of the mediation must be identified and considered. Most importantly, the client's expectations must be managed and controlled either by the lawyer or by the mediator. The ability of the mediator to control these expectations is enhanced dramatically if parties prepare their clients for the process.

Certain essential elements will be addressed by the mediator in every case. These elements typically include explanation of how the process works, the mediator's role in the process, the confidentiality of the process and the time involved to achieve resolution. Certain items must be emphasized. First, clients should understand that mediation is an opportunity to resolve the case most efficiently prior to trial. In order to accept that opportunity, however, all parties must review the case realistically. Parties must be ready to accept new information and modify their position. Compromise is almost always a required part of a successful mediation. At the mediation, clients must focus on the future. Quite frequently in residential cases, there

will be strong feelings or emotions present for homeowners. Homeowners often feel they have been abused by the system, treated unfairly by the home builder or its insurer, and left in a financially untenable position. General contractors often feel they have bent over backwards to assist homeowners, and that they have been unfairly faced with the obligation of rebuilding or repairing problems well beyond their actual responsibility. Claims of fraud or criminal activity can inflame emotions of defendants. All of these emotions, however, must be put on the back burner. Parties must not dwell in the past. Instead, they need to focus on the future and determine how to best resolve the claim with a minimum of time, cost or risk. Controlling expectations is key, and lawyers should work with the mediator to help control their client's expectations. Mediations that are resolved within the levels of client expectations typically result in happier clients, better settlements and repeat business.

F. Prepare The Lawyers.

As indicated, mediation is different from litigation. Attorneys in construction defect claims must step back from their litigation mindset, and review the purpose and goals of mediation. As previously indicated, at trial the key is to persuade the court or jury. In mediation, the key is to persuade the other party. Legal arguments must be made with the purpose of mediation in mind. Similarly, attorneys should work with the mediator to help facilitate the settlement process. Counsel for plaintiffs or defendants should let the mediator know early what key issues may exist with their clients. Attorneys and the mediator should jointly discuss strategy for the process. All mediators recognize that negotiations occur between counsel and mediators. At the same time, mediators recognize that they are assisting the lawyers in negotiations with their clients. The most successful mediations occur when lawyers and

mediators partner together to determine whether a case can be resolved and the best methods to achieve that resolution.

All of this preparation is intended to increase the chances of success once the mediation process itself starts. Since a critical component of preparation is to understand the mediation process, the next portion of this paper will address the process, as it relates to mediation of residential construction disputes.

## II. THE MEDIATION PROCESS

### A. Structure of the Negotiation Process.

The structure of the negotiation process can significantly reduce distractions and impediments to a successful mediated settlement. It is important that the parties have an opportunity to discuss the rules and structure of the negotiation process and have a common clear understanding of what type of process will be used during the mediation. Options for the negotiation process include:

- Full disclosure – all offers and demands as well as the contributions of each defendant are disclosed to all parties
- Blind or undisclosed offers – the contribution of each defendant to a particular offer is confidential, although the total offer is disclosed to all parties. The advantage of this approach is to reduce inhibitions on defendant's contributions to settlement due to their concern about their percentage contribution to a given offer.
- Double blind – the contribution of each defendant to a settlement offer is confidential and the total settlement offer is not disclosed to the defendants. The plaintiff is advised of the settlement offer and all parties are advised of the gap between the last offer and demand. The justification for this approach is to reduce the attention of defendants on the percentage of their contribution to an offer and instead encourage maximum offers based on an analysis of the strengths and weaknesses of the claim.

B. Preparation of Parties for the Mediation Process.

1. Negotiation Process.

Frequently parties, particularly plaintiffs, have no previous experience with mediation and with the give and take of the negotiation process. It is very helpful to the process if attorneys prepare their clients to understand that the negotiation will start with a demand from the plaintiff that is high and that the defendants will likely make an offer that is a fraction of the first demand. The negotiation will proceed through a series of demands and offers that move toward a compromised agreement.

2. Evaluation Process.

It is important that plaintiffs have an understanding of the strengths and weaknesses of the claims and defenses in the case including:

- The effect of experts' evaluations and opinions
- The effect of repair bids provided by plaintiffs and by defendants
- The effect of defenses asserted by defendants such as statute of limitations
- The effect of limited insurance coverage of any defendant

3. Recognition of the Need to Address Emotional Factors.

It is very common that the plaintiffs have no previous experience with litigation and with the mediation process. Their feelings of threat to their home and family, uncertainty about the process and perceptions of unfairness can result in strong feelings of fear and anger that need to be addressed during the mediation process. It is very helpful if before the mediation the plaintiffs are given an opportunity to discuss and understand the facts of the case and the strengths and weaknesses of the claims and defenses. As the plaintiffs develop a more clear understanding of the merits of the claim and of the process, the emotional intensity can be

reduced. In addition, in some cases it is necessary for the mediator to spend time with the plaintiffs simply listening to their concerns and questions. Rapport that can be developed with the mediator early in the process can prove very useful later on as the negotiation process moves toward conclusion.

4. Persons With Authority in Attendance During the Mediation.

Persons with settlement authority being present at the mediation is preferable, although not always possible. If persons with settlement authority for the parties with a larger role in the case cannot be present it is best to advise the parties of that fact.

When coverage issues have been raised for a particular defendant it is much more important that persons with authority be present at the mediation. In addition, it may be necessary to have personal counsel for the defendant present to give advice regarding any uninsured exposure.

C. Establish What Facts Are Agreed and What Facts Are Disputed.

It is very helpful to a negotiation process if the parties have a common and clear understanding of what facts are agreed upon and what facts are disputed. This is especially true when the parties have agreed to an early mediation before conducting any formal discovery. The benefit of that approach is to avoid the cost and delay of the litigation process. However, for the mediation to be successful it is crucial that the parties identify and exchange sufficient information so that the claims can be evaluated by all parties, including the mediator. That information could include one or more inspections of the home with necessary test cuts, spray testing of windows as well as exchange of all necessary documents. The basic type of factual information that needs to be exchanged includes:

- Scope of repair – full tear off versus partial tear off and replacement of stucco; reuse versus replacement of windows; supplemental repairs as necessary –

