MUDDY BREWING
MEDIATION

Teaching Note

Plot line synopsis

Muddy Brewing is a two-party construction mediation between a developer/owner and an architect. The plot line is an amalgam of a case I mediated in the Massachusetts Middlesex Multi-Door Courthouse, before most current students were born and a real Ohio brewery building's recent woes. For plotline inspiration and technical details in this case, I am indebted to Amanda Albrecht, PE, Esq., a former construction engineer, former law student, and current Assistant Dean of Academics at the University of Cincinnati's College of Engineering and Applied Science, and to her husband's experience with a brewery building.

Developer BZ Boone had purchased an old brick warehouse building partially set into a hillside along a riverbank, intending to turn it into a restaurant and brewery, with upper floor office space.

Boone hired Ryan Rorie of Rorie Space Design as the project designer and Groban Construction, at the General Contractor. Boone knew Groban's founder had just stepped down from an active role and was succeeded by his son, George.

While Boone, the general contractor, the building inspector, and the architect incorporated the structural engineer's recommendations for securing and reinforcing the building's structural elements, they apparently missed or ignored the engineer's disclaimer language regarding soil and ground conditions and failed to seek a current assessment. Boone did not advise them that the engineer's report was obtained before the decision to house a brewery and its cellaring and storage equipment in the warehouse.

Boone spent more than $5 million on renovations, including 4 stories and a basement level. The first floor (ground level) housed a large kitchen and restaurant on the east side and brewing equipment on the west side. The west side of the basement level contains cellaring equipment and serving tanks for beer and cider. The restaurant design included new patio extensions at ground level. Built into a hill, the basement level included a walk-out to the back. Patio extensions were also constructed, just under those on the ground floor. Public tours and post-tour tastings were planned for the basement level, with brewery pub food at the main level. At both levels, the patios were accessed via sliding glass doors set into the original building shell.

The second floor of the building was outfitted as office space with a conference room and four bathrooms. The third and fourth floors were divided into four office areas, a total of 20 offices, four conference rooms, four kitchens and four bathrooms. Boones' business plan included renting these office areas. At the time of the disaster described below, future

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leases had been signed for one office area and several companies had expressed interest in renting there.

Initial troubles started a month after Boone moved their company's employees into the second-floor office spaces. The bathroom sink faucets splashed with too much force – spraying users – and the bathroom window fan units leaked when it rained. Boone expressed concern about bathrooms on each level – a total of 20 - to Rorie, who promised to check the sinks and window fans.

The real trouble began nine months later, after major construction was completed and brewery equipment installed. After two weeks of rain, an intense storm dropped four inches of water within 24 hours. The rain caused mudslides which came down the hillside and piled up over the new patios and foundation walls. The pressure from the mud caused the moveable windows' frames to bend and separate from the restaurant and patio walls and shattered the windows. The sliding glass doors also bent, snapped, and shattered. The floors and subfloors on that side dipped and buckled, causing interior water damage to walls and upholstered benches and chairs on that side. Major areas of the floor and subfloor under the brewery equipment at the ground-level and lower-level buckled and dipped. The sagging floor and subfloor would have become more pronounced and dangerous if the beer production cycle had been underway and the beer tanks full. It takes 1-2 months after brewing for beer to be ready. Thus, Boone couldn't open the restaurant or tasting areas for four + months after construction fixes in the brewing areas.

To address the bathroom issues, Boone retained another architect/general contractor to review the plans for the sinks and wall fan units. They determined Rorie had spec'd the wrong faucet type for the sinks and inadequate flashing for the wall fans and found interior wall water damage. They estimated the cost of redoing the flashing plus interior wall repairs at $4,000 per bathroom - $80,000 - and replacing the faucets at $500 per bathroom - $10,000. Boone's total estimated cost for addressing the bathroom issues is $90,000.

The major structural damage to the property is the more significant problem. Until that is addressed, Boone cannot operate the brewery or the restaurant. The building inspector has declared the bottom two floors of Boone's Brewhouse to be unsafe and unusable.

Boone (through the insurance company) paid approximately $100,000 for clean-up and repair of water damage to interior restaurant walls and furnishings. The insurance company authorized payment of $80,000 for purchasing replacement sliding wall window units, and $40,000 for the sliding glass doors and frames on the bottom and ground floor levels – plus $60,000 for installation and finishing work. In total, the insurer has paid $100,000 and authorized $180,000 more. Installation and these payments were delayed pending investigation of the cause of the damage.

Boone hired a new structural engineering expert to determine what caused the windows and door frames opening to the two patio areas to buckle and break, and the floors to dip and buckle. In consultation with the city's building inspector and engineering department,

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they determined that the heavy brewery equipment carried excessive weight and the ground underneath the warehouse must have shifted over time. The area under the two new patios built out from the original building shell was susceptible to rain and mud. Opening the building to the patio areas, and excavation on that side made the building unstable and the ground more subject to shifting, exacerbated by adjacent rain and mud. The entire site is subject to landslides.

Boone's expert determined that major foundation work would be required to use the building safely. A retaining wall must be added to the edge of the patio to stabilize the hillside. The foundation walls on the building's east side must be reinforced to resist the pressure of future mudslides. On the building's west side, blocking and bridging must be installed between the joists under the street-level brewing equipment, and helical pile underpinning must be installed under the basement level to help the foundation support the weight of the working brewery equipment. The expert stated that such a project would cost more than $1,000,000 and would take at least three months. No doubt, it would have been faster and less expensive if done during the initial construction and renovation stage.

For Boone, delay costs money. Boone's Brewhouse business plan projected $100,000 per month in restaurant revenues, $80,000 per month in beer revenues (including outside sales) and $20,000 per month in rental from the 4 office units ($5,000 each): a total of $200,000 per month. Boone's business interruption insurance does not cover any pre-opening period.

Boone sued Groban Construction, Rorie Space Design and Ryan Rorie personally, to recover the Brewhouse losses and all repair costs. The total damages claimed are $10 million, including loss of value to the property, lost rent, estimated cost of repairs, loss of personal property, and a myriad of other items. (That $10,000,000 includes a lot of padding, as usual.) Groban Construction recently filed for bankruptcy protection and appears to have little or no assets to satisfy creditors.

Reconstruction and repairs are underway. By the time the work is done, it's undisputed that the brewery and restaurant opening date will be four months later than planned.

In a recent conversation, counsel for both parties agreed their clients would do well to try mediation to resolve their dispute.

On teaching: timing, efficiency, parsing damages and reasoning

I anticipate that this case will take at least three or four hours to mediate in a workshop or class.[1] It would no doubt take longer "in real life."

[1] I confess that this case is new; my estimate is based on another simulation with a similar structure. Interestingly, students in the University's Construction Management Program have completed a negotiation version of that problem within 45 minutes or so. It's true they are only given that amount of time in the class

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Reasoned, critical parsing of the damages

A notable and perhaps unusual aspect of this case is that, in order to settle, the mediator and the participants must dig into the damages numbers. Parsing the damages lays bare the importance of reasoning through the parties' rationales, and allows for efficient solutions, even without exploring creative options beyond the legal claims.

A key to resolution is the mediator's recognition that a significant share of claimed damages flow from the property's original characteristics. It's now clear that the entire site is subject to landslides, and the ground underneath the original warehouse had shifted over time, before the project began. For the building to support heavy brewery equipment, reinforcement was always needed. The area under the two new patios built out from the original building shell was susceptible to rain and mud. Opening the building to the patio areas, and excavation on that side made the building unstable and the ground more subject to shifting, exacerbated by adjacent rain and mud. Boone's expert determined that major foundation work would be required to use the building safely. A retaining wall is needed from the edge of the patio to stabilize the hillside.

Though unknown to Boone, these characteristics of the property were surely not the fault of the contractor or the architect. It's fair for the mediator to ask the plaintiff/plaintiff's counsel: "What if the architect and the contractor had noticed the initial engineer's disclaimer about soil and ground conditions, and alerted Boone to potential problems?

True, Boone would have been spared cleanup and repair costs (covered by the insurer) but would still have been required to do the site work and structural reinforcements. And the project would have taken longer to complete, even if not the full extra 4 months.

As Rorie observes (in their role information): "...major foundation work and structural reinforcement would still have been required. That would have cost the same $1,000,000 and caused substantial project delay." Rorie is not willing to be saddled with that. Rorie anticipates Boone will argue the costs would have been lower and delay shorter if this work were done at the beginning. Rorie won't necessarily concede the point, or "not right away. But even with that, the cost wouldn't have been more than 25% lower - $750,000 – or the delay less than two months."

Rorie's points are valid.

As Rorie sees it, the real consequences of anyone's failure to see and warn about the risks were the $100,000 in repairs to the interior restaurant walls and furnishings plus $80,000

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period, but impasses are rare. These students tend to bypass the legal issues, and many find the opportunities for mutual gains. As this case is more factually complex, it might even take business students a bit more time.

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for replacement sliding window wall units, $40,000 for sliding glass doors and frames, plus $60,000 for reinstallation and finishing work – a total of $280,000. (Because Rorie alleges they did raise the potential site problems, and that Boone and Groban Construction were equally capable of seeing them too. Rorie is not eager to pay even for these repairs. Still, Rorie grudgingly sees that it would be reasonable to compromise on 50% or $140,000ish on this aspect of the claim.)

It's also true that Boone's confidential information acknowledges the damages numbers they listed refer to lost revenues of $848,000 from four months of delay from the original opening date. A savvy mediator will ask if those are gross revenues, or net profits. The answer is they are gross figures; profits would be only 25%.

In mediation, the key is to separate damages due to alleged negligence of the architect and/or contractor from costs due to the characteristics of the land. And it's always worth asking whether lost revenues claimed are gross figures or net profits. That leaves lower damages totals, easier to reach in settlement. In real cases, often the key to settlement is in working through these damages numbers and reasoning with care.

Efficient Options Based on Differing Valuations

This case sets up economically efficient trades based on differing cost estimates for some of the repairs and value placed on the rental office spaces. This facilitates settlement.

As stated above, Boone estimates the cost of redoing the flashing plus interior wall repairs at $4,000 per bathroom - $80,000 - and replacing the faucets at $500 per bathroom - $10,000. Boone's total estimated cost for addressing the bathroom issues is $90,000. Rorie has a general contractor friend willing to do the bathroom repairs at $2,000 - $2,500 per unit, or $40,000 - $50,000, and source and install faucets at $2,500 - $5,000 – a total of $45,000 - $55,000. If the mediator learns this, it should be possible for Rorie to offer to undertake responsibility for the bathrooms. Boone should count this offer's value at $90,000, but it will cost Rorie only $45,000-$50,000. That's an efficient trade. (In real life, there would no doubt need to be approval of the new contractor, inspection of the job, etc.) Note: Even Boone's confidential information acknowledges the $90,000 estimate is high. They put it at $70,000 but haven't yet let their lawyer in on the secret. This can be a lesson to lawyers: do probe your client's estimates for padding.

The Boone building office space is another area for creating efficiency. Rorie Space Design currently pays $11,000 per month rent on a lease set to expire in two months. Rorie would be willing to rent one of the Boone building's office areas.

Boone's confidential information on rental expectations creates opportunity for creating value. Based on the market at the time, Boone had originally estimated monthly rental for each space at $7,500. Later, due to rising local rents and the spectacular design, Boone listed them at $8,000 per month. Given the mudslide fiasco, Boone would take monthly rents of $7,500, or $7,000 for immediate rental on a long-term lease.

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If the mediator discovers this information, mutual gain opportunities should be obvious. If Rorie takes office space on a long-term lease at anything more than $7,000 and less than $11,000 a month, it generates generate cash flow savings for Rorie and gains for Boone. For example, if Rorie pays $8,000 a month, they save $36,000 per year (which could be part of an offer), and Boone gets $12,000 more per year than they would have accepted. Or if Rorie pays $11,000, then Boone gets $36,000 more per year.

Design services are another opportunity for mutual gains. Rorie Space Design is not a one-person shop; it includes a team of architects and designers. Boone is willing to allow Rorie to pay some part of what's owed in design services for renovation work in Boone's home and in another 10-unit rental townhouse development they own nearby. Boone likes Rorie's design approach. Boone views Rorie as bright and young and hopes they have learned from this. Boone estimates the reasonable value of the architect's services for these two projects would be $40,000 - $50,000.
(For any skeptics among the readers, I vaguely remember that in the real Middlesex County case, future discounted or free architect's services were part of the deal.)

Note: the clients' role information discusses rental rates and design services. Only Rorie knows what they are paying on their current lease, that is due to expire soon. Boone surely knows what rents would be acceptable in the brewhouse building's office space. The lawyers know nothing about any of this. The point is that mediators should explore beyond legal issues to learn more about the parties' contexts, constraints, and interests.

About working with insurance

Rorie's information speaks about their insurance policy with DIC (Design Insurer's Corporation), which carries a $100,000 deductible. The insurance policy limits are $5,000,000. Under the insurance contract, Rorie splits the cost of attorneys' fees 50/50 with DIC until the deductible is reached but ends up paying higher premiums for any amount the insurer pays on their behalf. (Rorie has settlement authority, though DIC must approve a settlement above the deductible.)

Rorie hasn't considered (before talking to their lawyer), that rejecting the plaintiff's $10,000,000 demand – double the policy limits - doesn't create a risk for DIC of "bad faith" liability to an insured. However, if the demand goes lower than $5,000,000, DIC is obligated to consider the numbers and Rorie's exposure and be sure Rorie agrees to holding out for a lower number. Rorie's lawyer knows "DIC will recommend settling for an amount that makes sense, based upon real risk and provable damages – not Boone's pie in the sky expectations. DIC sure as heck isn't going to cover improvements to the site and structure that Boone would have had to do if informed earlier."

Rorie is willing to pay a small portion in cash - $30,000 to $40,000 - and the remainder either over time (perhaps $20,000 per year) or as future design services. It is also in Rorie's interest to think of ways to "use up the deductible" within the language of any

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settlement agreement, so that the insurance company's cash can be used (within reason) to satisfy Boone.

Note that the insurance deductible issue points to ways of handling “gains” created by the rent expectation differentials. If Rorie agrees to rent office space at $7,000, they would save $48,000 a year in rent expense. They could then afford to pay the $100,000 deductible “over time,” with the savings generated. (The other way, paying $11,000 in rent, wouldn’t count against the deductible, so it’s less advantageous to Rorie. Boone shouldn’t care how they are paid.)

Settlement positions and legal givens

Boone’s lawyer has informed them they won’t be able to collect from Groban due to their bankruptcy. All should understand that under the law of joint and several liability, “if you’re in it for 1%, you’re in it for 100%.” Thus, if a jury allocates any fault to Rorie, they are responsible for paying the full amount. That’s why Rorie was also named individually. Rorie and Rorie Space Design and their insurer are the only realistic source of compensation.

So, the real question is NOT: what % should Groban’s fair share be? If Rorie acknowledges a high probability that a jury would allocate any fault to them, they will be responsible for the full award. I suppose one could call this evaluative mediation. Maybe, if the mediator articulates that conclusion. But really, the mediator should be able to pose the question: If a jury does find for the owner, what are the chances of Rorie escaping with 0% liability?

Even though any amount over their $100,000 deductible will come from DIC, Rorie doesn’t think they or DIC should authorize paying more than $190,000 - $200,000 (based on a share or repair costs and bathroom costs) “unless convinced the actual costs were higher or that [they] have missed some compelling argument relating to allocation of fault or the cost of this mess.” While they “reject the idea of covering inflated project delay damages,” confidential information also suggests up to 25% of the delay damages - $750,000 - claimed might legitimately be added to the total. This “unless convinced” language, plus recognition of some legitimate delay damages leaves some room for the other side’s presentation and the mediator to influence Rorie’s and the insurer’s top numbers.

With that in mind, the case should be able to settle for a dollar amount, with the architect taking on the bathroom repair and, perhaps, payment over time. With a nod to pareto efficiency and mutual gain, great agreements will include Rorie renting in the brewhouse building, and using the savings for settlement, and perhaps Rorie’s offering design services without charge or at reduced rates.

Emotions and Acknowledgement

Emotion in a construction case? One last point that shouldn’t be lost: right at the beginning, the simulation prompts the architect to be angry – outraged – by Boone’s decision to sue

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them personally. Boone contracted with the architectural business for design services, not with Rorie personally. Rorie may feel personally attacked and vulnerable because of it. Boone's attorney would explain that they sued Rorie to personally to protect against the possibility that the design company could turn out to be as judgment proof as the general contractor. For them it was protective, not personal. Blame this one on the lawyer. Boone would acknowledge a good working relationship with Rorie, admiration for Rorie's and the design firm's talent, and a desire to work with them on future projects.

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