Unraveling the Mysteries of Construction Defect Claims

OVERVIEW

Below is a brief overview of the anatomy (the what, when, where and how) of construction defect litigation.

What is construction defect litigation? Construction defect litigation is a lawsuit brought by homeowners and/or the homeowners association against the builder, general contractor and subcontractor for constructing their homes in such a manner as to fall below the standard of care for the construction industry and/or the minimum requirements of the various building codes and ordinances.

When did construction litigation begin? The application of theories of construction defect claims is a relatively new development. In fact, it was not until the Supreme Court in 1974 held that the California Supreme Court held that builders and sellers of new construction should be held accountable under implied warranties for fitness for a particular use.[1] Most other states have followed suit.

Where did construction defect litigation originate? Construction defect claims began to "take off" in San Diego, California with the San Diegan housing boom in the late 1980s. Today, litigation migrates with the the housing booms. Today, areas of hot practice included, Nevada, Arizona, Washington, Oregon, and Colorado.

How is construction defect litigated? Construction defect litigation is deemed complex due to the amount of parties that are involved. The simplest of construction defect cases consist of the homeowners, and/or the homeowners association ("HOA") the developer and the subcontractors hired by the developer to construction the project.[2]

Because of the number of parties involved, organizational systems have been established to manage the litigation of these types of cases. This includes the implementation of a case management order that clearly defines the discovery process. This includes carefully crafted discovery questions that each party is to answer; the order for depositions; establish a neutral location for which the parties can deposit the voluminous documents; the appointment of a special master to address discovery concerns as they arise; and the appointment of a mediator to mediate the case.

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[1] Pollard v Saxe & Holles Dev. Co., 12 Cal. 3d 374, 525 P.2d 88, 115 Cal. Rptr. 648

[2] Parties involved in construction defect claims include developers, converters, construction managers, lenders, general contractors, subcontractors, property managers, architects and other design professionals, geologists, soils and structural engineers, board of directors of homeowner associations, insurance companies and real estate brokers and agents.

PROCEDURAL PROCESS

A. Pre-Litigation Process

1. Calderon Process

Construction defect litigation is extremely costly. It is all the parties' best interest to resolve these claims are efficiently and early as possible. Effective July 1, 2002, California homeowners associations have pre-litigation requirements under Civil Code Section 1375 commonly known as the *Calderon Process*. The *Calderon Process* is a pre-litigation resolution mechanism created by the California legislature in attempt to facilitate early resolution of construction defect case with 20 or more units with a common interest (this includes condominium projects and planned developments).

The *Calderon Process* sets for a procedure in which homeowners association must notify the developer of the alleged construction defects and provide the developer with a statutory amount of time (that can be extended upon agreement by the parties) for a mutual resolution of the alleged defects including time for the developer to repair and/or fix any of the defects alleged by the parties.

a. Notice to Developer

The homeowners associations must give written notice to the developer of the project before filing a complaint for construction defects. Notice to the developer must include all of the following:

(1) A preliminary list of defects;
(2) A summary of the results of a survey or questionnaire distributed to homeowners to determine the nature and extent of defects, if such a survey has been conducted or a questionnaire has been distributed.
(3) Either a summary of the results of testing conducted to determine the nature and extend of defects of the actual test results, if such testing has been conducted.

b. 90-Day Settlement Period

Once the notice has been sent to the developer, the 90-day settlement period begins, unless the association and developer agree to a longer period. Within that time, the association and developer must either attempt to settle the dispute or agree to submit to an alternative dispute resolution.

c. Developer's Request to Meet with Board of Directors

Within 25 days of the date the developer receives the association's notice, the developer may request, in writing, to meet and confer with the board of directors to inspect the property and conduct testing.

It is at the time that the developer usually notifies the subcontractors and its insurance carriers that the *Calderon Process* has been initiated. This is to allow subcontractors to participate by reviewing their work and determining if they are willing to remedy the alleged construction defects either by repairing them and/or contributing settlement monies.

If the developer does not make a timely request to meet with the board of directors or to inspect and conduct testing, the homeowner association is be relieved from any further obligations under the Calderon Process and can file a formal complaint.

d. <u>Time and Conduct of Meeting</u>

The meeting must take place no later than 10 days from the date of the developer's written request. Discussions between the participating parties are privileged and as such are not admissible in evidence in any civil action, unless the association and developer agree otherwise.

The meeting for the purpose of addressing the following issues:

(1) The nature and extent of the claimed defects.
(2) Proposed methods of repair, to the extent there is sufficient information.
(3) Proposals for submitting the dispute to alternative dispute resolution.
(4) Requests from the developer to inspect the project and conduct testing.

e. <u>Notice to Insurers</u>

If the developer requests a meeting with the board of directors, then the developer must deliver the association's notice to any insurers that have issued policies to the developer. This puts the subcontractors and their insurance companies no notice that they may have a duty to defend and indemnify the developer for losses identified in the association's notice.

f. <u>Ivestigative Testing by Developer</u>

If the association conducted any testing prior to when written notice was sent, then the developer must be allowed to test those same areas. Testing in these areas must be completed within 15 days from the date when the areas have been made available to test, unless the association and developer agree to a longer date. If the developer does not complete testing with in the 15 days, the association does not have to make that property available for testing.

The developer is to pay for all costs for testing requested by the developer and is to restore all property tested to the condition is was prior to testing. The developer will usually try to pass these costs along through the subcontractor’s insurance under their contractual duty to defend and indemnify the insured.

g. <u>Developer's Settlement Offer and Request for Second Meeting with the Homeowners Association</u>

Pursuant to the *Calderon Process,* the developer is required to submit the homeowners association within 30 of testing, or if no testing conducted, 30 days after the first meeting:

(1) A written request to meet with the board to discuss a settlement offer
(2) A settlement offer that gives the reasons for the terms of the offer.
(3) A statement that the developer has sufficient funds to meet the terms of the offer.
(4) A summary of testing results that were conducted to determine the defects, if testing had been conducted. If the developer fails to meet the above criteria, then the homeowner association does <u>not</u> have to satisfy any obligation to conduct a second meeting.

h. <u>Second Meeting with Board of Directors</u>

The homeowners association is to meet with the developer 10 days after the settlement offer above has been received to discuss in further detail the alleged defects and the homeowner associations terms for settlement.

i. <u>Failure to Comply with the *Calderon Process*</u>

Judicial relief can only be sought by asserting a procedural deficiency action. This action must be filed with the court no later than 90 days after the developer's answer to the homeowners association's complaint has been served. The court will then schedule a hearing within 21 days to determine whether the association or developer has substantially complied with the *Calderon Process*.

If the court finds that the homeowners association did not substantially comply with the *Calderon Process*, then the court will give the association 90 days to establish substantial compliance. Then, if the court determines that the homeowers association did not substantially comply with the process, the court may dismiss the action without prejudice, or another remedy may be fashioned. The court may not dismiss the case without prejudice, and may take the developer's actions into consideration when fashioning a remedy.

If a court finds the developer did not pay its share of any costs, then the court shall order the developer to reimburse those costs within 30 days, with interest, and the court may award additional costs or penalties.

B. Complaint

If the parties are unable to resolve their differences in the *Calderon Process*, homeowners association will proceed with filing a complaint against the developer. Plaintiffs who are not required to comply with the *Calderon* Process will begin their litigation at this juncture. The plaintiffs may also file directly against the subcontractors as well but the homeowners association will usually let the developer file a cross-complaint against the subcontractors.

The Developer upon receipt of the plaintiffs' complaint will prepare an appropriate answer and then file a cross-complaint against the subcontractors who worked on the project.

The subcontractors will then file an answer to developer's cross-complaint. Some of the subcontractors may in turn file a cross-complaint against the developer and/or other subcontractors. This could include secondary subcontractors that the primary subcontractors contracted with for work at the project.

CASE MANAGE ORDER

Discovery commences after the complaint and all appropriate answers are filed and served, the parties begin the arduous process of conducting discovery. A case management order is utilized to manage and expedite, and attempt to control the costs of resolving complex litigation. The proposed Case Management is usually prepared by the developer; circulated and agreed to amongst the parties and then order by the court.

In construction defect cases the CMO can be used to organize discovery, provide for a document depository, and provide for how discovery disputes will be resolved. The CMO generally includes a description of documents to be produced, a statement of work, destructive testing requests and a master schedule detailing performance deadlines and scheduling meetings. Among the matters scheduled are site visits, destructive testing, mediations or settlement conferences, and hearings. Perhaps the most important item a CMO contains is the description of the Neutral's role in the process.

SUBCONTRACTOR'S SCOPE OF WORK

The first issue for developer and subcontractor is to determine the scope of work for each subcontractor is only liable to extent for its scope of work. A subcontractor's scope of work is determined by the contract, P.O. orders and invoices. In large law offices this task is usually given to the paralegals.

The determination of a subcontractor scope of work is often over looked as mundane and unimportant, but it as critical as any other component of a construction defect case. This is especially true if more then one subcontractor performed work for the same trade.

Example: A Plaintiff is alleging defects with the curb and gutters at a project. Three subcontractors (Sub A, Sub B, and Sub C) performed curb and gutter work at the project. Plaintiff's curb and gutter expert does a detailed expert report showing where each and every curb and gutter defect occurs.

A careful review of the each of the subcontractors scope of work that Sub A worked on the first third of the project. Sub B worked on the 2nd third of the project and subcontractor C worked on the last 3rd of the project.

Plaintiff's expert report indicates that there are no curb and gutter defects at the first 3rd of the project. Subcontractor A was dismissed from the case with a waiver of fees and costs.

Subcontractor A would probably have contributed to the settlement if his counsel had not determined his client's scope of work.

INDEMNITY ANALYSIS

At the heart of every construction defect lawsuit is a claim by the developer against the subcontractors for defense and indemnity pursuant to the terms of the subcontract agreement. There are as many subcontracts as there are subcontractors. Thus the analysis of the type of indemnity agreement between the developer and subcontractor is fact specific. (It is not uncommon to have different subcontracts with different indemnity clauses, within the same project.) Accordingly, a general discussion of indemnity claims follows.

Recently, the Fourth District Court of Appeal issued an exhaustive analysis of the legal principals behind "INDEMNITY" in the case of Maryland Casualty v. Baily & Sons (1995) 35 Cal. App.4th 856. In its analysis, the court opined: California courts have developed certain principals of interpretation applicable specifically to indemnity agreements. (See Peter Culley & Associates v. Superior Court (1992) 10 Cal. App.4th 1484, 1942 [13 Cal. Rptr. 2d 624].) One of those long-established principals provides that "[a]n indemnity clause phrased in general terms [e.g., one which does not mention the effect of the indemnitee's negligence] will not be interpreted ... to provide indemnity for consequences resulting from the indemnitee's own actively negligent acts.," (Markley v. Beagle (1967) 66 Cal. 2d 951, 962 [59 Cal.Rptr 809, 429 p.2d 129].) The original rationale underlying this rule was that because an agreement for indemnification against one's own negligence is not favored and is an exception to the general rule, an agreement to indemnify an actively negligent indemnitee will not be implied in theabsence of express and explicit language. (Citation) From these basic principals, the Courts of Appeal have defined three types of indemnity agreements, creatively identifying them as type 1, type 2, and type 3, each of which are subject to certain rules governing the interpretation of each type of agreement. (See, Mac Donald & Krause v. San Jose Steel (1972) 29 Cal.App.3d413.) Under the Mac Donald & Krause analysis, the court reiterated the traditional rule that an actively negligent indemnitee may not recover when

the contractual provision does not contain an express statement that a negligent tortfeasor may obtain indemnity for its own negligence. However, a passively negligent tortfeasor is entitled to recover for its own acts of passive negligence under a type 2 agreement. As indicated above, unless the agreement specifically mentions the effect of the indemnitee's negligence, the provision will be interpreted to be a general indemnity clause, and the issue of active versus passive negligence would need to be determined. Under prevailing California case law, passive negligence is found in mere non-feasance, such as the failure to discover a dangerous condition or to perform a duty imposed by law. Active negligence, on the other hand, is found if an indemnitee has personally participated in an affirmative act of negligence, was connected with negligent acts or omissions by knowledge or acquiescence, or has failed to perform a precise duty which the indemnitee has agreed to perform. (Herman Christianson & Sons v. Paris Plastering (1976) 61 Cal. App. 3d 327).

As a result of the active versus passive issue, the indemnity provisions of the contract are of little assistance in obtaining immediate coverage on the part of the General Contractor or Developer, and create a substantial issue between the General Contractor or Developer and its Subcontractors.(See also, Reagan Roofing v. Superior Court (1994) 24 Cal.App.4th 425 - the court in dicta, noted that determination of the duty to defend and its relationship to the duty to indemnify, was premature in that no finding had yet been made as to whether the subcontractors were negligent in the performance of their work, which would give rise to the duty to defend and the related duty to indemnify.) Due to the fact specific nature of the active versus passive issue, an early analysis as to the "type" of indemnity provision, contained in the contract, should be made and a discovery plan to show active negligence on the partof the General Contractor/Developer should be established.

THE EXPERTS' ROLE IN CONSTRUCTION DEFECT LITIGATION

The next issue to be addressed in a construction defect law suit is to determine the the determination of potential liability, repair methodology and ultimately the cost of repair that will form the basis of the damages being claimed. Attorneys are hired for their legal knowledge. They are not experts in the substantive areas of the law, including construction no matter how long they have been practicing in this area. The liability analysis rests largely with the findings, opinions and conclusions of the Construction Expert. (With this said both attorneys and paralegals should be familiar with their client's trade. This can be easily accomplished by getting "How To Books" from the local hardware store or at the nearest bookstore.)

The key to success in a construction related cause of action, is the retention of a qualified expert at the earliest possible stage. Attorneys tend to know little about actual construction practices, construction technologies, and Building Code requirements it, therefore, becomes imperative that the expert step to the forefront and assist at the initial stage. By utilizing the expert as a consultant early on, the expert becomes a vital component that advises and guides the attorney directly towards vital discovery issues and documents. Because of the ever increasing importance of the expert, and the

possibility of the expert "running wild", and thereby generating excessive fees, the importance of locating and retaining the right expert cannot be over emphasized. In the expert retention process, the following should be considered:

- Look for construction and design professionals who are proactive and familiar with the customs and practices of the design professionals, developers, contractors, subcontractors and materials suppliers.

- Design and construction practices may differ substantially by the Building Codes, Zoning andother Ordinances adopted and enforced by the local Governing Authority. Look for experts familiar with these codes.

- Look for experts who have garnered numerous years of proactive "hands-on" experience in their fields, which enables them to apply not only theory, but which enables them to apply their life's experiences as well.

- Look for experts that are aggressive, who will dig up the relevant facts, and who are willing and capable of providing the attorney with consistently detailed information.

- Look for experts that are easily available to the attorney, when the attorney needs him or her.

- It is very important for the legal team to utilize the education and experiences of their experts by allowing the experts to educate the attorney with as many technical terms and technical aspects as possible pertaining to the relevant issues at hand. Think about the many times you may have misused technical construction terminology, or misconceived the true nature of the technical issue at hand. An educated attorney is an effective attorney.

Traditionally, construction has been divided into specific "Divisions" as defined by the Construction Specifications Institute (C.S.I.). These divisions break each trade, or specialty down into 16 specific divisions with many sub-divisions that provide a high level of organization. These 16 Divisions are:
Division 1: General Requirements
Division 2: Site Work
Division 3: Concrete
Division 4: Masonry
Division 5: Metals
Division 6: Carpentry
Division 7: Thermal and Moisture Protection
Division 8: Doors, Windows and Glass
Division 9: Finishes
Division 10: Specialties

Division 11: Equipment
Division 12: Furnishings
Division 13: Special Construction
Division 14: Conveying Systems
Division 15: Mechanical
Division 16: Electrical

The project Architect usually will follow these 16 divisions when he or she prepares their "Project Specifications".
The project specifications often are contained within a separate book, commonly referred to as the "Project
Manual". This is usually done in conjunction with commercial, industrial, public schools, health care facilities,
essential services facilities and public works projects.
With residential projects such as single family, tract housing, apartments and condominium construction
projects, it is far more common to find the "Project Specifications" contained on the plans, usually confined to
sections entitled "Notes".
Since it would be extremely rare for the defense team to be representing all or most of the aforementioned 16
construction divisions in any single cause of action, it becomes imperative that counsel clearly define the scope
of their client(s) work by carefully reviewing their Contract Agreement. With large Subdivisions, such as multiple
or Tract Housing and Common Interest Developments, such as Condominiums, they usually are constructed in
multiple phases starting with the "Models". Therefore, it is equally imperative that counsel clearly define which
phase or phases and units contained within each phase of construction their client was contracted for and
subsequently subject to liability.
While not precluding any or all of the 16 CSI Divisions, some of the most common and high-cost defect issues
fall within the following categories:
1. Soils: (Division 2: Site Work)
2. Structural Integrity / Seismic Resistance: (Division 3: Concrete, Division 4: Masonry and
Division 6: Carpentry)

3. Mechanical: (Division 15: Mechanical)
4. Plumbing: (Division 15: Mechanical)
5. Electrical: (Division 16: Electrical)
6. Water Intrusion: (Division 5: Metals, Division 7: Thermal and Moisture Protection, Division
8: Doors, Windows and Glass and Division 9: Finishes)

By now, you are probably beginning to see the complexities of the interrelationships of "the trades". Each trade
has an interdependency upon each preceding trade. In example the roofing contractor cannot roof the structure
without the framing contractor constructing the frame. The framing contractor cannot frame the building without
the concrete contractor placing the foundations. Likewise the concrete contractor cannot place the foundations
without the excavating contractor cutting, filling and compacting the earth ... and so it goes.
Therefore it is critical that defense counsel clearly distinguish the scope of their clients work and how that work
was interdependent upon other trades.
If an alleged defect issue pertains to the work of one subcontractor that has been followed by the work of another
subcontractor, it must be determined which subcontractor was actually responsible for the alleged defect.
One small case in point: Assume it is alleged that the framer (your client) caused defective work as may be
evidenced by excessive holes drilled or notched out in the wall studs, thereby creating a loss of its structural
integrity. Assume further that the defects as alleged do in fact exist. What do you do? Look to the responsible
party such as the plumber who drilled excessively large holes to access his pipes, or the electrician that notched
out the studs to make way for his wiring conduits.
In order to make these determinations, it is of the utmost importance to review the subcontract(s) of not only
your client, but also any and all other trades that may have had anything to do with the work your client actually
performed.
In addition to subcontracts and depending upon the nature of the claim, the relevant issues surrounding the
case, many of the key discovery issues can also be found by looking to the following sources:

Codes and Ordinances

There are numerous codes in application that govern construction. The most commonly applicable is the

The broadest of the codes is the Uniform Building Code (UBC). The UBC is a set of regulations covering all major aspects of building design and construction relating to fire, life safety and structural safety. The UBC was first enacted by the International Conference of Building Officials (ICBO) in October 1927. Revised editions of this code have been published approx. every 3 years since that time.

Many municipalities have adopted amendments to the UBC, such as the City of Los Angeles, County of LosAngeles, County of Orange, and many other Governing Authorities throughout the State of California.

There are additional uniform building codes that discuss in specificity different trades. These uniform codes include:

- Uniform Mechanical Code
- Uniform Plumbing Code
- Uniform Fire Code
- Uniform Housing Code
- Uniform Code for the Abatement of Dangerous Buildings
- Uniform Sign Code
- Uniform Administrative Code
- Uniform Building Security Code
- Uniform Code for Building Conservation
- Uniform Zoning Code
- National Electrical Code

One of the most common mistakes during discovery is the citation and utilization of the wrong code(s), or the incorrect Edition of the Code. Common practice by the writers of the codes is to publish a new edition every three years, with the governing authorities being required by the State to adopt the new edition every three years. Therefore, if a project was constructed in 1988, the applicable codes might not necessarily be the 1988 edition, it might be the 1985 edition of the code, depending upon when the code was published and subsequently adopted by the governing authority, as well as the date in which the project was permitted for construction.

This is very important because a party is only accountable for the requirements of the code enacted at the time of the construction. A party is not liable for future changes to the code. A parties potential liability can be reduced if a incorrect code is being relied on to determine if the subcontractor fell below the standard of care and or did not comply with the code requirements.

Ordinances on the other hand, are regulations which are adopted by the local governing authority, which may adopt or modify specific sections of code to apply to a specific application, manner or situation, other than for which it was originally intended for by the code. Therefore, when in discovery, it is important not to overlook local ordinances.

Other items for consideration during discovery may also include the following:

1. Original Construction Drawings and Specifications
2. Approved Change Orders
3. Architects' or Engineers' Clarifications

4. Construction Exception Reports, Correction Notices, etc.
5. Construction Schedules and Revised Updates
6. Contracts: Prime and Subs (All that are applicable)
7. Correspondence and Memorandums
8. Field Notes by the Architect and Consulting Engineers
9. Logs
10. Project Meeting Notes or Meeting Minutes
11. Reports:
a. Daily Reports
b. Applicable ICBO Reports
c. Applicable Manufacturers' Specification Sheets and Test Reports (Construction Specifications Institute [CSI] and Sweets Catalog Sheets)
d. Applicable Manufacturers' or Producing Mills' Certifications (Mill Certifications)
e. Applicable Results of Soils and Materials Testing Reports
12. Requests for Information and Answers
13. Revision Sketches and Drawings
14. Submittals and Shop Drawings
15. "As-Built" Drawings

CONCLUSION

Now that you have diligently reviewed the complaint, reviewed your clients' contract, defined their scope of workand to which phase or phases their work was performed, garnered applicable case law, it is now time to focus on the actual nature of the plaintiffs' list of alleged defects and determine whether or not your client is potentially
liable.

It now becomes absolutely crucial that all alleged defects be defined as clearly as possible, as to exactly what is truly defective, where they may actually exist and which "Established Standard(s)" the design or work is in violation of. This, in my opinion, is the true heart of the case.

Here it becomes very important to bifurcate the alleged defects into two categories: "Design Defects" and "Construction Defects". Each type is a different species in and of itself. Commonly destructive testing is performed by plaintiff in order to establish the actual existence of the defects, as alleged, and to provide "ironclad" documentation of their existence. This is an opportunity that demands the presence of both counsel and their experts to witness and provide thorough documentation of these tests and findings.

It is also very important to be cognizant of the means and methods utilized by the plaintiffs experts whileconducting these destructive tests. It is a common occurrence for the plaintiffs experts to cause more damage than may actually exist. In example, when removing stucco in order to expose the lath, nailing and flashing paper

surrounding windows and doors, the materials are damaged in the process, thus rendering false or "tainted" findings. Unless the damage, or alleged defect can be proven to have existed prior to the time of the destructive test, it can be easily lost in the convenient interpretation of the plaintiff expert.

In the event that defects are factually identified, there is no escaping the next phase of your task. That task is to establish a clear and reasonable repair methodology and factor accurate and realistic costs for repairs or replacement. Caution is recommended here, because sometimes the "cure is worse than the disease".
Good old fashioned common sense is in order at this juncture. Remember the old Army adage? "There's the right way, the wrong way and the Army way!" Meaning that there are many solutions and options available to resolve and "mitigate" the problems of defective construction. The nature of the scope and extent of the defective work is the crucial factor to consider.

With the present nature of construction defects litigation, being proffered by innuendo and insinuation, the proverbial "Smoke and Mirrors" it is most often difficult or even impossible to pin down the plaintiffs' experts to prima-facie facts. Yet this must be done! Use your experts to assist you with questions to ask plaintiffs' experts during deposition, mediation or even trial (if it goes that far).

Until meaningful legislation is passed which provides us with a clear and legal definition of precisely what a defect really is (other than something that is not "Perfect") and thereby provides the legal profession with clearer parameters in which to operate within, the nature of construction defects litigation and in particular the defense thereof, will remain a difficult and costly undertaking.