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Preconference Workshop 3

***CONSTRUCTION DEFECT TRENDS AND
DEVELOPMENTS***

Presented by

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Defect



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CONSTRUCTION DEFECT TRENDS AND DEVELOPMENTS

Richard H. Glucksman¹
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The continuing growth of construction defect claims and complex litigation involving alleged defective or dangerous conditions within structures across the country over the last decade can be traced to a number of factors. First, there has been an increase, or the advent, of an expectation of perfection in every single detail of construction, from the foundation slab to the roof, including installed products and items under warranty through their manufacturers and homebuyers have sought to make the general contractor the guarantor of the perfection of each of these items. Further, there has been an increase in the awareness the average homebuyer has regarding construction defect claims, thanks to several high-profile and highly publicized court battles over construction defects and especially mold allegations.

Additionally, the number of plaintiff's lawyers eager to assert construction defect claims has increased, while their boldness in seeking new homeowners to represent and their knowledge regarding this relatively specialized area of law have deepened. Finally, a lack of legislation and judicial clarity in the area of construction defect litigation, construction standards or regulations, and limitations on suits for construction defects for property damage or personal injury have led to an atmosphere of at times uncontrolled litigation and spiraling building, insurance, and litigation costs.

The issues that need to be understood in the scope of "construction defect litigation" are numerous and broad and we focus these materials on three overriding factors:

- legislation setting forth construction requirements and defects
- legislation intended to manage the process of resolving construction defect claims
- the costs and risks of litigating different types of construction defect claims

It is clear now that states were slow to react to the onslaught of construction defect claims and disputes that progressed from a trickle in the 1980's to become one of the fastest growing areas of litigation in many states. This is due to a proliferation of construction while home values plummeted, litigation skyrocketed, and awareness of construction defects and mold increased. Many states have just now begun the process of stemming the tide of litigation with new standards to advise homebuilders and homebuyers alike as to what their expectations for future claims and home quality should be.

There has been an additional wave of legislation addressing the manner for settling or resolving these disputes with or without proceeding to court. A move is afoot to provide builders with a "Right to Repair," which could allow homeowners and builders to avoid lawsuits, or to limit or control them, by attempting a good faith repair of the claimed defect prior to the vesting of the right to sue in the homeowner. California and other Western states have been at the forefront of this movement, as they have

¹This handout was coauthored by Michael L. Newman, also of the Chapman, Glucksman & Dean law firm.

been at the center of the construction defect storm. Many other states have developed guidelines or regulations for categorizing defects, resolving disputes, proceeding through the courts, and providing a coveted "Right to Repair."

As an adjunct to the increase in construction defect claims has been turmoil in the insurance industry as to how to underwrite builders in light of the likelihood of future suit, and as to how and when to assist in the defense of builders once claims are made, but before suit has been brought. A major factor is the impact of Additional Insured Endorsements in the litigation process, and the rights of the additional insured.

A SHORT HISTORY OF CONSTRUCTION DEFECT LITIGATION

Construction defect litigation began to appear in the early 1980's and gained momentum throughout the late 1980's and the 1990's. Prior to an explosion in the mass-production of homes, most construction defect suits centered around so-called "bad contractors" or unique problems with a particular home or complex. A booming economy in the late 1980's and again in the 1990's resulted in an increased demand for home ownership, including the ownership of condominiums. This demand was most profound in Southern California in the 1980's, during an expansion in the defense and aerospace industries, and in Northern California in the 1990's, during the information technology boom. Therefore, California found itself at the forefront of new types of construction projects (and later at the forefront of the resulting litigation.)

These national booms in construction led to the mass-production of buildings, especially condominium complexes. Furthermore, the demand on inexpensive housing led to a construction boom that invited inexperienced or unprofessional contractors to the industry and new owners to the market, with little experience in owning and maintaining a home. Also, mass production ignored basic differences among the geographically different parts of the country in which the homes or condominiums were built or installed. In addition to these factors, the legal environment began to change. Some jurisdictions adopted strict liability standards for construction defects, and legislatures were, for the most part, silent as to the regulation of the construction industry and construction defect claims in particular.

Following the economic boom came a deep downturn in the economy, causing homeowners to lose income, as well as homes and condominiums to lose value in a falling real estate market. It was also at this time that homeowners came to realize that workmanship in their rapidly-built homes appeared to be at a lower quality than they had anticipated. Additionally, existing legislation created a complex statute of limitations analysis in which plaintiffs had to assert their rights on "patent" defects quickly, but had many years to discover "latent" defects. Coinciding with the downturn in the economy, Plaintiffs' attorneys began to increase publicity for homeowner lawsuits to recover for loss of market value (Plaintiffs asserted diminution in value due to alleged defects, defendants asserted the lowering market in general). One major contributor to the increase in suits was the threat to Boards of Directors for Homeowners' associations that failing to bring suit would subject them and their errors and omissions insurance carriers to liability for failing to satisfy their fiduciary duty to their homeowners.

The burdensome expense of these earlier construction defect suits arose in the discovery process, during which each party to a suit, including different homeowners, the general contractor, the subcontractors, and homeowners' associations, had the right to propound interrogatories, document production demands, and demand depositions. The Courts became overwhelmed with the burdens these large, complicated, and messy suits presented, and attempted to manage these suits as best they could. It became clear, however, that some better system was needed than the regular course of settlement conferences, mediation, arbitration, and trial.

Several innovated solutions developed during the litigation process. The advent of the "Case Management Order" allowed the court to direct the progress of the case and prevent the burdensome paperwork that often accompanied these matters in the past. Some courts began establishing complex judicial panels, most notably the California Superior Court for Orange County. Other jurisdictions have developed guidelines for individual judges to follow in complex matters, as opposed to creating dedicated panels to complex cases. Additionally, the advent of the "Special Master" or "Discovery Referee" allows the court to refer the parties to an independent and dedicated individual to oversee and regulate the discovery process outside of the court system. In addition to these arrangements, attorneys for general contractors and subcontractors have also attempted to enter into Joint Defense Agreements between themselves and their insurers to manage and coordinate their defense of lawsuits.

Beginning in the late 1990's, many legislatures began the long process of bringing order to construction defect litigation. Most states have attempted to bring together many interested parties when drafting this legislation, including builders, judges, homeowners, insurance industry representatives, attorneys for plaintiffs and defendants, and many, many others. Also, judicial analysis of theories of recovery and responsibility for claimed defects has also expanded, and some jurisdictions have adopted theories for insurer liability for construction defect verdicts under the "continuing loss," "time on the risk," or other theories. Some general contractors prefer to obtain "wrap-up" policies which provide for one insurer to cover the entire project.

MOLD: A CATALYST FOR LITIGATION

Although not necessarily a component of every construction defect matter, it is impossible to consider the wave of construction defect litigation without also considering the effect that mold has had on the construction industry. Mold is ubiquitous on Earth, and is in every home and building in every state. However, claims for "toxic mold" or water damage which homeowners or building owners fear will develop into mold problems, have increased drastically due to several nationally-publicized lawsuits. Also, as homeowners' expectations increase, even the slightest water-intrusion or appearance of mold can cause fear and an impulse for immediate remediation, causing expensive mold-related construction defect claims.

Mold litigation to date primarily involves straight construction defect claims and the allegation that in addition to repairing the construction defect itself, costly mold remediation is also required; straight personal injury claims arising out of exposure to mold or a combination of both personal injury and construction defect claims.

Plaintiff's claims often include causes of action for personal injuries as well as economic losses. These losses can include relocation expenses, remediation, replacement, and remodeling costs, loss of value of the property and loss of use of the property. Personal or bodily injury claims can include a multitude of injuries, conditions, and symptoms, whether scientifically linked to mold exposure or not. In addition to current medical symptoms, the plaintiff will often seek damages for possible future medical and other expenses. In claims involving disputes with insurance companies, the plaintiff can seek punitive damages for bad faith or delay on the part of insurers.

Overall, negligence and strict liability are the most common theories of recovery asserted against builders, architects, designers, contractors, property developers, and owners. Another common theory is based on strict liability against contractors and manufacturers of materials used in the building process. However, in many jurisdictions, the plaintiff must show that the defect was connected with a personal injury or property damage, otherwise recovery is barred by the "economic loss rule."

As stated before, publicity of claimed mold infestations has become commonplace in the news. Aside from several well-known celebrity claims of mold infestations, increasing jury awards in seemingly-mold

related matters have raised the public's awareness even further. On May, 2001, a case in which a Texas jury awarded a family \$32 million in damages resulting from their home's infestation with mold garnered much attention to mold litigation despite the important fact that it was not related to personal injuries due to mold. This case centered around the alleged bad faith of the family's homeowners insurance carrier. The carrier was held liable for refusing to pay for mold remediation and for failure to comply in good faith with the policy executed for the family. The jury awarded the large judgment in connection with their handling of the mold claim, and not specifically for damages resulting from mold exposure. Importantly, although rarely reported, the trial judge in the matter actually excluded the plaintiff's medical experts from testifying and the personal injury claims were not allowed.

In fact, an increasing number of medical and scientific studies have questioned the link between mold and actionable personal injuries due to the lack of scientific evidence for such claims:

"Over the past several years, increasing public attention has focused on a potential or suspected role in human illness from the mold *Stachybotrys Chartarum*, commonly know as "black mold," particularly in association with water-damaged buildings. In Texas, this attention has been manifest not in scientific or medical publications, but rather in the lay press and in an increasing number of insurance claims filed for mold remediation of homes and workplaces. Texas Medical Association's Council on Scientific Affairs has been asked to update the "state of the medical science" in this important area.

"To study this issue, the council conducted a search of medical and scientific literature and contacted Texas and national experts/specialists. After reviewing available data, the council has concluded that public concern for adverse health effects from inhalation of *Stachybotrys* spores in water-damaged buildings is generally not supported by published reports in medical literature."²

More and more, the already high cost of repair estimates for claimed construction defects often claimed by the homeowner or building owner can include significant costs for mold remediation. This includes costs for removal and/or repair of building materials which the owner claims have been exposed to mold, cleaning the air and returning the property to its previous condition. The costs for these repairs can significantly increase the initial demand and must be analyzed by experts on the defense side. Insurers must consider the initial claim for mold and remediation in light of the scrutiny jurors have recently placed on response to claims of mold.

To the extent mold is found to exist and remediation is actually required, these costs will most times be passed on to the subcontractors involved in the water intrusion issues. Importantly, these issues must also be reviewed to determine if the purported mold was caused by alleged construction defects or other sources including homeowner neglect. Regardless, the allegation of mold in the typical construction defect matter, even without allegations of personal injuries, could significantly increase the cost of defending these matters and potential settlement and verdict value.

²Report of the Council on Scientific Affairs of the Texas Medical Association, available at <http://www.texmed.org/has/CSA%20Black%20Mold.doc> (September 2002).

NATIONAL TRENDS IN CONSTRUCTION DEFECT LEGISLATION

The growing national trend towards an expansion of construction defect litigation has forced several issues to the forefront of consideration by legislators, lobbyists, and attorneys. First among these concerns is a standard by which constructed homes may be judged to determine whether a defect exists at all. The second concern is to minimize the burden on the judicial system and afford builders the opportunity to avoid having to constantly defend their work in the court system. Finally, there is a concern that the nature of buying and owning a home requires that clarity be lent to the issue of limitations and repose periods for asserting complaints and lawsuits based on claimed defects.

Many states have tackled these issues with differing laws. In this year alone, many states have passed some version of a "right to repair" or "notice and opportunity" law, including Alaska, Colorado, Florida, Idaho, Indiana, Kansas, Kentucky, Montana, Nevada, South Carolina and West Virginia. Those states join Arizona, California, Michigan and Washington, while legislators in Ohio, Oregon and Pennsylvania continue to consider such a rule. Clearly, a form of law permitting a builder to address a homeowner's claimed defects and attempt to make a curative repair and avoid litigation is the favored form of legislation for controlling the sheer number of construction defect lawsuits and attempting an alternative method for resolving these disputes, rather than simple or complex litigation.

Other states have attempted to develop more clearly-defined codes for Construction standards. The most prominent of these states have been Texas and Nevada. Texas' new legislation calls for a panel of experts to promulgate a set of construction codes, and also sets forth a method for litigating a construction defect case.

Of the above legislation, the most prominent and ambitious attempt to take control of construction defect litigation, bring down costs, and establish a reliable method for determining risk and exposure, is California's new "right to repair" law. Known as "SB 800," the law sets forth standards, the right of a builder to repair and avoid litigation, the timeline for inspection and compliance, individual statutes of limitation for many components, a dispute resolution process, and guidelines for litigation. This law is the most comprehensive in the country, and was intended to be a multifaceted solution to California's burgeoning construction defect flood. SB 800 represents a compromise among many players in the construction defect industry, and may form an example for a new wave of Construction Defect legislation.

State legislation passed in the 2002-2003 legislative sessions include Alaska's HB 151, California's SB 800, Colorado's HB 1161, Florida's SB 1286, Idaho's HB 133, Indiana's SB 451, Kansas' HB 2294, Kentucky's HB 289, Montana's SB 289, Nevada's SB 241, Oregon's SB 909, South Carolina's SB 433, Texas' HB 730, and West Virginia's SB 440. For more detailed and comprehensive information, please review the laws themselves, or contact the local or state Builders' or Insurers' organizations.

CALIFORNIA'S S.B. 800— A COMPREHENSIVE APPROACH TO CONSTRUCTION DEFECT STANDARDS, LITIGATION, AND DISPUTE RESOLUTION

As an introduction to the laws sweeping the nation in an attempt to reign in the runaway explosion of Construction Defect litigation, this detailed analysis of California's comprehensive approach is provided as an example of one state's attempted solution to many problems associated with Construction Defect litigation. Every state differs, and most have not sought to attack the problems as completely as California has. Still, the law does not solve all of the problems, most notably the insurance and risk-man-

agement issues arising with the added cost of the right to repair and the additional pre-litigation mediation and arbitration. However, the scheme is clearly set forth and the goal is noble; the state has attempted to not only give homebuyer clear notice of their rights pre-purchase, but it gives builders and their insurers a clear picture of the duties and responsibilities, as well as the risks associated with different approaches to disputes.

Introduction

SB 800 (Codified as California Civil Code § 43.99 and Title 7, [commencing with §896] of Part 2, Division 2) is intended to be a revolutionary “next step” in construction defect litigation, following in the footsteps of the Calderon process. It requires homeowners to allow builders the right to repair a home or to waive this right, before the homeowners are allowed to file a lawsuit for construction defects. For homeowners, it may provide additional rights, including a detailed list of defects that are actionable.

Overall, it appears that the most important goal of the new legislation, which applies to all homes sold on or after January 1, 2003, is to minimize litigation and allow a homeowner and builder the opportunity to address and repair claimed construction defects without proceeding to litigation.

Legislative Analysis

SB 800 has a “Bill of Rights,” so to speak, that sets forth actionable defects. These include water intrusion, defects in plumbing and drainage systems, defects in soil and structural components that allows cracking or deterioration of the home, and interference with the proper operation of installed components such as an HVAC unit, electrical systems, doors, and other components. The law includes qualifications for heating and air conditioning systems, roofing materials, exterior wall finishes and fixtures, and ceramic tiling.

SB 800 also sets forth particular statutes of limitations for original homeowners as well as successors-in-interest. There is a one year Statute of Limitations, running from the close of escrow for defects in irrigation and drainage systems. There is also a Statute of Limitation of one year, running from the date of occupancy of the proximate unit, for any failure to comply with noise transmission standards for attached structures.

There is a two year statute of limitations, running from the close of escrow, on decay in untreated wood posts and defects in landscaping systems and installed dryer ducts. The Statue of Limitations is four years from the close of escrow for plumbing and sewer defects, electrical system defects, defects in exterior pathways, driveways, hardscape, and similar improvements, and corrosion in untreated steel fencing. The Statute of Limitations is five years from the close of escrow for paint or stain decay. The law mandates that builders provide home buyers with a one year express written limited warranty covering the fit and finish of a number of installed items.

Before filing a lawsuit, a potential plaintiff must satisfy a series of pre-litigation procedures. The homeowner must notify the builder in writing of the specific claimed defect and attempt to obtain satisfaction through normal customer service procedures. The builder must then provide all documentation relating to the construction and maintenance of the individual home, components of the home and the entire complex or development within 30 days of a written request for the documentation. A failure to respond to a written request within the 30 days will allow a homeowner to file a lawsuit.

After the notification and initial document exchange, the builder may inspect the premises within 14 days from the builder’s acknowledgment of the claim, and conduct a second inspection within 40 days of the initial inspection, if requested in writing. If the builder intends to hold any subcontractors liable for the defect, the builder must notify them and allow them to attend an inspection, with notice to the

homeowner. However, an insurer may not be involved with an inspection. If the builder fails to inspect, the homeowner may file a lawsuit.

Within 30 days of the inspection, the builder may offer, in writing, to compensate the homeowner, repair the defect, and submit the matter to four hours of mediation. This writing must include a detailed analysis by the builder of the defect and a time line for repair, including information regarding the builder's options for contractors to complete the repair. The homeowner then has 30 days to accept the offer and allow the repair. The mediation must take place within 15 days of the submission of a request to mediate to the mediator, or within 15 days of the parties agreement to mediate. The mediation is at the expense of the builder, unless the homeowner wishes to be involved in the selection of the mediator and also pay a portion of the mediator's expenses.

If the builder chooses to repair, repairs should be initiated within 14 days of the acceptance by the homeowner and a selection of a contractor, or within 7 days of the mediation, if one takes place, or within 5 days of the obtaining of a permit, if one is necessary. All repairs must be completed within 120 days, and the builder must supply the homeowner with all documentation relating to the repair work.

If the builder chooses to repair only some of the claimed defects, the builder must explain, in a detailed writing, why it chose those repairs, and the homeowner may institute litigation regarding the other defects. If the builder repairs, the statute of limitations for filing lawsuits may be extended to accommodate the homeowner and allow the homeowner to sue after undergoing a mandatory four hours of mediation at some point in the process. The fact that a repair effort was made, evidence of the pre-repair state of the home, and the parties' actions may be admissible at trial.

Subsequently discovered claims of unmet standards should be administered separately, however, if the claim is for the same violation in the same detached home, the claimant may not be required to reinstate the process. If the claim is in an attached project and the claim is for a connected component system as is already the subject of this process, the claimant may not need to reinstate the process as to that system.

The damages available to the homeowner include the reasonable value of replacement or repairs made necessary by the defect or repair effort, relocation and storage costs, lost business if the home was used as a principal place of business, reasonable investigative costs for each claim, and any costs or fees recoverable by contract or statute.

The defenses available to the contractor include unforeseen acts of nature, failure to mitigate or prevent damages, contributory negligence, statute of limitations, prior written release, successful repair, normal wear and tear, and any other applicable affirmative defenses.

Effects of the Bill

SB 800 was intended to simplify the construction defect litigation process. It is intended to allow the builder to engage in a repair that would hopefully eliminate the impetus for the homeowner to sue the builder for money to engage in repairs. It is also supposed to give builders guidelines regarding the specific types of standards to be applied to determine if an item is defective or not, and therefore give homeowners notice as to what their rights are with regard to their homes.

The practical effect of SB 800 is that it compels the builder who chooses to utilize the process to engage in repair work, document production, and pay for mediation without any guarantee that these efforts will prevent a lawsuit from going forward. Indeed, builders may be required to admit that the claimed defect is not in compliance with the law before going forward with repairs. These admissions and repairs may then be admissible in a court of law in a subsequent suit over the defect. The law also hurts homeowners, since each and every defect must be made subject to a different repair and mediate pro-

cess, so that water seepage through window flashing (installed by a contractor) may be required to be handled separately from water seepage through the window frames (a “manufactured product” under the law), or through the door next to the window, or the ceiling above the window.

It is also possible that the builder will have to engage in a different repair for each claimed defect, leading possibly to replacing the window and then coming back weeks or months later to pull the window back out in order to replace the sealant in the wall below the window. Until these issues are the subject of litigation, the long-term implications of the bill are somewhat unknown.

What the Builder Needs to Do

The Builder has a number of choices to make regarding compliance with this Bill. A builder can either comply with the terms of the law itself or draft an “enhanced protection agreement” that complies with the law through a scheme crafted by the builder. This “enhanced protection” will likely require the builder to make itself more available for dispute resolution and require the same level of compliance with discovery and repair work.

A critical implication of the Bill is the documentation that must be included with the Bill of Sale. The Purchase Agreement should include advisory notices regarding the use of an “enhanced protection agreement” or the terms of SB 800 itself. The Purchase Agreement should also include a copy of SB 800 in its Signed and Chaptered form or portions of the Bill in their codified format. A builder may want to include a set of claim forms in order to standardize the claims process. The Builder should also seriously consider rewriting maintenance guidelines and warranties in order to more explicitly state the required levels of homeowner upkeep and to protect the builder in case of future demands for repair.

Another important aspect of the Law is the discovery and production of documents called for by the Bill. Builders will want to set up some document retrieval system that will allow them easy, quick and inexpensive access to all documents for an extended period of time. Because SB 800 creates an expedited document recovery provision that forced builders to turn over virtually all documentation related to a home or condominium as well as the project in which the building is located, builders will need to consider storage methods carefully. Specifically, documentation that must be given to a homeowner within 30 days of a written request includes all documentation related to the individual residence and, where applicable (no statutory definition), to the entire development or tract, including plans, specifications, grading plans, soils and other reports, and engineering specifications. Also, the builder must turn over all maintenance and preventive maintenance records, all documentation related to maintenance of manufactured and installed products, including warranty information, and all information related to the builder’s contractual warranties. The sheer volume of documentation covered by this 30 day written request for documents is one of the more burdensome provisions that builders will need to include in their document storage and retrieval considerations.

Issues to Consider

Builders need to consider several critical facets of their operations in light of the effects SB 800 will likely have on construction defect litigation:

- Whether an “enhanced protection agreement,” avoiding SB 800, is appropriate
- Whether opting out of the SB 800 dispute resolution process would be beneficial
- What types of information should be included in Purchase Documents
- Ways to ease the storage and retrieval of documents

- Which mediators should be used for mandatory mediation
- Which contractors should be used in response to demands for repair.

Creation of an "Enhanced Protection Agreement"

Section 901 of SB 800 allows the builder to draft and enforce an alternative to strict compliance with the terms of the Bill, called an "Enhanced Protection Agreement." SB 800 does not set forth specific requirements for such an agreement, but states that the normal standards set forth in Chapter 2 (laying out the defects) would be used to measure the reasonableness of the agreement. Use of the agreement would not limit the process that the parties must undergo, it would only modify the protections laid out in SB 800. The benefit to the builder of contractually granting the homeowner greater rights is not clear.

Creation of an "Alternative Contractual Nonadversarial Provision"

Section 914 of SB 800 allows a builder to create and enforce its own nonadversarial procedure that would differ from the process set forth by SB 800. The builder may be able to set forth its own time periods for responding to complaints and its own process for resolving claimed defects. However, once the builder opts into an alternative process, it is required to adhere to that process and is bound by that process. Should the alternative process be deemed unenforceable or if the dispute is unresolved at the end of the alternative process, the homeowner may then be free to sue, or to theoretically enforce the SB 800 process.

Projects that have closings both Pre- and Post- SB 800

It is clear that SB 800 applies to all homes with closing dates on or after January 1, 2003. Many commentators are urging builders to attempt to make pre-litigation processes uniform by offering SB 800 protections to homeowners who purchased prior to January 1. It is theoretically possible for builders to contract with current homeowners to make the SB 800 process applicable, or to engage in an "alternative contractual nonadversarial provision" or an "enhanced protection agreement." While it would be preferable to have all parties under the same litigation procedure (and allow the builder an opportunity to repair claimed defects on all homes in a development), each builder must consider the implications of affording SB 800 rights to all homeowners.

With regard to document retrieval, developments or condominium complexes that have been completed but had homes unsold as of January 1, 2003 will require builders to maintain documents for the entire complex in the event homes in the complex sold after SB 800 comes into effect become the subject of the new process. This is because any homeowner now *may* have the right to request documentation related to the entire complex, even if the claimed defect is limited to the interior of the home or condominium.

Ongoing Litigation

It is not clear how SB 800 will effect ongoing litigation. The law by its own terms applies only after January 1, 2003, however, it is possible that builders can "contract into" the SB 800 process, if desired by the builder and the homeowner. This would allow the homeowner an opportunity to have the repairs made, and since litigation is ongoing and discovery has already been prepared, the difficult discovery provisions of SB 800 are neutralized.

Class Actions and Multiple-Plaintiff Lawsuits

Section 932 of SB 800 states that “[s]ubsequently discovered claims of un-met standards shall be administered separately under this chapter...” This seems to eliminate the possibility of class action lawsuits or lawsuits involving multiple plaintiffs from the same development. This will increase defense costs by multiplying the number of individual claims, but will prevent plaintiffs’ attorneys from soliciting potential class members and certifying class suits. Builders should therefore be prepared to handle repair requests as they arise, instead of pooling resources and repairing many similar defects together.

Insurance Issues

Prior to making any decisions regarding SB 800, it is imperative that builders contact their insurer to request advice regarding compliance or adoption of an “enhanced protection agreement.” SB 800 does not afford insurers any further protections, and it shuts them out of the inspection process while possibly increasing repair and litigation costs. Many insurance interests and lobbying firms opposed SB 800 and have, since its adoption, expressed their lack of support for the Bill. It is not yet clear what the ramifications of SB 800 will be, and insurers have reiterated their intent to steer clear of the California housing market until the process set forth by SB 800 is made clearer and proves to be cost-effective.

Mediation

SB 800 requires that mediation take place within 15 days of the submission of a request to a mediator. A possible effect of this provision is that the most popular and most qualified mediators could be cut out of resolving SB 800 disputes. This could result from the lack of notice and the possibility that the best mediators will not be available on such short notice.

As a hypothetical, a well-qualified mediator might have his or her schedule booked for the month of April, but the dispute resolution schedule mandates that, in order to mediate the dispute, that mediator must be available 15 days after his or her presence is requested. If the dispute arises in early March, the process may take 20 to 30 days for inspection and repair, and if the homeowner is still not satisfied, mediation is mandated prior to suit. If the request for mediation is made on April 1, the mediator must be available by April 15 in order to qualify to be the mediator. If that mediator is not available, the parties must seek a different, more available, mediator.

Should a builder draft an “alternative contractual nonadversarial procedure,” it is highly recommended that a more formal pattern for mediation be set forth, such as a provision allowing for mediation by a specific mediator, or a set of mediators, whereby those mediators could be considered regardless of schedule, even if mediation is delayed. This would comply with SB 800’s requirement that mediation take place and still ensure that a talented, desirable mediator preside over the settlement process.

Conclusion

SB 800 is probably the nation’s most comprehensive new law providing homeowners and builders a “legal” opportunity to address claimed defects short of litigation. The right to repair is accompanied by many associated problematic issues, such as the duty to repair to the owner’s satisfaction or risk facing a lawsuit, the duty to notify homeowners of their rights, the duty to turn over all documentation to the homeowner within 30 days, and the duty to pay for mediation. Additionally, there is the possibility that compliance with the terms of SB 800 will become as costly as protracted litigation, while still leaving open the possibility of litigation. The burden of this increased cost will be passed on to insurers, and the general feeling among insurers has been less than overwhelmingly favorable towards SB 800 for that reason. The promise of the law lies in the possibility that fewer suits will rise to the level of litigation due primarily to the repairs that the builders will be able to make. The actual realities and ramifications of the SB 800 legislation remains to be seen.

Checklist and Timeline For Compliance with SB 800

Homeowner sends claim notice to builder

Within **14 days** after notice, Builder must acknowledge notice

INSPECTION

Within **28 days of notice**, Builder must complete its initial inspection

Within **48 hours** of initial inspection, Builder must restore home to pre-inspection condition

Within **3 days** of initial inspection, Builder must send homeowner request for second inspection

Within **40 days** Builder must complete its second inspection, if requested

Within **48 hours** of second inspection, Builder must restore home to pre-inspection condition

DOCUMENTATION

Within **30 days** after notice, Builder must send all pertinent documents to homeowner

REPAIR

Within **30 days** of inspection (first or second) Builder must offer to repair

Within **30 days** of offer to repair, Homeowner must respond to offer

- Homeowner may request that another contractor conduct repairs

Within **20 days** of election, there may be one additional noninvasive inspection for the benefit of other contractors

Within **35 days** of election, Builder must present homeowner with a list of three alternative contractors from which the homeowner may choose to conduct the repairs

Repair must be complete within 120 days.

If a Permit is Needed

After homeowner authorizes repairs and commensurate with all other deadlines, repair must begin within **5 days** of obtaining a permit.

MEDIATION

If homeowner seeks mediation, mediation must commence within **14 days** of request.

The parties have **7 days** to mediate

Repair must be complete within 120 days.

**SB 800 COMPLIANCE GUIDE—
A COMPILATION OF SELECTED DEFECT COMPONENTS AND STATUTES OF
LIMITATIONS AND REQUIREMENTS FOR SUITS**

DEFECT	STATUTE OF LIMITATIONS	REQUIREMENTS	CODE SECTION
Air Conditioning	10 yrs after substantial completion	Must provide in a manner consistent with size and efficiency design criteria from Title 24	§896(g)(5)
Appliance (Installed)	Useful Life	Must install so as not to interfere with the product's useful life	§896(g)(3)
Attached Structure	1 yr from occupancy of adjacent structure	Must comply with inter-unit noise transmission standards (if applicable)	§896(g)(6)
Balconies	10 yrs after substantial completion	Must not allow water to pass into the adjacent structure; Must not allow unintended water to pass within and cause damage to the system	§896(a)(5); §896(a)(6)
Chimneys	10 yrs after substantial completion	Must not cause an unreasonable risk of fire outside the chimney	§896(d)(2)
Decks	10 yrs after substantial completion	Must not allow water to pass into the adjacent structure	§896(a)(5)
Decks (cont'd)	10 yrs after substantial completion	Must not allow water to pass within the system itself and cause damage	§896(a)(6)
Doors	10 yrs after substantial completion	Must not allow water to pass beyond, around or through door or moisture barriers	§896(a)(1)
Doors (cont'd)	Useful Life	Must install so as not to interfere with product's useful life	§896(g)(3)
Drainage	10 yrs after substantial completion	Must not be installed to allow water or soil erosion to enter or contact structure causing damage to another building component	§896(a)(9)
Drainage (cont'd)	1 yr from close of escrow	Must operate properly so as not to damage external improvements	§896(g)(7)
Electrical Fixtures	Useful Life	Must install so as not to interfere with the product's useful life	§896(g)(3)
Electrical Systems	10 yrs after substantial completion	Must construct and install so as not to cause unreasonable risk of fire	§896(d)(3)
Electrical Systems (cont'd)	4 yrs from close of escrow	Must operate properly and not materially impair use of the structure	§896(f)
Framing	10 yrs after substantial completion	Must not allow water, water vapor, or excessive condensation to pass beyond, around or through the deck door or moisture barrier (inc internal barriers), or to enter the structure causing damage to another component.	§896(a)
Framing (cont'd)	4 yrs from accrual	1 yr fit and finish warranty (n/a to damage caused by other components)	§900

DEFECT	STATUTE OF LIMITATIONS	REQUIREMENTS	CODE SECTION
Heating	10 yrs after substantial completion	Must be capable of maintaining 70 degrees at a point 3 feet above the floor in any living space	§896(g)(4)
HVAC Units	Useful Life	Must install so as not to interfere with product's useful life	§896(g)(3)
Load Bearing Components	10 yrs after substantial completion	Must not contain significant cracks or significant vertical displacement	§896(b)(1)
Mechanical Systems	10 yrs after substantial completion	Must not cause an unreasonable risk of fire	§896(d)(3)
Noise	1 yr from original occupancy of adjacent unit	Must comply with inter-unit noise transmission standards set by government at original construction	§896(g)(6)
Plumbing	10 yrs after substantial completion	Lines and components shall not leak	§896(a)(14)
Plumbing (cont'd)	4 yrs from escrow	Must be installed to operate properly and must not materially impair the use of the structure	§896(e)
Plumbing (cont'd)	Useful Life	Must install so as not to interfere with the product's useful life	§896(g)(3)
Roofs	10 yrs after substantial completion	Must not allow water to enter the structure or pass beyond, around or through moisture barriers, including internal barriers	§896(a)(4)
Slabs	10 yrs after substantial completion	Must not allow water or vapor to enter the structure and damage another building component; or limit installation of type of flooring typically used for the particular application	§896(a)(7); §896(a)(8)
Stairs	10 yrs after substantial completion	Must not allow water to pass into the adjacent structure or within the system	§896(a)(5); §896(a)(6)
Structural	10 yrs after substantial completion	Must not allow water or vapor to enter the structure causing damage or limit installation of type of flooring typically used for the particular application	§896(a)(7); §896(a)(8)
Structural (cont'd)	10 yrs after substantial completion	Must not contain significant cracks or vertical displacement or cause the structure to be structurally unsound	§896(b)(1)
Structural (cont'd)	10 yrs after substantial completion	Must not contain significant cracks or separation	§896(g)(2)
Stucco	10 yrs after substantial completion	Must not allow water to enter the structure or pass beyond, around or through the moisture barriers, must not contain significant	§896(a)(10); (g)(2)
Walls (Exterior)	4 yrs from accrual	1-yr fit and finish warranty (n/a to damage caused by other components)	§900
Windows and Their Systems	10 yrs after substantial completion	Must not allow water to pass beyond, around or through window or moisture barriers (inc. internal barriers)	§896(a)(2)
Windows and Their Systems (cont'd)	Useful Life	Must install so as not to interfere with the product's useful life	§896(g)(3)

STATE APPROACHES TO CONSTRUCTION DEFECT LITIGATION

ALASKA'S HB 151

The purpose of this law is to limit court actions which may be brought for claimed construction defects. Any construction contract must contain notice of the construction professional's right to cure a defect before the homeowner may file an action. Potential plaintiffs must give the construction professional notice of the claim within one year after the defect is discovered, subject to a 10-year statute of limitations which begins running from the date of substantial completion. The statute of limitations is tolled between the time notice is served and the time Plaintiff should reasonably understand that settlement will not succeed. Response to the notice must include an offer to inspect the dwelling, offer to compromise or settle by monetary payments without inspection, or a statement that the claim is disputed and the defect will not be repaired or settled.

Refusal by the homeowner to allow inspection creates a rebuttable presumption that damages could have been mitigated and the homeowner chose not to mitigate his or her damages. If inspection is allowed, the construction professional must submit a written statement within 14 days offering to repair the defect, to compromise and settle, or stating that the professional disputes the claim and will not repair the defect. Acceptance of the claim must occur within 30 days. If a reasonable offer is rejected, the claimant may bring suit immediately, but may not recover an amount that exceeds the reasonable cost of repairs or the amount of the offer. The court may deny attorney fees and may award attorney fees and costs to the construction professional. Any insurance compensation shall be deducted from the award.

COLORADO'S HB 1161

The purpose of the act is to limit claims for damages filed against construction professionals. In any construction defect action brought, the homeowner must serve on the builder an initial list of construction defects. Negligence claims are prohibited if they are brought on the basis of failure to construct a residential improvement complying with building codes or standards unless there was actual or probable damage to or loss of use of real or personal property.

Notice of a potential claim must be given to the construction professional 75 days prior to filing an action, or 90 days in the case of commercial properties. The statute of limitations is then tolled for 60 days. The claimant must then allow an inspection to be completed within 30 days of service of the notice. Within 30 days of completion of the inspection or 45 days in the case of residential property, the construction professional may send an offer to settle or an agreement to remedy the claim. The claimant must accept in writing within 15 days of delivery.

If the offer is made but not accepted, or if notice is not responded to, the construction professional is liable for treble damages if the claimant can show that the consumer protection act has been violated. Treble damages and attorney fees awarded may not exceed \$250,000. If no offer is made, the claimant may file an action. Any action brought which is not in compliance with these procedures is stayed until compliance is achieved. No claimant may recover more than actual damages unless he can prove that the consumer protection act was violated, and that either (a) the monetary offer to settle is less than 85% of the amount awarded as actual costs; or (b) the reasonable cost to complete the offer to remedy is less than 85% of the amount awarded as actual damages. Damages in personal injury cases where non-economic damages may be awarded are limited to \$250,000, and these actions are not subject to treble damages. These amounts may be adjusted in the future to accommodate for inflation.

FLORIDA'S SB 1286

This law provides for notice and opportunity to repair defects and sets forth prerequisites for bringing a construction defect action. Notice must be provided by the homeowner 60 days before filing the action. The homeowner claimant should serve notice within 15 days after the discovery of the defect (but failure to do so does not always bar the filing of an action). Notice tolls the statute of limitations to either 60 days after the notice is received or 30 days after the end of the repair period.

Inspection by the builder must occur within 5 business days after service of the notice, and notice must be forwarded within 10 days by the professional to each subcontractor who may reasonably be held responsible. Each subcontractor has the right to inspect the dwelling within 5 days of receipt of notice. A written response must be served within 25 days, either offering to remedy the defect, offering to compromise and settle, or stating that the defect is disputed. The offer must be accepted or rejected within 15 days, or 45 if it is an association. Rejection must contain a statement of the settlement offer with the word "Rejected" printed on it. An offer to settle or cure the defect does not operate as an admission of liability. Any construction contract must contain conspicuous notice to the homeowner of the builder's right to offer to cure the defect or pay to settle.

IDAHO'S HB 133

The "Notice and Opportunity to Repair Act" provides that notice of a claimed defect must be provided to the builder and providing notice operated to toll the statute of limitations for 60 days after the period of time during which the filing of an action is barred. Within 21 days of receipt of notice of the claim by the builder, the builder must serve a written response requesting an inspection, offering to compromise, or stating that the claim is disputed, at which time the claimant homeowner may file an action in court. If the inspection or settlement offer is rejected, written notice must be served and an action may be filed. If no response is given within 30 days, the offer may be terminated upon written notice.

If inspection is allowed, the builder must serve within 14 days a written offer to remedy, an offer to compromise and settle, or a statement that the builder will not engage in a repair. Rejection of an offer to repair must be in writing, and may be withdrawn upon notice to the claimant if no response is received within 30 days. Any offers or proposals are not considered admissions of liability and are not admissible in any subsequent court action.

Damages are limited to the reasonable cost to cure, the reasonable expense of necessary temporary housing, the reduction in market value, and reasonable and necessary attorney fees. The total damages may not exceed either the amount the homeowner paid for the residence or the current market value of a like residence with no defect, whichever is greater. If the builder fails to make a reasonable offer, fails to make a reasonable attempt to complete offered repairs, or fails to complete in a workmanlike manner the repairs specified, the limitations on damages are not applicable. If the homeowner claimant denies a request to inspect, unreasonably rejects an offer, or does not provide the builder with a reasonable opportunity to repair, the claimant may not recover an amount in excess of: the reasonable cost of the offered repairs or the amount of the reasonable monetary settlement offer. Further, the homeowner is entitled to the amount of reasonable and necessary attorney fees incurred prior to rejection of the offer. The act also provides seven affirmative defenses.

KANSAS' HB 2294

This law requires that the contractor be given notice prior to filing of an action by a homeowner. If no notice is given, the action is dismissed without prejudice. The statute of limitations is tolled if the homeowner gives notice within 90 days of entry of the order of dismissal of the action without prejudice. If notice is given, the statute is tolled for 180 days after either the date the notice is mailed, the date the

contractor agrees to make payment or the contractor remedies the defect, whichever is later. Within 15 days of receipt of notice, the builder must submit a copy of the notice to each subcontractor who may be responsible. Within 30 days of this service, the contractor must serve a written response proposing inspection, offering to remedy the defect, offering to compromise and settle, or stating that the defect is disputed. If the contractor fails to do so or fails to fully perform the terms of his offer, a claim may be brought without further notice.

Inspection must occur within 30 days of the claimant's notice to the contractor. Within 30 days after the inspection, the contractor shall serve a written offer to remedy the defect, offer to compromise and settle, or a statement that the contractor will not proceed further. Any acceptance must be served within 30 days. The contractor may provide notice to an insurer who issued a policy covering all or part of the conduct or business of the contractor or subcontractor. This notice constitutes the making of a claim under the policy. Any construction contract under this act must contain conspicuous notice of the contractor's right to offer to repair defects.

An individual may not offer to or provide anything of monetary value to a property manager or someone in an association to discourage the filing of a construction defect claim, or may be charged with a misdemeanor. An association may bring a construction defect claim only upon a vote of the association's member owners during a meeting at which a majority of the votes are allocated, and upon a vote of the executive board. Notice must be given to each owner at least 21 days before the meeting.

KENTUCKY'S HB 289

The "Notice and Opportunity to Repair Act" states that, for a construction defect claim, the construction professional is not liable for (a) the failure of a person other than the professional or his agent, employee, or subcontractor to take reasonable action to reduce damages or maintain the residence; normal wear and tear, shrinkage, and other normal issues, or (b) the repair or remediation of any defect disclosed in writing in clear language and signed by the claimant prior to the homeowner's purchase of the residence.

Written notice must be served on the construction professional prior to the filing of the claim. Within 21 days, the professional must respond in writing, either proposing inspection, offering to compromise and settle, or stating that the claim is disputed. Rejection of the builder's response by the homeowner must be written. If not received within 30 days after the claimant's receipt of the response, the construction professional may terminate the offer by serving written notice and the claimant may then bring an action. Within 14 days after completion of the inspection, the professional must serve a written offer to cure the defect, an offer to compromise and settle, or a written statement that the construction professional will not proceed further to remedy the defect. Rejection or acceptance must be in writing. The offer may be withdrawn upon written notice if no response is received within 30 days from the claimant. Notice of the contractor's right to inspect must be in the contract.

NEVADA'S TITLE 40

The State of Nevada established its approach to Construction Defect disputes in Title 40, Sections 600-695 of the Nevada Revised Statutes. Nevada's long-established "Title 40" defines several critical terms, including what structures are included in the code, what is covered by a warranty, and who is covered by the Code. Title 40 also clearly sets forth the Contractor's liabilities, responsibilities, and the limits on what is guaranteed by the Contractor.

Title 40 requires written notice on most actions arising out of claimed defects, and provides for informal inspection, written response, and document production. Title 40 limits recovery by the homeowner to reasonable attorneys' fees, costs of repairs, reduction in market value, loss of use, reasonable value of

damage caused by repairs, and various additional costs and interest. The Contractor must provide a pre-litigation settlement proposal, and homeowners must accept any reasonable proposal or risk forfeiting several rights.

Title 40 is Nevada's attempt to respond to a crisis it is facing, perhaps rivaled only by the situation in California, which threatens to destabilize the construction and insurance industries in Nevada. Nevada's legislature has also enacted new provisions with the same goal as Title 40, including SB 241, discussed below.

NEVADA'S NEW SB 241

The purpose of this new act, an additional measure meant to complement Title 40, is to establish provisions for notice and a right to inspect and repair prior to commencement of an action. The act also establishes the State Contractor's Board as a resource to answer questions and assist in resolving disputes concerning matters which may relate to construction defects.

The homeowner is required to provide notice to the builder. Within 60 days after receiving notice of the defect, the builder may respond to the homeowner and may also provide a disclosure of the notice to all other homeowners within the claimant homeowner's development. The statement to all other homeowners must advise them of the claimed defect and must include a statement advising the homeowners that they are to have 30 days to request an inspection or forfeit some rights under the Act.

No more than 30 days after receipt of notice, the contractor must forward a copy of the notice to each subcontractor whom the contractor reasonably believes is responsible. No later than 30 days after receipt of notice, the subcontractor shall inspect the defect and provide the contractor with a written statement indicating whether they have elected to repair the defect, including a cost estimate. The contractor must respond to the homeowner within 90 days, stating whether it has elected to repair the defect, settle the claim, or deny liability for the claimed defect.

If the builder opts to repair, the repairs must be completed within 105 days after receipt of the notice if there are four or fewer owners named in the notice. If there are five or more homeowners named in the original notice, the builder has up to 150 days to complete the repairs. If a homeowner received notice from the builder and wished that repairs be made, the builder has up to 105 days to complete them. If for any reason the repairs cannot be completed within the time period specified in the Act, the builder and each homeowner shall set a reasonable time. An election to repair may not be made conditional upon a release of liability. Within 30 days of repair, the contractor must provide the owner with a statement of the repairs made.

If a contractor has received notice of a defect, they may submit it to the insurance company, who must treat the claim as if a civil action has been brought. Failure to present such a claim to the insurer does not relieve the insurer of any duty under the policy to the contractor.

TEXAS' HB 730

This legislation calls for the creation of a commission to develop and enforce a set of construction standards as well as create a forum for the resolution of construction defect disputes that avoids litigation in the courts. Unlike the California law, the Texas law defines most construction defects very broadly and is not as detailed in its setting forth of Statutes of Limitations.

Texas' legislation creates the Texas Residential Construction Commission, which is charged with promulgating construction standards, overseeing a state-sponsored inspection program, licensing builders, and licensing and overseeing arbitrators who will engage in the resolution of claims arising out of al-

leged construction defects. The standards to be promulgated are intended to create uniformity among all residential building construction projects, and are geared to not only bring clarity to the construction industry, but also to display a prompt response to the concerns of Texans regarding mold infestation.

The Commission is to be composed of representatives of the building industry, consumers, and professionals, and will develop standards that are reasonable guides for builders and will hopefully result in fewer claimed defects and more reasonable expectations by home purchasers. The Commission will also provide guidance for homeowners regarding maintenance, care, and upkeep of homes to as to avoid the potential for mold or other latent homeowner-contributed defects.

While California's construction defect law was developed by building industry representatives and representatives of the plaintiff's bar, the Texas legislation was developed with a specific intent to control risk exposure. Insurance industry representatives were consulted and contributed its concerns to the dialogue regarding the law.

One of the more important developments to arise out of the insurance industry's input is the Commission's involvement in pre-dispute claims review. Aside from what is now becoming a standard "right to repair," a homeowner in Texas must now file a complaint with the Commission detailing the claimed defect, as well as the expenses it has caused the homeowner to incur, and where applicable, the injuries the homeowner claims to have suffered as a result of the defect. The Commission is then responsible for assigning an inspector from the pool of approved inspectors to visit the home, inspect the claimed defect, and issue a recommendation to the Commission. The Commission's findings, after a period of review by a panel and comments by the homeowner and builder will then issue a finding, which becomes a rebuttable presumption for a later trial. This rebuttable presumption may be rebutted under a "preponderance of the evidence" standard.

The statute of limitations for filing a complaint with the Commission is 10 years, so that the complaint must be lodged by the 10th anniversary of the transfer of title from the original builder to the first purchaser of the home. Where the claimed defect is in an improvement or possible a prior major repair, the statute of limitations begins to run from the date of the completion of the repair or contract for the improvement. If a homeowner fails to comply with the process set forth in the legislation, the homeowner may forfeit his or her right to pursue his or her claim.

CONCLUSION

As the construction defect litigation industry continues to expand and draw critical resources from state court systems, each state in the nation will need to review its rules, regulations, and statutes to attempt to respond to the growing volume of complaints and suits. Many states have already begun the process of modifying state codes and developing case law addressing construction defect claims, causes of action, and statutes of limitations, as well as alternative dispute resolution processes. This process of analyzing state schemes for managing the often extremely complex process of bringing and proving construction defect claims will undoubtedly continue until states are able to, if not stem the tide of litigation, then at least keep the litigation from becoming over-burdensome to the court systems.

Insurers will need to take an active part in managing their own insureds' responsiveness to claims of defects, in order to bring the claims process to a conclusion without having to defend complicated defect claims in the courts. Also, insurers will need to consider the requirements of their respective states' new legislation in order to advise their clients of the proper manner in which to quickly and inexpensively comply with the statutory requirements.

ADDITIONAL INSURED ENDORSEMENTS IN THE CONSTRUCTION DEFECT CONTEXT

Additional Insured issues have become very contentious in light of rising costs of defense and the increase in the number of construction defect cases. Virtually every construction defect case will present some version of an additional insured issue, whether it be general contractor versus subcontractor or some other form. It is now commonplace that developers and general contractors require their subcontractor to name them as additional insureds. In fact, most standard form contracts include language to this effect. At a minimum, the additional insured provisions are intended to protect developers and general contractors from exposure to vicarious liability for acts of subcontractors.³

Developers and general contractors have become more sophisticated over the last decade. They now contend that the additional insured coverage is intended to protect them for their own liability, as well. They assert that an important basis of the bargain in the subcontract was that the subcontractor would provide this key insurance for both defense and indemnity obligations, and that this additional insurance is primary to their own insurance.

In many actions, it will be undisputed that an additional insured endorsement has been issued to a developer or general contractor for a particular project and time period. Nevertheless, the nature and extent of these endorsements can become contested because there are several types of additional insured endorsements, including form endorsements with different edition dates and manuscript endorsements prepared by individual carriers. Therefore, each endorsement must be separately analyzed to determine if coverage exists.

For the most part, the analysis of any standardized form which is used on an industry-wide or national basis will not vary from state to state.⁴ However, it is clear that more judicial scrutiny has been conducted in California courts with regard to the effect of an additional insured endorsement that has come into issue in a construction defect matter. California therefore has a well-developed body of law which can and should be consulted by attorneys outside of California for guidance as to how such issues have been addressed in prior matters. Though California and Nevada law is obviously not binding in any other jurisdiction, western courts have undoubtedly blazed a trail that other states continue to look to in developing their regulations.

Types of Additional Insured Endorsements

There are three types of generally recognized additional insured endorsements: 1) forms from Insurance Service Offices, Inc. ("ISO"), specifically the CG 20 09 and the ISO CG 20 10; 2) manuscript endorsements specially drafted by the insurer; and 3) blanket additional insured endorsements. Overall, the "CG 20 10" offers the broadest coverage for additional insureds, the "CG 20 09" provides more limited protection for on-going operations only; and manuscript and blanket endorsements vary in their range of coverage.

ISO "CG 20 09" and ISO "CG 20 10" Endorsements

The 1993 version of the ISO "CG 20 09" endorsement, also known as the "long form," grants the additional insured, such as a developer or general contractor, insured status "but only with respect to liabil-

³For references, please contact the authors.

⁴For a more detailed analysis, state-by-state, of laws regulating indemnification, please see Allen Holt Gwyn and Paul E. Davis, "Fifty-State Survey of Anti-Indemnity Statutes and Related Case Law," The Construction Lawyer, Summer 2003, pp. 26-33.

ity arising out of [the named insured's] work for the additional insured(s) ... or [a]cts or omissions of the additional insured(s) in connection with their general supervision of [the named insured's] work" Moreover, the "20 09" form only covers the developer or general contractor for damages arising out of the named insured's on-going operations. In other words, this edition of the "20 09" arguably does not confer additional insured status after the subcontractor has completed work on the project.

The ISO "CG 2010" endorsement, also called the "short form," comes in two versions. The 1985 version covers the builder with respect to liability "arising out of [the subcontractor's] work" for the builder by or for the subcontractor. By contrast, the 1993 version applies only to liability "arising out of [the subcontractor's] *ongoing* operations" performed for the builder. *Manuscript Endorsements*

Manuscript endorsements are prepared by the insurer and take on various forms. For the most part, the insurers have attempted to reduce the scope of the additional insured coverage below that of either of the ISO form endorsements. Counsel representing general contractors or owners must be aware of these subtle, yet key differences, and they should insist that the subcontractor provide actual copies of the endorsements to confirm that they do provide broad form coverage for on-going and completed operations. This precaution should ensure that coverage exists beyond the construction process and for the entire length of the applicable statute of limitations, which in many states is ten years.

Blanket Additional Insured Endorsements

Many subcontractors, who have been required to name developers and general contractors on each project they construct over a number of years, take advantage of a blanket endorsement. For instance, ISO has a manuscript additional insured endorsement that extends insured status on a blanket basis to a category of persons or organizations with special or contractual relationships to the named insured. These types of endorsements make it unnecessary to separately name a developer or general contractor as an additional insured on each project on which the subcontractor works for a builder. This simplified approach may result in the subcontractor obtaining additional jobs for the builder over rivals who offer only limited additional insured coverage.

Understanding the Language in Additional Insured Endorsements

"Arising Out of"

Both ISO additional insured endorsements provide coverage for the additional insured's liability "arising out of" the named insured's work. Although courts have reached several conclusions regarding the interpretation of this language, most decisions now broadly construe the phrase to require that the incident was causally connected with the named insured's work. In other words, "arising out of" is satisfied by "but for" causation.

For example, in *American States Insurance Co. v. Liberty Mutual Insurance Co.*, an Illinois court required only a minimal causal link, explaining: "We find that 'but for' [the employee's] employment by [the subcontractor] and [the subcontractor's] presence on the job site, [the employee] would not have been injured." This simple connection was enough to satisfy the "arising out of" language of the policy and to require the subcontractor's insurer to bear the burden of defense.

In comparing the language "arising out of" to "caused by," a federal court demanded only a minimal connection:

The phrase "arising out of" is more expansive than the words "caused by" used in some policies. When the former phrase is used in a liability policy, an unbroken chain of events need not be established but rather a simple causal relationship must exist between the accident or injury and

the activity of the insured. The causation standard is not elevated to the strict “direct and proximate cause” standard of general tort law.

Similarly, a California appeals court in *Acceptance Insurance Co. v. Syufy Enterprises* required merely a minimal showing of causation. The plaintiff was a contractor’s employee who was injured while climbing through a hatch on the roof, which was negligently maintained by the building owner. An ISO “CG 20 10” (1985 version) endorsement on the contractor’s commercial general liability (“CGL”) policy named the building owner as an additional insured.

Acceptance Insurance Co. (“Acceptance”) attempted to deny coverage to the building owner by contending that the plaintiff was injured while going through the hatch on the roof and his work was limited to the roof itself. Therefore, Acceptance claimed that the injury did not “arise out of” the named insured’s work. Furthermore, the contract did not require the contractor to name the owner as an additional insured. Acceptance argued that the endorsement must be limited to when the building owner is vicariously liable for the injury and not when the building owner is actually negligent.

The court disagreed and instead noted that “the arising out of” language: “[D]oes not import any particular standard of causation or theory of liability into an insurance policy. Rather, it broadly links a factual situation with the event creating liability, and connotes only a minimal causal connection or incidental relationship.” In this matter, since the plaintiff could not have done his work without passing through the hatch, the connection between the injury and the work was more than incidental and therefore the “arising out of” requirement was satisfied.

Even an expansive reading of the language “arising out of,” however, still requires some connection. In *Imperial Casualty and Indemnity Co. v. High Concrete Structures, Inc.*, a federal court found that the additional insured did not make a sufficient showing to satisfy the “arising out of” language. Since the insurer limited the scope of coverage to claims arising out of the rendering of professional services and the suit was based on defective manufacturing, the insurer did not have a duty to defend.

No Vicarious Liability Requirement

Coverage afforded additional insureds is not limited to vicarious liability for the named insured, but can include acts for which the additional insured is directly liable, depending on the jurisdiction.⁵

For instance, the *Acceptance* court did not construe the endorsement as limited to when the additional insured would be held vicariously liable. Instead, the court found the following:

Insurance companies are free to, and commonly have, issued additional insured endorsements that specifically limit coverage to situations in which the additional insured is faced with vicarious liability for negligent conduct by the named insured. We believe the better view is that when an insurer chooses not to use such clearly limited language in an additional insured clause, but instead grants coverage for liability “arising out of” the named insured’s work, the additional insured is covered without regard to whether injury was caused by the named insured or the additional insured.

⁵See *McIntosh v. Scottsdale Ins. Co.*, 992 F.2d 251, 254 (10th Cir. 1993); *Hormel*, 938 F. Supp. at 558; *Acceptance*, 69 Cal. App. 4th at 330. *But see* *Washington Sports and Entertainment, Inc. v. United Coastal Ins. Co.*, 7 F. Supp. 2d 1, 9 (D.D.C. 1998) (holding that architect’s professional liability insurance policy limited coverage for landowners as additional insureds to their vicarious liability since it limited coverage for additional insureds to liability arising from the professional services performed by the architect); *Travelers Indem. Co. v. Hanover Ins. Co.*, 470 F. Supp. 630, (E.D. Vir. 1979) (holding that insurer had no duty to defend additional insured where the policy provided coverage insofar as the additional insured’s liability derived from negligence of insured).

Based upon such decisions, a strong argument can be made by an additional insured that it is entitled to coverage if there is any connection between the injury and the work performed by the named insured, even if the injury is caused by the additional insured.

Completed Operations Coverage

In the California case of *Pardee Construction Co. v. Insurance Co. of the West*, Pardee, the developer and general contractor, required that its subcontractors obtain liability insurance naming Pardee as an additional insured for work performed, including completed operations. Although Pardee was eventually listed as an additional insured, the insurers did not issue policies to the subcontractors until after the subcontracts with Pardee were executed and the subcontractors completed their work.

Later, the homeowners association sued Pardee, alleging defective construction. Pardee tendered its defense to the subcontractors' insurers, who denied coverage. Pardee, in turn, sued the insurers. The insurers' position was that they did not intend these policies to provide coverage for the particular project.

On appeal, the court held that where an insurer issues commercial general liability policies to subcontractors, including completed operations coverage as to projects completed before the inception of the policies, the insurer owes a duty to defend an additionally insured general contractor or developer.

The insurers issued endorsements providing coverage limited only by the phrase, "liability arising out of 'your [the named insured's] work' for [the additional insured] by or for you." Given 1) that the products-completed operations hazard definition specifically utilized the language "arising out of ... 'your work,'" and 2) that "your work" was defined as "[w]ork or operations performed by you or on your behalf," the court found that completed operations as referred to in these policies was intended to be included in the type of liability referred to in the endorsements. In addition, the insurers acknowledged that they intended to provide the subcontractors completed operations coverage for projects completed before inception of the policies. The sum effect was that the insurers failed to expressly limit covered completed operations as to a time or a particular project in their policy and endorsement language.

Coverage for General Supervision

In *National Union Fire Insurance Co. v. Nationwide Insurance Co.*, the plaintiff, who was an employee of a plumbing subcontractor in a construction project, was instructed by the general contractor to work on a floor that had accumulated rain water. He subsequently slipped, fell on the floor, injured his knee, and then filed suit against the general contractor for failing to remedy the condition. In the underlying action, the trial court found that the general contractor was solely negligent and that its negligence did not arise out of its supervision of the subcontractors work.

The general contractor tendered its defense to the subcontractor's carrier, under an additional insured endorsement. The endorsement, however, required the general contractor to be held liable for the subcontractor's actions or omissions to qualify as an additional insured. The court in the coverage action ruled that because the trial judge had found the general contractor liable for its own acts and not for the negligence of the subcontractor, the general contractor was not entitled to indemnity under the additional insured endorsement.

By contrast, in *Transamerica Insurance Group v. Turner Construction Co.*, a Massachusetts Appeals Court found that although the general contractor had a supervisory role, it did not excuse the subcontractor's own contributing negligence. Consequently, the court did not allow the subcontractor's insurer, who had issued an additional insured endorsement for the general contractor, to shift the responsibility for defense costs onto the general contractor's insurer. The court explained: "That the general contractor, because of its over-all supervisory role, would be a target for a claim of negligence ... is precisely

the purpose of having the subcontractor's insurance name the general contractor as an additional insured."

Notice of Cancellation

In many jurisdictions, an insurer need not notify an additional insured if the insurer cancels the insurance policy. Nor does an insurance broker owe a duty to provide notice of cancellation. In the California case of *Kotlar v. Hartford Fire*, the lessee received a certificate of insurance informing him that he was named as an additional insured on the lessor's policy. Prior to the expiration date, the insurer canceled the policy and sent notice only to the lessor. The court held that the lessor should have sent notice of cancellation to the lessee; by extension a subcontractor might owe a similar duty to notify its additional insured builder of a cancellation.

Additional Insured Endorsements Versus Certificates of Insurance

Most developers and general contractors require their subcontractors to name them as an additional insured on their policies of insurance. However, up until recently many unsophisticated (and even at times sophisticated) builders did not obtain copies of actual additional insured endorsements for their files. In some cases, builders only obtained certificates of insurance that simply noted the builder was to be named as an additional insured on their policy of insurance.

Certificate of Insurance, Generally

The certificate of insurance is a form which is completed by an insurance broker of the named insured at the request of the named insured. The form is used to confirm that the subcontractor has insurance and the types and amounts of coverage.

The terms of the insurance contract prevail over the language of the certificate of insurance because the certificate serves merely as evidence of the insurance and is not a part of the insurance contract.⁶ As a result, if the certificate of insurance does not state anywhere on the form that the developer or general contractor is named as an additional insured on the policy, the certificate standing alone arguably does not confer additional insured status. A developer or general contractor generally should demand more proof, including a specific additional insured endorsement, to confirm their additional insured status.

Although a broker for the subcontractor may have prepared the certificate of insurance, in many cases he or she did not follow through and actually obtain the necessary endorsement. Further, many brokers do not have the authority of the insurer to issue the endorsement. This creates a host of additional legal issues and as a result, although a developer may hold a certificate that states it is named as an additional insured on the subcontractor's policy of insurance, the subcontractor's carrier will deny the tender of defense and contend that the agent did not have express authority to bind the carrier.

⁶ See *SLA Property Management v. Angelina Casualty Co.*, 856 F.2d 69, 73 (8th Cir. 1988) (citing *Boseman v. Connecticut General Life Insurance Co.*, 301 U.S. 196, 203 (1937)). The court acknowledged a South Dakota case that held that where the certificate of insurance contains provisions not contained in the master policy itself, the certificate is construed to be an integral part of the policy. See *id.* at 73 n.6. However, the court distinguished the present case by pointing out that the certificate at issue contained no substantive provisions, but merely set out the names and addresses of involved parties and the nature of coverage. See *id.*

Ostensible Agency

In the above context, ostensible agency is also a key issue.⁷ An agency is either actual or ostensible. An agency is ostensible when the principal intentionally, or by want of ordinary care, causes a third person to believe another to be his agent who is not really employed by him. In California, for example, three requirements are necessary before recovery may be had against a principal for the act of an ostensible agent:

“[1] The person dealing with the agent must do so with belief in the agent’s authority and this belief must be a reasonable one; [2] such belief must be generated by some act or neglect of the principal sought to be charged; and [3] the third person in relying on the agent’s apparent authority must not be guilty of negligence.”

Decisions vary by jurisdiction on this issue. For instance, some courts have further held that “[o]stensible agency cannot be established by the representations or conduct of the purported agent; the statements or acts of the *principal* must be such as to cause the third party to believe that the agency exists.”⁸ The rationale is that the liability of the principal for the acts of the ostensible agent rests on the doctrine of estoppel.⁹

Hardly a new issue, ostensible authority is arising all too frequently in construction defect matters. The ostensible agency doctrine is designed to protect the putative insured in those circumstances when it is unclear whether the agent had authority to bind coverage. However, the additional insured carrier often argues that the additional insured had actual or constructive notice that the broker did not have authority to bind or was aware of the limits of the broker’s authority, in which case the doctrine of ostensible agency does not apply.

Additional insured carriers, who in many cases did not intend to underwrite the wave of construction defect litigation that currently exists, will argue that the language on the standard certificate of insurance (the widely used Accord form) is adequate to place the additional insured on notice that the agent did not have authority to bind the insurer. Specifically, the printed form states: “THIS CERTIFICATE DOES NOT AMEND, EXTEND OR ALTER THE COVERAGE AFFORDED BY THE POLICIES BELOW.”¹⁰

Most general liability policies also contain a provision that states that the policy can only be modified by an officer or director of the insurance company. Some courts have held that this is satisfactory to place the additional insured on notice that the agent does not have authority to bind the insurer.

To the additional insured carriers’ displeasure, however, not all cases turn out this way. In *American Casualty Co. v. Krieger*, the additional insured carrier contended that the insurance broker who issued the certificate of insurance, was not the carrier’s ostensible agent. Further, the certificate was a standard form in wide use in the insurance industry, issued by the Accord Corporation, without the carrier’s name printed on the form. The trial court agreed with the carrier, finding that the broker procured insurance for his clients and was not an agent of any particular insurance company.

⁷Courts have used different terms to refer to “ostensible agency,” including apparent agency, apparent authority, and agency by estoppel. See *Armato v. Baden*, 71 Cal. App.4th 885, 897 n.4 (1999) (citing *Baptist Memorial Hosp. System v. Sampson*, 969 S.W. 2d 945, 948 n.2 (Tex. 1998)). As a practical matter, though, there is no distinction among the terms. See *id.*

⁸2 Witkin, Summary of California Law, Agency, And Employment § 40 (9th ed. 1987).

⁹See *Kaplan*, 59 Cal. App. 4th at 747. The elements of estoppel are (1) representations made by the principal; (2) justifiable reliance by a third party; and (3) a change of position from such reliance resulting in injury. See *id.* (citing *Preis v. American Indemnity Co.*, 220 Cal. App. 3d 752, 761 (1990)).

¹⁰Accord Certificate of Insurance Form 25-S (7/90).

On appeal, the court found that the carrier was aware that the broker issued the standard form certificates as proof of coverage. Because of this knowledge, the carrier “conveyed the impression to one named as an additional insured that these certificates reflected an actual amendment to the policy.” Accordingly, the court held that an insurance company that issues a policy through the services of a broker may create an ostensible agency whereby the broker would have apparent authority to add an additional insured to that policy.

Due to the additional legal issues that arise when a builder only receives a certificate of insurance, it is important that a builder obtain an actual copy of the additional insured endorsement before any work begins on the project. If a valid finding is made that the certificate of insurance does not bind the insurer, then a legal action against the broker may also need to be considered. Such suits are becoming more prevalent and more hotly disputed.

Subcontractor Defaulting on Insurance Premiums

In more than a few cases, it has been found that a subcontractor did not pay the premium for its policy or for the endorsement, which resulted in the cancellation of the policy or the endorsement. To avoid this problem, counsel for developers, general contractors, and insurers should require the subcontractor in the subcontract agreement to notify the builder in writing if a notice of cancellation has been issued or if there have been any changes in the coverage.

The Current Effect of Additional Insured Endorsements in Construction Defect Litigation

Although the typical construction defect mediation still involves discussions about water intrusion issues, nailing patterns, leaking pipes, and coverage issues, another hotly disputed area involves the duties and responsibilities under additional insured endorsements. Some jurisdictions have held that an additional insured stands in the shoes of the named insured and is entitled to full coverage,¹¹ while other jurisdictions, or in other areas of subject matter, the additional insured is held to have a lower level of coverage or protection.¹² Many jurisdictions permit severability or separation of insureds which permits the insurer to treat differently situated insureds under a named policy with additional insured entitled in differing manners.¹³

Mediation Process

In the past, carriers for the developer often would allow the carriers for the subcontractors to simply make a lump sum payment to either the developer or the plaintiff to resolve both the indemnity and cost of defense issues. The trend, especially over the last several years, is for developers and their insurers to take a harder line on additional insured issues and, as a result, require the subcontractors’ carriers to pay both an amount to satisfy the indemnity obligations of their insured and a separate payment directly to the primary carriers to reimburse them for the defense costs incurred by the developer in the lawsuit. The result is a reduction in the pool of settlement funds typically available. This makes settlement at the mediation stage more challenging.

¹¹See *Marathon Ashland Pipe Line, LLC v. Maryland Casualty Company*, (10th Cir. 2001) 243 F.3d 1232.

¹²See *Jacobs Constructors, Inc. v. NPS Energy Services*, (3rd Cir. 2001) 264 F.3d 365.

¹³See *Erdo v. Torcon Construction Company, Inc.*, (N.J. Super. 1994) 645 A.2d 806.

Cost Sharing Agreements

In an effort to resolve these additional insured issues at an early stage in the litigation, the sophisticated developer's counsel and the carriers may attempt to reach an early agreement with the additional insured carriers on the additional insured issues through the use of a cost sharing agreement.

In very general terms, the primary carriers and the additional insured carriers agree early on that each will pay a portion of the defense costs for the developer. The additional insured carriers also decide at this time how to apportion their share of the defense costs among themselves.

There are many methods of determining the amount each additional insured carrier is required to contribute to the defense. Some of the typical apportionments are:

1. *Pro Rata Approach*: Each additional insured carrier per subcontractor has an equal share.
2. *Tiered Approach*: Each subcontractor is placed in a tier based upon their potential liability. For example, roofers, framers, and sheet metal subcontractors are placed in one group and their carriers are required to pay a larger share than subcontractors placed in lesser groups, such as finish carpenters, painters, and landscapers.
3. *Percentage Approach*: The additional insured carriers pay a percentage of the defense costs based on the contribution toward settlement or judgment at trial against their subcontractor in relation to the total settlement or judgment of the matter.

The utilization of such an agreement makes for a more efficient and effective defense as the carriers are equitably sharing in the costs of the defense from the beginning, retaining only one counsel and avoiding separate and often costly coverage actions.

The Duty to Defend

Though insurers have attempted to place limitations on the scope of the duty to defend an additional insured, a series of cases has solidified the California public policy rationale for maintaining a broad judicial interpretation of the duty to defend. As discussed above, in *Maryland Casualty Co. v. Nationwide Insurance Co.*, the court found that language that seemed to limit the scope of the duty to defend was void as being against public policy, and therefore the duty to defend exists unless there is specific and unequivocal language abrogating that duty.

Following this decision, the California Court of Appeals revisited a wrinkle in the duty to defend an additional insured in a California case discussed above, *Pardee Construction Company v. Insurance Company of the West*. This time the court again expanded the scope of the insurer's duty by holding that, where insurers issue a commercial general liability policy to a subcontractor that includes coverage for completed operations, the insurer owes a duty to defend the additional insured in lawsuits arising out of projects completed even before the inception of the policies. The court found that the insurers failed to expressly limit completed operations as to time or particular project in their policy and endorsement language.

Finally, in a major California decision on the effect of the duty to defend, *Presley Homes, Inc. v. American States Insurance Company*, the court held that the duty to defend a subcontractor exists even where there is no contractual obligation to do so. Presley, a real estate developer, contracted with two construction companies to complete a housing development. The Cassidys, purchasers of a home in Presley's development, sued for injuries they attributed to alleged construction defects. Presley tendered the defense of the Cassidy claim to American States Insurance Company, and American agreed to defend some, but not all, of the claims pending, arguing that most of the claims were not covered by

the insurance policy Presley held. Presley sued American, and the trial court ruled in favor of American, stating that the American policy does not require American to defend the entire policy.

In explaining why the trial court was incorrect, the reviewing court relied on a number of important precedents in insurance coverage, which collectively stand for the proposition that the duty to defend a suit is broad and an insurer must defend the entire suit, including covered and uncovered claims, and seek reimbursement for its defense of uncovered claims after the lawsuit has settled or proceeded to a verdict. American argued that its position was distinguishable from the precedent in that its contract did not provide Presley a reasonable basis for concluding that it would be entitled to a full defense of a suit against it. This argument was based on the fact that American States was the insurer for a subcontractor on the project, and Presley was an additional insured who would generally not be contractually entitled to a defense.

The court rejected this argument, stating that American States had a duty to defend the additional insured and the entire suit because “an insurer’s duty to defend the entire action is based on public policy, not the terms of the parties’ contract.” The *Presley* holding therefore greatly expands the scope of the duty to defend an additional insured in construction defect matters, and should form the basis of an initial review of the insurer’s duties to any project that comes into dispute. Other states have still failed to resolve the murky issues related to a broad duty to defend,¹⁴ but it is likely that they will look to California and the effects of these California decisions on the process.

The Duty to Indemnify

In *Acceptance Insurance Company v. Syufy Enterprises*, the California Court of Appeals addressed the language of an endorsement which covers defects “arising out of” and “arising from” what is termed “your work.” The court held that California courts have been consistent in their interpretation of such phrases in the context of the duty to defend and indemnify, and that the narrowness implied by the statements is not acceptable in light of the prevailing desire to ensure indemnity under such insurance policies. *Syufy* therefore lays the groundwork for a broad judicial interpretation in favor of insured where the coverage set forth in the insurance contract is in any way implicated. The California Supreme Court reaffirmed this principle in the recent case of *Vitton Construction Company, Inc., v. Pacific Insurance Company*, where it held that even the most minimal level of causation will be sufficient to trigger coverage.

In *Fireman’s Fund Insurance Companies, v. Atlantic Richfield Co.*, the California Court of Appeals held that an additional insurer is required to provide coverage where the accident was caused by the additional insured’s own defect. ARCO contracted for maintenance work to be performed on its plant, and was named as an additional insured in a CG 20 10 11 85 endorsement procured by the contractor. One of the contractor’s employees was injured while stepping on a wooden step owned and maintained by ARCO and the employee sued ARCO, alleging negligence. The contractor’s insurer, Fireman’s Fund, agreed to defend and indemnify ARCO with a reservation of rights, settled the underlying action, and sued ARCO to recover its settlement and defense costs, contending that the accident did not arise out of the subcontractor’s work.

The court held that Fireman’s Fund had a duty to defend and indemnify ARCO. The Court based its decision on *Acceptance Ins. Co. v. Syufy Enterprises*, which held that an additional insured is covered without regard to whether the injury was caused by the named insured or the additional insured, as long as there is a minimal causal connection or incidental relationship between the work of the named insured and the additional insured’s liability. The Court found that the connection between the contractor’s work and ARCO’s liability sufficient to establish the minimal causal connection because the em-

¹⁴See, e.g., *Schal Bovis, Inc., v. Casualty Insurance Co.*, (Ill. Ct. App. 2000) 315 Ill.App. 3d 353

ployee was present at his employer's worksite and was performing a work-related task as the time of the accident. Therefore, since the duty to defend arose in light of the facts giving rise to the litigation, the complementary duty to indemnify also arose, as the same legal principles operate to effectuate the public policy rationale set forth by the courts.

State Anti-Indemnity Provisions¹⁵

Many states have case law or statutory regulations which set up anti-indemnity rules for construction projects. Most states have recognized the danger of permitting small subcontractors to indemnify, or be held to provide indemnity, for larger portions of construction projects than would be fair and equitable. Some states prohibit contracts which force a small subcontractor to have such responsibility, others strictly regulate the circumstances under which such types of contracts will be permitted. The following is a brief analysis of state laws on the subject:

- **Alabama** has very loose regulation of indemnification, however the state's common law and judicial decisions prohibit indemnification for intentional misconduct or criminal actions.
- **Alaska** bars indemnification for the negligence or misconduct by the indemnitee in §45.45.900.
- **Arizona** has statutes barring, among other things, indemnification of design professionals (§ 32-1159) and the negligence of the indemnitee (§ 24-226 and § 41-2586).
- **Arkansas** permits indemnification with virtually no restrictions.
- **California** bars indemnification for the indemnitee's willful misconduct and/or negligence or for design professionals. (Civ. Code § 2782). Additionally, unlike most states, section 3864 of the California Labor code specifically permits indemnification for workers' compensation purposes.
- **Colorado** has few restrictions on indemnification, but does prohibit agreements regarding indemnification in contracts with public entities (§ 13-50.5-10(8)).
- **Connecticut** prohibits indemnification for the indemnitee's negligence.
- **Delaware's** restrictive laws generally bar indemnity, including where the indemnitee is negligent, including design professionals (Title 6, § 2704).
- The **District of Columbia's** codes are silent, but its case law generally permits indemnification.
- **Florida's** codes bar certain forms of indemnification such as for the indemnitee's gross negligence or intentional conduct and for the actions of a design professional (§ 725.06.08).
- **Georgia's** § 13-8-2 bars indemnification for indemnitee's sole negligence.
- **Hawaii's** § 431: 10-222 bars indemnification for indemnitee's negligence or intentional misconduct.
- **Idaho** Code § 29.114 bars indemnification for indemnitee's sole negligence.

¹⁵See above, fn. 2.

- **Illinois** permits indemnification for negligence (740 Ill. Comp. Stat. 35/1).
- **Indiana** has indemnification for the indemnitee's or design professionals negligence or intentional conduct (§ 26-25-1).
- **Iowa** statutes are silent but case law allows indemnification where the agreement is clear and unequivocal.
- **Kansas** statutes are silent but case law allows indemnification where the agreement is clear and unequivocal.
- **Kentucky** statutes are silent but case law allows indemnification where the agreement is clear and unequivocal.
- **Louisiana's** codes bar indemnification on public projects [§ 38:2216(G)].
- **Maine's** statutes are silent but case law allows indemnification where the agreement is clear and unequivocal.
- **Maryland** bars indemnification for the indemnitee's sole negligence (Ch & Jud. Prog. Code § 5-401).
- **Massachusetts** law bars indemnification by subcontractors (Ch. 149 § 296).
- **Michigan** bars indemnification for indemnitee's sole negligence (§ 691.991) and prohibits or vitiates any contractual requirement to name indemnitee as Additional Insured.
- **Minnesota** bars indemnification for indemnitee's negligence (§ 337.02) but expressly permits additional insured agreements (§ 337.05).
- **Mississippi** bars indemnification for the indemnitee's negligence (§ 31-5-41).
- **Missouri** has specific regulations for when indemnification can occur and bars indemnification unless it is considered at the time of contracting. However, Missouri expressly prohibits indemnification of design professionals and expressly permits additional insured agreements (§ 434.100).
- **Montana** has no specific statute regarding indemnification but case law permits indemnification where the intent of the parties is clear and unambiguous. Further, Montana's Worker's Compensation regulations bar indemnification.
- **Nebraska** prohibits indemnification [§ 25-21.187(1)].
- **Nevada** has no statutory regulation of anti-indemnity statutes.
- **New Hampshire** case law permits indemnification, however, § 338-A:1 prohibits indemnification of design professionals.
- **New Jersey** prohibits indemnification for the indemnitee's negligence, including the negligence of design professionals (§ 2A:40A-1) but does not have a requirement relating to additional insured agreements.

- **New Mexico** prohibits indemnification for an indemnitee's negligence or for the negligence of a design professional (§ 56-7-1) but does not have case law regarding additional insured agreements.
- **New York** prohibits indemnification for the indemnitee's negligence (Gen. Oblig. Law § 5-322.1) and prohibits indemnification of the design professional (Gen. Oblig. Law § 5-324) and Worker's Compensation regulations limit the application of implied indemnity theory.
- **North Carolina** prohibits indemnification under § 22B-1.
- **North Dakota** bars indemnification for design professionals under § 9-08-02.1.
- **Ohio** prohibits indemnification under § 2305.31 but Ohio Courts have yet to agree on effectiveness of additional insured agreements.
- **Oklahoma** has no statutes regarding indemnification, however, Oklahoma case law permits indemnification where the intent of the parties is clear and unambiguous.
- **Oregon** bars indemnification under § 30.140. However, a bar on indemnification contained within Worker's Compensation regulations may be waived by the employment contract and § 30.140(2) permits additional insured agreements.
- **Pennsylvania** has no specific statute regarding indemnification in general but does bar indemnification for the design professional under Title 68, § 491. Further, case law permits indemnification where the intent of the parties is clear and unambiguous and Worker's Compensation regulations permit the waiver of the general bar on indemnification.
- **Rhode Island** prohibits indemnification under § 6-34-1.
- **South Carolina** prohibits indemnification under § 32-2-10.
- **South Dakota** prohibits indemnification under § 56-3-18 and separately bars indemnification of the design professional under § 56-3-16.
- **Tennessee** prohibits indemnification for the indemnitee's negligence under § 62-6-123.
- **Texas** has no general regulations on indemnification. However, Texas Civil Practice and Remedies Code § 130.002 bars indemnification of the design professional. Otherwise, the common law permits indemnification where the intent of the parties is clear and unambiguous in their agreement.
- **Utah** prohibits indemnification for the indemnitee's negligence under § 13-8-1.
- **Vermont** has no specific statute regarding indemnification but Vermont case law permits indemnification where the parties' intent is clear and unambiguous in their agreement.
- **Virginia** bars indemnification under § 11-4.1 and specifically bars indemnification for a design professional's negligence under § 11-4.4.
- **Washington** prohibits indemnification for the indemnitee's negligence under § 4.24.115 and state Worker's Compensation regulations prohibit an agreement to indemnify unless the prohibition is express waived by contract between the parties.
- **West Virginia** prohibits indemnification under § 55-8-14.

- **Wisconsin** has no specific statutes regarding indemnification. Wisconsin case law does allow indemnification where the intent of the parties is clear and unambiguous at the time of agreement. However, there are Worker's Compensation regulations which restrict the ability of the parties to agree to indemnify.
- **Wyoming** has no statutes, published cases or regulations restricting or permitting indemnification or additional insured agreements.

Conclusion

A keen knowledge of additional insured issues is necessary to gauge risk exposure as the subject is moving to the forefront of construction defect litigation. It is essential in properly evaluating a construction defect claim that the implications of the additional insured endorsement issues are fully considered. As a result, judges, mediators, insurers, attorneys, and clients are all becoming more sophisticated in this area of the law, which is impacting each and every construction defect case.

Many states continue to develop bodies of state laws regarding indemnification, additional insured endorsements, and regulations for employment contracts regarding indemnification. As California courts seem to have taken the lead in publishing decisions relating to additional insured issues in construction defect litigation, other Western states have begun to adopt the policy California has been establishing. Until a more comprehensive body of case law has been established around the country, California laws may inform the attorney in another state seeking to litigate issues presented by additional insured endorsements that have been placed in issue in a construction defect case.

THE POTENTIAL FOR CLASS ACTIONS IN THE CONSTRUCTION DEFECT SETTING

Although most typical construction defect matters do not involve class action allegations, more and more class actions are being filed which involve construction defect issues, including for example, projects involving defective component products, such as furnaces, pipe or window issues and actions involving mold issues. As a result, it is important to understand class action requirements and protocol. Class actions in California, as in other states, are governed by both statutes and case law. The California Supreme Court has also sought guidance from Rule 23 of the Federal Rules of Civil Procedure. Based upon the number of decisions, California rules and Federal rules, it does appear that there is a significant amount of flexibility in handling class actions. However, it is possible that the effect of the provisions of SB 800, regulating the procedures for construction defect litigations, may bar the certification of a class even where there are sufficient similarities to otherwise merit a class. This is due to SB 800's provisions which require separate rights of response and repair for different homeowners.

There are at least three major types of class or representative actions in California, including general actions under Code of Civil Procedure § 382, representative Unfair Competition Law actions under Business and Professions Code § 17200, and Consumer Legal Remedies Act actions under Civil Code § 1752. There are also a number of class-formation rules related to federal laws covering civil rights and financial transactions. In all but the general § 382 action, specific rules govern notice, pleading, and procedure. In § 382 actions, the statute is written in an extremely general manner and the procedures are governed by normal rules of California procedure, and the presiding judge is invested with a great amount of discretion in ruling on the case.

CERTIFYING A CLASS

California Code of Civil Procedure § 382, which governs “Representative Actions in California,” states:

“If the consent of any one who should have been joined as plaintiff cannot be obtained, he may be made a defendant, the reason thereof being stated in the complaint; and when the question is one of a common or general interest, of many persons, or when the parties are numerous, and it is impracticable to bring them all before the court, one or more may sue or defend for the benefit of all.”

To have a class certified, the plaintiff must prove first that there is an ascertainable class, and second, that common issues of law and fact predominate over those issues which require individual adjudication. This second requirement can also be stated as a “well-defined community of interest in the questions of law and fact involved.” Each requirement is to be analyzed by the court separately and distinctly, because the two prongs of the test have independent purposes.

The key requirement in showing the need for the class is that the number of potential class members is so great that joinder of each individual stakeholder would be impractical and burdensome. The representative must show a willingness and an ability to fairly and reasonably protect the rights of the other class members. Furthermore, the attorney for the representative and the class must display the qualifications required to handle the class action. The plaintiff must also show that the class action method of litigation is superior to any other method for resolving the conflicts between the parties, such that the certification of the class will benefit the plaintiffs and defendants, as well as the court and the judicial system.

The burden of pleading the need for the certification of the class is on the plaintiff seeking certification, who must show the need for the class certification as a matter of fact. A trial court is not required to hold an evidentiary hearing when ruling on class certification or a class settlement absent a noticed motion and scheduled hearing. However, oral argument is required when the court entertains a demurrer to class action allegations, and cannot summarily dispose of class action issues without entertaining argumentation. Furthermore, in order to satisfy class membership, the attorney must “show a probability that each class member will come forward and prove his or her separate claim to a portion of the recovery.”

Where individual issues regarding liability predominate, a class should not be certified regardless of the arguments in favor of judicial economy. The court in *City of San Jose v. Superior Court*, in deciding whether to certify a class in a real estate case, also considered the creation of subclasses, in order to group together those litigants who did have similar operative facts and liability issues without forcing litigants with completely different underlying cases. Ultimately, the *City of San Jose* court decided not to use subclasses because they felt the real estate doctrine of uniqueness of land would preclude any meaningful grouping of similar claims, but left the door open to the creation of subclasses in cases where an entire class of litigants have relatively similar or connected claims, and several groups within the larger class have much more closely-related claims. Furthermore, where different affirmative defenses exist for different individual litigants, those different defenses create different issues of law and fact and should mitigate against the certification of a class.

DISCOVERY IN CLASS ACTIONS

When discovery is necessary before a class is certified, it is generally directed to the named parties. Often times, discovery is utilized to assist in an early decision as to whether the matter is proper for certification. When discovery is found to be necessary to determine legal and factual issues, often times the court will place certain limitations on the discovery, including allowing only a limited time period to complete class related discovery and limiting the number and scope of depositions.

In order to go forward with a more efficient and effective discovery process, it may be beneficial to the parties to enter in to a Case Management Order or discovery plan in order to avoid a duplication of efforts. Further, if the parties do not agree to such a plan, it is likely that the court will order it.

ATTORNEYS AND NOTICE ISSUES

Once a matter has been certified as a class action, the court will then determine if and when notice should be given to potential class members of the action and to give the class members the ability to opt out of the action.

Attorneys may communicate in a much freer manner with potential members of a class of litigants than they would be able to communicate with other non-clients. In fact, the United States Supreme Court has theorized that a class representative's attorney or an attorney for a class of litigants may have a Constitutional right to communicate with those litigants and potential members of a class. In *Gulf Oil v. Bernard*, the Court struck down an order that prevented attorneys from contacting or communicating with people who were potentially effected by an ongoing mass litigation.

Under the applicable Federal and Bar Association rules, class member contact is also excluded from prohibitions on solicitation. *Federal Rule of Civil Procedure 23(d)* protects an attorney's right to contact members and potential members of a class. *ABA Model Rule of Professional Conduct 7.2* specifically excludes from the definition of proscribed solicitation the notification of members and potential members of an ongoing class action.

The clearly may be a significant issue in dispute between the plaintiff and defense in that the defense certainly does not want the plaintiffs to be able to openly contact and communicate with potential parties to join in the lawsuit.

CONCLUSION

In construction defect matters which involve an ascertainable class and common issues of law and fact predominate over those issues which require individual adjudication, it may be beneficial to all parties to adjudicate these issues in one matter in order to avoid a duplication of efforts, time and costs. However, in the cases where the risks outweigh the potential benefits, all efforts should be made to attack the class action allegations and oppose a Motion for Certification. Clearly, each case needs to be evaluated on an individual basis in order to make a determination in this regard.

CONCLUSIONS AND FINAL THOUGHTS

There is a clear need to give definition for construction defect litigation. Builders need guidelines under which to build. Homeowners need parameters within which they can know whether to demand repair or sue. Insurers need some assurance that they will not be underwriting themselves into certain liability for many construction defect actions.

Where guidance and practice come together, construction defect litigation can become well-defined and predictable, with general principles and established practices which will allow builders, insurers, and homeowners to respond to alleged defects in construction in a timely and comprehensive manner. Legislators have been slow to formulate methods for responding to the confusion wrought by the waves of construction defect litigation, but with major legislation passed in California, Texas, and several other hard-hit states, it seems that the regulation of construction defect litigation has begun in earnest.

By next year, it is extremely likely that even more states will have drafted and codified sets of regulations, methods for resolving disputes, and rules for indemnification and additional insured endorsements that are either designed to compliment those laws already enforced, or possibly attempting to create different methods for achieving the same goals. The attention of insurers and risk managers should be on the drafting of legislation which affords them a better opportunity to evaluate the risks of underwriting contractors and provides them the ability to predict the landscape in which they intend to venture. While, by its nature, the underwriting of construction projects is a risky venture, insurance is necessary to make housing affordable and assist contractors in responding to and, where applicable, defending against claims of defects by homeowners. As state legislatures take on this challenge, it is imperative that all interested parties contribute to their efforts so that they may draft laws which provide homeowners assurance that true defects will be repaired while attempting to stem or manage the tide of construction defect litigation.