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## RESIDENTIAL CONSTRUCTION DEFECT LITIGATION

### An epidemic

There is an epidemic of construction defect litigation in Washington. Recent legislative changes have not stemmed the flood of claims and the frantic pace of multi-family housing construction means more claims will follow.

In a construction defect lawsuit filed last week, a Condominium Owner's Association sued a Developer/General Contractor, alleging a wide range of construction defects. The Developer, in turn sued 12 subcontractors and 4 design firms, seeking contribution. Each of these parties will undoubtedly have some form of insurance. What is less clear is whether the parties have coverage for the alleged defects.

### The fog of insurance coverage

One would think by now the industry would understand what insurance coverage exists for construction defects. Unfortunately, this is not the case. Insurers have consistently taken the position that Comprehensive General Liability Policies (CGL) do not cover contractor errors in workmanship that lead to damage to a residence.

In August 2007, the Supreme Court of Texas held that a contractor's CGL policy cover a homeowner's claim that the defective construction of a foundation had damaged the house frame and its finishes. *Lamar Homes v. Mid-Continental Casualty Company*, 2007 Tex. Lexis 797, 50 Tex. Sup. J. 1162 (August 31, 2007). Courts around the country are split on this insurance coverage issue.

When the contractor or developer is uninsured or underinsured for a construction defect, the likelihood of a claim against the design professional, with his or her professional liability insurance, increases. Everyone likes a deep pocket.

### Practical Risk Management Suggestions

If your firm is involved in multi-family residential construction, ask yourself these basic questions:

#### **Make sure your Professional Liability Policy provides coverage for multi-family residential work.**

Some carriers either exclude coverage for multi-family design work or limit coverage to a percentage of annual billings. Be forthright in describing the nature and extent of your multi-family design work at renewal time and keep your carrier informed as to the nature and extent of this work as the policy term progresses.

**Have your insurance broker or counsel review the owner, developer and general contractor's CGL coverage or Builder's Risk coverage.**

The most significant risk you face in multi-family construction is a claim by a client for contribution after the client is sued for construction defects. Meaningful insurance coverage for your client is your first line of protection. "All Risk" Builder's Risk coverage can also provide some protection for damage to the project caused by defective work during construction. Become educated on what this insurance really covers.

**Be sure all subcontractors are insured and contractually required to fix or pay for defective work.**

Many construction defect claims arise out of defective work by subcontractors. Subs are having difficulties obtaining meaningful CGL coverage for residential construction. On larger projects, developers, general contractors and subcontractors may be covered by a single project specific policy purchased by the owner (known as an OCIP). These policies are complex and should be reviewed by your broker or by counsel.

**Know your client.**

What is the track record of the developer from prior projects? Is there a history of claims? Is the developer adequately capitalized to handle claims?

Will you be contracting with a project-specific entity (generally an LLC) that will go out of business when the project is turned over to a homeowners' association? Will the principals in the project-specific entity personally guarantee your contract?

**Develop your scope of work with due regard for foreseeable risks.**

Will you be allowed to develop a design that incorporates current state-of-the-art features to address proper weather protection?

Have you identified foreseeable problem areas like unstable soils, steep slopes, excessive ground water, lack of roof overhangs, unprotected flat decks?

Who will be on the design team and will other design team members be able to deliver their responsibilities for a quality design? Are they adequately insured?

Will you be responsible for coordinating and integrating all design elements?

What will be your responsibilities for obtaining necessary permits?

Will there be a waterproofing or building envelope consultant, and if so, will this entity be under contract to you or to the developer? Will you be allowed to select or approve the waterproofing consultant? Will the waterproofing consultant monitor construction? Is the waterproofing consultant adequately insured?

What will be your role during the course of construction? Will you review and approve shop drawings? Will you make periodic inspections of the work? Will you be attend weekly job site meetings during construction?

Will you be afforded the opportunity to develop a punch list of construction issues at substantial completion and will you be assigned the role of reviewing completion of punch list items prior to final completion and the sale of any units?

Is the construction timeline for your work reasonable?

Will you be allowed to recommend and to approve all building elements that could affect quality, such as windows, doors, roofing systems and waterproofing?

**Coordinate your work with others.**

Will the developer retain a separate Construction Manager? If so, what will be the division of responsibilities between you and the Construction Manager? Will the Construction Manager play any role in design? Is the division of labor between you and the Construction Manager adequately documented?

If other design firms have separate contracts with the developer, are those contracts uniform and integrated with regard to scope of work, risk allocation and dispute resolution?

Will there be design-build elements in the project delivery such as HVAC, elevators, fire suppression, electrical, plumbing? If so, will you review and comment on design-build submittals? Will those submitting design-build plans be required to carry professional liability insurance?

How will change order requests be handled?

How will submittals be logged, reviewed and approved?

**Know the general contractor.**

Will you be assisting the owner in selecting a general contractor?

If the owner is the general contractor, is the owner up to this task? Does the owner have a track record for constructing projects of comparable scope?

Is there a construction contract between the owner and the general contractor? Will you be allowed to comment on the contract form?

Will the owner require that the general contractor have written contracts with all subcontractors and will the risk allocations of the prime contract flow to the subcontracts? Will the owner approve all subcontracts?

**Get paid.**

Does the owner have the funding to pay for design services, especially prior to the construction loan?

Do you have adequate copyright protection for the conceptual design you prepare in case the owner terminates your services before you finalize construction documents?

Does the owner have a funding commitment? Does the building need to be pre-sold before funds will be released by the lender?

Do you have the right under your contract to request assurances about funding throughout the project? Does your contract allow you to stop work if you are not being paid?

Have you discussed your lien rights with the owner?

**Understand your insurance.**

How will the project be insured?

Do you have professional liability coverage for condo work? Is your coverage adequate for the foreseeable risks?

Will the owner provide an OCIP that covers design services? Is your professional liability policy at risk before the OCIP comes into play? Are you responsible for a high deductible under the OCIP?

Is the OCIP policy large enough to cover foreseeable claims?

Is there a waiver of subrogation within the OCIP?

Will the owner and designers be “Additional Insureds” under the general contractor’s CGL policy?

Who will carry Builder’s Risk coverage during the course of construction? Will the Builder’s Risk coverage be on an “All Risk” form?

### **Understand your contract.**

Do you have a signed design professional contract in place before commencing any work?

Does your design services agreement address all of the risk issues listed above?

Have you asked your professional liability insurance broker, carrier or your attorney to review your proposed contract?

If your role or scope changes, will your contract be amended?

Are all indemnity obligations imposed on you in the design services agreement limited to incidents of professional negligence?

Can you obtain a meaningful limitation of liability clause in your contract?

Is there a waiver of consequential damages?

Are you satisfied with the disputes resolution provisions in the contract, including prevailing party attorney’s fee clauses?

Are you protected against the unauthorized re-use of your documents for other projects?

Can you obtain a waiver of subrogation clause from the owner? Can the owner include a waiver of subrogation clause in the Condo Declarations, binding the Homeowner’s Association and Unit Owners?

This checklist is just one method of managing risk on residential construction projects. Many professional liability carriers also provide sample risk management checklists for their insureds. The AIA Trust has published a “Risk Management Recommendations for Condominium Projects” and a “Condo Project Evaluation Form.”

Design firms doing multi-family residential design work should carefully consider the issues highlighted here, designate appropriate lead principals to approve any condominium assignments, and prepare a “go/no go” evaluation form to manage the intake process for new work in this area.

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