STRUCTURAL BUILDING COMPONENTS MAGAZINE (FORMERLY WOODWORDS)
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Our Legal Reality

"Tackling the Construction Defect Issue" by Kent J. Pagel, WTCA Outside General Counsel

One of the largest U.S. property and casualty insurance carriers is on record stating that "[lawyers]…are [currently] poised in a number of states to concentrate their efforts on construction defect litigation." I interpret this statement to mean that the explosion of construction defect litigation seen primarily in California, Arizona, Nevada and Colorado is now expected to migrate to other states. Although these other states have not in the past been immune to construction defect litigation, the goal shared by many, including component manufacturers, is to not let construction defect litigation become a full-fledged "industry" within a particular state. An industry where architects, engineers and former building contractors work full-time at construction defect consulting, and where attorneys devote law practices to promote and feed off the frenzy that can spring out of such litigation.

The factors that seem to determine whether construction defect litigation will be prevalent in a particular state are:

- a recent history of rapid housing growth
- shortages of qualified construction laborers
- poor soil conditions
- presence of water intrusion
- a litigious environment with an active plaintiffs' lawyer bar
- a political and judicial environment supportive of tort law expansion

While as you can see a great deal of construction defect litigation is initially asserted over the foundation of the building or water penetration which has caused rotting and deterioration, it is quite common for those trades supplying or installing materials for wall, floor and roof systems to be joined as

[1] One innovative California lawyer out to generate business for himself publishes a manual titled Home and Condo Defects: A Consumer Guide to Faulty Construction. I ordered a copy, but since I do not appear to be an anxious plaintiff I was told that I do not qualify for the author's discount (e.g. which enables consumers to buy the book quite inexpensively). In any event I will let you know my thoughts on the book in a future article.

[2] One California law firm lists five years worth of settlements and verdicts totaling $220 million—an average of $3.7 million per case.

[3] In an upcoming issue I will follow-up with a second article recommending a plan of action in the event a product claim is brought against the truss manufacturer. The truss manufacturer is also advised to develop and adhere to a rigid risk management and litigation avoidance program to minimize the risks faced in product defect litigation.

defendants in a construction defect lawsuit.

One risk consultant who publishes statistics, categorized construction defects into a "Top 10" list and found floor, wall and roof structural systems as number one on the list and roofing problems as number two on the list. Litigating over walls, floors and the roof, as they comprise the structural integrity of a building, quickly increase the amount of damages that can be asserted and the settlement that can possibly be obtained by plaintiff lawyers.

The growth of construction defect litigation is largely attributable to the networking and advertising done by plaintiff lawyers through the Internet and other mediums.[1] Lawyers routinely pose a question-and-answer web page on how to file a construction defect case; offer to analyze a case for free; offer to provide in-house seminars to disgruntled homeowners and their friends (e.g. neighbors who have purchased homes from the same builder or through the same developer); provide tips on how to recover from insurance companies; and indicate, of course, the past successes they have had in previous construction defect cases.[2]

It has also become quite common that homeowner representatives serving on existing homeowner associations, out of fear that they may be sued personally, feel compelled to proactively investigate construction problems to protect themselves. These homeowner associations exist for all condominium construction and for many single-family neighborhoods. Plaintiff lawyers who suggest the homeowner representatives may not be fulfilling their fiduciary duties to the homeowners if they choose to ignore the possibility of construction defects fuel the concern over individual liability. Such plaintiff lawyers have aligned themselves closely with the inspectors and architects who conduct inspections for the homeowner associations and are quick to point out how a particular building may not be constructed in accordance with certain building code requirements. If the builder or contractor balks in response to such an inspection, the homeowner association will generally elect to file suit, especially as locating counsel to pursue the case comes so easily.

Builders themselves have undertaken precautions to curb the onslaught of construction defect litigation (or at least to minimize the impact they experience). In the process of protecting themselves, the builders have increased the exposure faced by the subcontractors and suppliers they use. Except for enhanced quality control and warranty programs designed to increase homeowner satisfaction (and thereby discourage litigation), most of the actions taken by the builders are detrimental to their subcontractors and suppliers.

Builders have also opted to shift responsibility to the trades through broad indemnity provisions and by asking that the trades name them "additional insured" on the trades' liability insurance policies. Many builders have also established new business structures such as limited partnerships, limited liability companies and corporations for specific projects or subdivisions allowing them to cash-out once the project is complete. Some builders are even operating without insurance. Not only does the formation of a new business entity increase the possibility that the truss manufacturer may not get paid during construction, but if the builder has cashed-out or elects to operate without insurance, the plaintiff lawyers may be left to litigate against those subcontractors and suppliers who have not cashed-out and are still operating their businesses.

Truss manufacturers, and the structural component industry in general, need to take proactive measures to avoid becoming “easy pickings” as the entire construction defect litigation problem continues to evolve. The following steps are intended to focus on what truss manufacturers can do to protect themselves on the insurance side.[3]

“WHY SHOULD I CARE, I HAVE INSURANCE?”

Without a strong product defense; a documented jobsite delivery package (see below for more information); a customer contract clearly indicating, among other things, your scope of work—WTCA's Design Responsibilities document was created specifically for this purpose; etc. the truss manufacturer's liability insurance carrier (assuming it agrees to pick up the defense of the case without a reservation of rights) will likely settle a construction defect claim. The prevalent mindset for the insurance carrier is to pay the plaintiff an amount that would otherwise be spent in defending the truss manufacturer. The more claims filed and the more settlements will ultimately mean, however, that the truss manufacturer's current liability carrier will probably not renew the policy and the carrier that ultimately agrees to pick up the insurance coverage for the future will certainly charge much higher premiums. A large self-insured retention or deductible may also be required. Consider that some smaller subcontractors and general contractors in California have been paying annual premiums of $650,000 for $1 million in liability coverage with a $250,000 deductible.

THE MORE OFTEN YOU PAY, THE MORE OFTEN YOU WILL BE SUED

Adding “insult to injury” are those plaintiff lawyers, who after repeated settlements on product defect claims become known, will bring claims against you more often. In other words if you (or your insurance carrier) is known to settle, you are automatically added to the next suit as it is expected a settlement can easily be secured. For instance, one small roofing subcontractor in Nevada reports juggling 47 suits at once.

INSURANCE COSTS ARE INCREASING & INSURANCE AVAILABILITY IS DECLINING

I have no official statistics to report. However, through anecdotal evidence I can report it is not uncommon for a manufacturer, with a good product defect claim history, to experience a doubling of liability insurance premiums in today's market. Quotes are becoming much harder to get. Many manufacturers are seeing that carriers who previously would quote a premium, have no interest when the manufacturer advises that it sells materials to the residential builder. For those carriers who do quote a premium, look for any special exclusions that may be requested

LOOK OUT FOR CUSTOMER CONTRACT INDEMNITY PROVISIONS & ADDITIONAL INSURED ENDORSEMENT REQUIREMENTS!

By agreeing to a broad indemnity provision or unlimited additional insured endorsements in their customer contracts, truss manufacturers and their liability insurance carriers may be forced to defend claims that go well beyond their scope of work (e.g. the design, manufacturing and

delivery of structural components). Not only will this practice eventually result in higher insurance rates or fewer insurance options at policy renewal, the types of indemnity provisions and additional insured requirements builders are imposing on their subcontractors and suppliers essentially require the truss manufacturer, if agreed, to become tagged with the defense and settlement for the poor performance of another party.

A common builder response to the growth in construction defect litigation is to opt to shift the responsibility by requiring their subcontractors and suppliers to name them "additional insured" on insurance policies. The requests have gotten quite narrow as the builder is looking for the broadest possible additional insured endorsement from as many subcontractors and suppliers as possible. For more information see the January/February 2001 article "Big Builder's Reaction to Construction Defect Lawsuits: The Dilemma for Truss and Wall Panel Manufacturers."

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"The Importance of Jobsite Submittal or Delivery Packages"

A proper jobsite submittal or delivery package, and the ability to document that it was received by your customer and the truss erector, is the one risk management practice that will best serve the truss manufacturer. This package should include a wealth of information, including but not limited to WTCA's Jobsite Warning Poster, copies of the product placement plan and the truss design drawings, WTCA's 1-1995 Standard Responsibilities in the Design Process Involving Metal Plate Connected Wood Trusses, and WTCA's Truss Technology in Building flyers on partition separation, temporary bracing and permanent bracing. For more indepth information on creating an effective program for jobsite submittals and delivery packages, please review the following articles from past issues:

"Jobsite Submittal or Delivery Packages: Part 1" by Kent J. Pagel, May 2000, pp. 34-35.
"Jobsite Submittal or Delivery Packages: Part 2" by Kent J. Pagel, June/July 2000, pp. 32-33.
"Jobsite Submittal or Delivery Packages: Part 3" by Kent J. Pagel, August 2000, pp. 32, 35.
"Jobsite Submittal or Delivery Packages: Part 4 (The Conclusion)" by Kent J. Pagel, November 2000, pp. 21-22.

"In the Courts"

Many insurance industry experts are encouraged by a December, 2000 California Supreme Court

decision that they hope will curb the growth of construction defect litigation, at least in California. In two construction defect actions against a developer, a contractor and subcontractors, by a condominium homeowner's association and owners of single-family homes in a subdivision, the trial court on the request of the defendants concerning the plaintiffs' claims of negligence, excluded evidence of alleged construction defects that had not caused property damage and related economic losses of the plaintiffs. The California Supreme Court agreed. This is noteworthy because in construction defect cases, plaintiffs have routinely offered exhaustive evidence of violations of applicable building codes, even though the plaintiffs had not sustained any property damage from such building code violations. Such evidence is usually quite persuasive to juries when determining whether the defendants are responsible. It will be interesting to see how this affects the continuing growth of construction defect cases in California, and whether other state courts will adopt similar decisions. Remember that construction defect law is a creature of judicial action by the courts, and not legislative action.

SBC HOME PAGE

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