FINDING HELP - IDENTIFYING OTHER POTENTIAL PARTIES AND ISSUES ENCOUNTERED IN DOING SO

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I. INTRODUCTION

Construction defect cases present a myriad of issues and challenges. The first is of course determining the cause or causes of the problem. This can evolve and even change along the way as observations and investigation continue and the relevant parties obtain a more complete and thorough understanding of everything. As part of this process, and central to the litigating of a construction defect claim, the party or parties who are responsible for the work causing the problems need to be identified. The party or parties who are responsible for responding to problems with that work, through risk transfer provisions or otherwise, must also be identified. This is an essential part of an effective and efficient resolution of a construction defect claim.

A. Identifying the Problem

The first and most important thing to do is to try to identify the problem. This generally requires some time, effort, and expense on behalf of each party, but it is an investment worth making. Parties often make the mistake of relying on or accepting an evaluation or opinion of an expert or experts retained by another party instead of thoroughly investigating the matter themselves. This is particularly true if the expert or experts retained by someone else has done an extensive investigation and produced a significant report.

Parties who find themselves notified of a defect or are otherwise brought into litigation or arbitration after other experts have already looked at things extensively often accept the apparently thorough investigation done by others along with their findings and do not conduct their own evaluation. A primary component of this decision to forgo a thorough investigation is often cost. There is usually a sense of uselessness too because the recently notified or added party figures there is not much else to learn. A presumably competent and experienced expert or experts has already spent a good deal of time looking at it and has diagnosed the problem.

Just because someone is competent or has a reputation for being competent does not necessarily mean they have correctly diagnosed the problem or, more likely, that they have correctly diagnosed the entire problem. Many a competent and generally respected expert has failed to get it completely right or to capture the whole picture. There are oftentimes multiple causes of a particular defect, as evidenced by the fact that experts often issue several reports that are changing and evolving over time. This can sometimes be the result of overworking a file but often there is nothing nefarious going on. An expert, even a competent one, can get zeroed in on a particular cause or causes and ignore other contributing factors. The expert may not necessarily be wrong, but he may not be correctly and fully identifying all of the causes of the problem. Further, there is always the possibility that the expert that has already done the extensive investigation, or more particularly his client, has motivations for identifying a particular cause or causes and directing the claim in a certain way. Whatever the case may be, parties make a big mistake when they do not evaluate the case themselves and, if appropriate, retain their own expert or experts to evaluate the claim.

B. Identifying the Players

1. <u>Identifying the Responsible Parties</u>

Once the problem or problems have been identified, or perhaps during this process, you can begin identifying the party or parties whose work maybe in question. The size of this group and the number of players on any one particular claim can vary significantly. There can be one problem (*i.e.* heave) with a number of parties responsible or a number of problems that are all one party's fault, usually the general contractor, or something in between. The task is to identify the problem or problems and then

identify the party or parties whose work might in any way impact and be a contributing factor or cause of the problem.

2. Getting Parties to Respond

Often the bigger challenge is not identifying the appropriate parties but in getting them to respond to the claim. A sub-contractor, manufacturer or design professional may simply ignore notification of a problem and on occasion a general contractor may even ignore complaints from an owner. More likely, the party who is notified of a possible problem with their work or product will respond by insisting that there is nothing wrong with their work or product and that it must be something else causing the problem. Sometimes they will do this initially or they may come out and inspect the problem and reach that "conclusion."

One of the most effective ways to limit the possibility of getting ignored by a potentially responsible party is to be prepared to provide them with information. The party who has notified additional parties of a problem that may relate to that party's work or product has likely done an investigation. Sharing the information and results of the investigation with the parties who are being notified often helps to speed up the process and the time it takes a party to recognize and acknowledge that they are in part responsible and should be involved in helping to seek a resolution of the problem. Providing these recently notified parties with the results of the investigation already done is often a good way to speed along this process. The owner, general contractor or other original parties may have expert reports they can provide to the recently notified parties. If not, it may be a good idea to have the expert prepare an abbreviated or summary type report so that the new parties can get up to speed quickly. There may be strategical reasons why you may not want to provide this information but it is certainly something to consider. The less information provided to a party the more time it is likely to take them to "warm-up" to the claim. If you want to hold out any hope for an early resolution through some sort of early mediation or otherwise, you better be prepared to provide a good deal of information concerning the investigation already done.

3. Identifying the Real Party in Interest - Contractual Risk Provisions

The most critical part of this entire process is not necessarily identifying and notifying the individual parties whose work is involved. It is identifying the "real parties in interest." These are the parties that are going to be responsible for defending and paying for the claim or a portion of the claim. Various risk transfer provisions by way of indemnity agreements and additional insured provisions may provide that the ultimate responsibility for paying for the defense or liability often lies somewhere other than with the party who is actually responsible. A thorough review of all of the contracts relating to the project is essential.

The contracts and other documents that relate to the project and/or the problem in question should be reviewed for any risk transfer provisions. The types of provisions that one is usually looking for are indemnity agreements and additional insured provisions.

a. Enforceability – Are the Agreements of Any Value?

The agreements must be analyzed and evaluated to determine whether they are any good. Any indemnity agreement must meet the express negligence rule and making that determination is often no easy task. Additional insured (AI) provisions are generally straight forward but can often be limited in scope. Indemnity agreements can likewise be limited in scope and any contractual risk transfer provision must be carefully evaluated. Once that has occurred, the party with whom the responsibility or liability ultimately rests, that is the party that

has accepted the transfer of risk, must be notified. That party often has to be convinced that the contractual risk transfer provisions are enforceable against them and convinced that they owe indemnity and/or AI coverage in addition to being convinced that the work that they provide indemnity or coverage for is a cause of or part of or all of the problem.

b. Further Hurdles - Coverage

The contractual transfer of the risk may also not be the end of the story. There may be further indemnity agreements shifting the risk and obligations on down the line. Further, just because there is a contractual obligation for a party to name another party as an additional insured on their insurance policy does not mean that the additional insured coverage will apply. One of the main problems often encountered is a failure on the part of the party promising to name another as an additional insured to actually get any additional insured coverage under their policy or to get the additional insured coverage that they promised by way of contract to get. This highlights a mistake that is often made by general contractors and/or owners. They fail to review all of the pertinent documents at the time the agreements are reached and/or the project has begun and specifically fail to obtain and review the insurance policies of the particular contractor and subs they hire on the project. Most often the general contractor just asks for and receives a certificate of insurance from the subcontractor indicating that the subcontractor has applicable insurance coverage. The certificate may indicate that there is AI coverage. However, the certificate of insurance itself does not provide any coverage and is essentially for informational purposes only. The coverage, if any, is provided only by way of the insurance policy.

Additionally, the coverage, and more specifically the AI coverage provided under the insurance policy obtained by the sub-contractor, may not provide any of the AI coverage actually contracted for or very limited AI coverage. One of the more common problems or limitations on the scope of the AI coverage is the lack of completed operations coverage. The subcontractor will provide the additional insured coverage under its insurance policy but that insurance policy will only provide coverage for ongoing operations and will not provide any completed operations coverage. That does not do a general contractor a whole lot of good when he is sued for a construction defect a year or more after the project is completed. The insurance carrier for the subcontractor will deny the AI coverage because there is no completed operations coverage under its insured's policy.

c. Waivers of Subrogation

Another risk transfer provision that can cause problems or issues is a waiver of subrogation. In the construction industry, it is very common for contractors to have contracts containing waiver of subrogation provisions, but few people understand what these provisions actually mean when they enter into these agreements. A subrogation waiver is a release between the insured and the offending party prior to the loss, which destroys the insurance company's rights by way of subrogation. In the simplest terms, a waiver of subrogation means that the insurer gives up its right of recovery of damages from other parties who may be at fault, thereby accepting the risk of a future loss. The waiver is intended to avoid litigation over damage claims and protect the parties to a contract by requiring one of the parties to provide insurance for all the parties. Id. at 13. Lawsuits take time and can result in costly project delays. By including a waiver of subrogation clause in the contract, the parties agree to allocate the risk of the insured event to a particular insurer.

Understanding what a waiver of subrogation means is only half the challenge. The next part is determining the scope of the waiver and whether it bars an insurer's subrogation rights in a specific situation. In

order to determine the effect of a subrogation waiver, the language of the waiver and the type of insurance at issue must be examined. Jurisdictions have taken two approaches to determining whether an insurer's subrogation rights are barred. The first approach distinguishes between "work" (as defined in the contract) and non-work property. Under this approach, the waiver only applies to damages to the "work," i.e., if the "work" was damaged, the waiver applies. *Trinity Universal Ins. Co. v. Bill Cox Constr., Inc*., 75 S.W.3d 6, 11 (Tex.App.—San Antonio 2001, no pet.) The second approach, used by the majority of jurisdictions – including Texas, draws no distinction between work and non-work, but rather limits the scope of the waiver to the proceeds of the insurance provided under the contract. Id. at 11. This approach examines the source of the insurance proceeds, i.e. "whether the loss was paid by a policy 'applicable to the work.'" Id. at 12.

This second approach was used by the appellate court in Trinity to determine which claims were waived by the insurer. In Trinity, a fire arose at a building owned by Dog Team, Trinity's insured. *Trinity*, 75 S.W.3d at 8. BCCI was the general contractor restoring and renovating Dog Team's building. Id. The fire arose as a result of welding work performed by a subcontractor, de Leon. Id. Trinity had issued an all risk/builder's risk policy to Dog Team for the renovations. Id. In addition, Dog Team also carried a general liability policy. Id. Trinity paid Dog Team its policy limits of $300,000 for the fire damage and then filed a subrogation action against BCCI and de Leon. Id. The Agreement between Dog Team and BCCI, which was a standard form contract provided by the American Institute of Architects, contained a subrogation waiver clause in which Dog Team and BCCI waived

> "all rights against each other and the Architect, Architect's consultants, separate contractors described in Article 12, if any, and any of their subcontractors…, for damages caused by fire or other perils to the extent covered by insurance obtained pursuant to this Article 17 or any other property insurance applicable to the Work, except such rights as they may have to the proceeds of such insurance held by the Owner as fiduciary."

Trinity, 75 S.W.3d at 9. In this case, the Trinity policy was obtained before the contract between Dog Team and BCCI was entered into; thus, the policy was not obtained specifically for this contract pursuant to Article 17. However, the court interpreted "any other property insurance applicable to the work" as referring to "insurance applicable to the location of the work or the building containing the work. . ." Id. at 15. Trinity's policy covered the damages from the fire; thus "the policy constitutes 'other property insurance applicable to the Work.'" Id. Because Dog Team waived claims against BCCI to the extent the damages were covered by property insurance, Trinity had no right of subrogation. Id.

The analysis applied in Trinity also controlled in *Walker Eng'g, Inc. v. Bracebridge Corp.*, 102 S.W.3d 837 (Tex.App.—Dallas 2003, pet. denied). In Walker, the waiver between the building owner, MBNA, and contractor, Austin Commercial, Inc., applied to "damages caused by fire or other perils to the extent covered by property insurance obtained pursuant to this Paragraph 11.3 or other property insurance applicable to the work. . . ." Id. at 839-840. An electrical arc or short created a hole in a nearby water line and resulted in significant flooding of the first floor. Id. at 838. MBNA's policy provided over $800,000 million in building and property coverage, and the parties agreed the policy covered the water damage. Id. at 838-839. Additional builder's risk insurance under the same policy applied to new construction and improvements at the building. Id. at 839. After MBNA brought suit against Walker Engineering and others,

Walker argued the subrogation waiver barred any claims by MBNA for the damage resulting from the flooding. Id. at 839. MBNA asserted the waiver was not applicable because the flooding was not covered by insurance obtained pursuant to Paragraph 11.3 or other insurance applicable to the work. Id. at 839-840. The Dallas Court of Appeals examined the contract and the waiver. The contract placed the burden for obtaining property insurance on MBNA, and this property insurance was to protect all the parties from property loss. The scope of the builder's risk coverage did not alter the contract. Id. at 840. The subrogation waiver was found to extend to damages covered by the entire policy, including the builder's risk coverage. The addition of the builder's risk coverage to the policy did not change MBNA's contractual duties. The court decided MBNA's insurance was "applicable to the work" under the waiver of subrogation clause. As a result, MBNA waived its right to sue Walker under the terms of the waiver of subrogation clause. Id. at 844.

Another thing to remember about subrogation waivers is they only waive subrogation rights to the extent the damages are covered by insurance. For example, in *Temple Eastex, Inc. v. Old Orchard Creek Partners, Ltd.*, 848 S.W.2d 724 (Tex.App.—Dallas 1992, writ denied), a fire destroyed an apartment complex. The owner was responsible for purchasing property insurance that applied to the entire "work" at the site. The subrogation waiver at issue provided in part:

> The Owner and Contractor waive all rights against (1) each other and the Sub-contractors . . . for damages caused by fire or other perils to the extent covered by insurance obtained pursuant to this Paragraph 11.3 or any other property insurance applicable to the work . . . .

Id. at 729-730 (emphasis added). The waiver shifted the ultimate risk of loss to the owner and barred the owner and contractor from seeking damages for the fire from subcontractors. However, the waiver barred any claims only to the extent the damages were covered by insurance. Id. In this case, the stipulated damages exceeded the applicable property insurance. Id. at 731. The Dallas Court of Appeals found that this stipulation indicated the property was underinsured. Id. However, the contract also included a provision requiring the Owner to notify the contractor, in writing, if it did not intend to purchase insurance for the full insurable valued of the entire work. Id. Thus, the Dallas Court of Appeals concluded the Owner assumed the risk of loss for damages in excess of the insurance coverage, making the owner liable for damages to the extent that an insurer would have been had adequate insurance been in place. Id.

Subrogation waivers are often limited to perils such as fire and water damage that occur during the course of the project. The thought is that one or more of the parties will agree to procure the builder's risk insurance for the project. Such a waiver, however, does not apply to a defect claim that arises after a project is complete. A waiver of subrogation of this type and scope should not preclude a subrogation claim that is later pursued under a liability policy that has paid on the defect claim. The scope of the waiver is the key. Unfortunately, the waivers themselves are often not in artfully worded and lend themselves to less than clear interpretations.

C. Getting Everyone Involved

Once you have determined who all the potential parties are, you need to bring them into the action. If you are already involved in litigation, you need to bring them into the litigation with a third party claim. If you are in arbitration or heading to arbitration, you need to notify them of the arbitration and make demand upon them to submit to arbitration if they are subject to an arbitration provision. If not, you may want to invite them to the arbitration or consider pursuing a separate action against them or putting off that action until a later time.

There are often multiple theories of liability that can be pursued against these additional potentially responsible parties. The most common and easiest to pursue is a claim for contribution. With a claim for contribution you are essentially saying that if you are found to be negligent then the other party or parties were negligent too and should be responsible for their proportion of the liability and damages. There may also be a basis for an indemnity claim. Common law indemnity in Texas is very limited and has virtually no application in the context of a construction defect claim. Contractual indemnity, however, can be pursued in the context of a construction defect claim. The enforcement of these agreements (i.e. whether they meet the express negligence rule) is rarely clear. If there is such an agreement, it is often worth including along with the claim for contribution.

There may be a claim for breach of contract or breach of warranty available as well. These are often over looked when bringing claims against subcontractors and other potentially responsible parties but they can be powerful claims. If you have a contract with a party such as a subcontractor and there is potentially a problem with their work, then it is likely that they have breached that contract if there is a finding of deficiencies in their work. Similarly, if there is any warranty that goes along with their work and deficiencies are found with the work, it is likely that they have breached that warranty. A claim for breach of contract or breach of warranty typically provides a basis to recover attorneys fees as well, so you may be able to get some of your fees back for defending a portion of the claim. Additionally, a claim for breach of contract or breach of warranty can come in very handy when the plaintiff's only viable claim against you is one for breach of contract or breach of warranty. A contribution claim is only good under Texas law when there is a negligence claim against you. Stated another way, you cannot get contribution on a claim for breach of contract under Texas law. You can essentially accomplish the same goal of getting another responsible party to respond to a claim for deficiencies related to their work with a claim for breach of contract or breach of warranty if that is a viable claim.

Once all of the parties have been brought to the table, you want to complete the evaluation of the strength of the claims against each of the additional new parties. There may be coverage issues, including problems with the existence or scope of additional insured coverage. This can then lead to an assessment of the solvency of one or more of the parties. If it is a healthy contractor there may not be as much concern over whether there is coverage or not. Limitations issues should also be addressed. If there is a viable negligence claim against you, then there is always a claim for contribution and one for indemnity if there is a contractual indemnity provision. Limitations does not begin to run on any claim for contribution or indemnity until there is a judgment against the party seeking contribution or indemnity. Consequently, so long as there is a claim or lawsuit going on, there is going to be a potential claim for contribution or indemnity and it will not be barred by limitations. A claim for breach of contract or breach of warranty, however, is a different animal. Generally, however, if a party is involved in a claim or litigation and determines that the work of another party or parties is implicated and they have a basis for a claim for breach of contract or breach of warranty, that claim can be pursued. Limitations should run from the date on which the party making the claim discovers that it has a basis for a claim for breach of contract or breach of warranty (i.e. discovers a problem with the additional party's work). In any event, it is always wise to evaluate those issues at the time that you begin to pursue claims against the additional parties.

This evaluation is all part of developing and implementing a strategy for proceeding with the case now that the new parties have been added. Often the goal is to seek a resolution as soon as possible. Property owners generally want the problem fixed and

are generally looking to the general contractor and perhaps the principle design professionals to fix the problem. The additional parties are typically subcontractors and other design professionals who are retained by the principle design professionals and perhaps a manufacturer. Typically, the newly added parties are often hit cold with the claim and do not know anything about the problems that have been going on with the structure. The general contractor and principle design professionals have often been dealing with and investigating the problems for a while. It is therefore vitally important when you are one of the parties that has been dealing with the claim for a while that you share information with the newly added parties if you want to make any progress towards a speedy resolution. If there are expert reports, share them. If not, consider providing them with access to information that you have gathered and that has been assembled by your experts and consider having your expert or experts put together a brief summary for them. Certainly give them access to the property to investigate it for themselves. This is especially true if you are trying to coordinate an early settlement conference or mediation. Even if you do all of this, however, recognize the fact that time is an essential element. It takes a party time to digest the claim and the possible cause or causes of the problems, to determine if their work is in any way involved, and to accept the fact that it is. In short, it takes a party a while to "warm up" to the claim. Naturally, the more significant the problems are with a particular party's work and, more importantly, the more significant the expense in repairing that party's work and/or potential exposure for that party, the more time it is generally going to take that party to be willing to part with that kind of money. It is in many respects a process and there is only so much you can do to speed it up.

II. CONCLUSION

Once all of the parties have been brought into the action, the claim proceeds like any other claim in many respects. However, multi-party construction defect cases have some unique dynamics. Generally, no one is your friend and no one is necessarily your total enemy. It depends on the issue or issues in question and there are often alliances revolving around the various issues.

You will find yourself aligning with some parties on some issues and with other parties on others. Bringing in additional parties adds to the complexity of the claim but it also provides additional parties who can help to get the claim resolved. More importantly, it hopefully gets the parties there who should be there, forcing those who actually performed the work or who are responsible for it to respond to deficiencies in the work.