

# RA&MCO QUARTERLY

## The Design and Construction Newsletter

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### Residential Condominium Construction Defect Claims: Part 2, Risk Management and Loss Prevention

In the preceding quarterly newsletter, we identified the nature and major causes of construction defect claims made by residential condominium owners and Homeowner's Associations against constructors and design professionals. It was recognized that these are a very worthy source of affordable housing for many as they represent an efficient use of land and capital. However, the practical experience of those that design and construct them has frequently been problematic, in that claims sounded in tort and/or contract are common and may extend to all parties that have had anything to do with such projects and their insurers with resulting expense, time and personal frustration it creates.

The very collective nature of a Homeowners Association and its multiple members permit a virtual immediate "critical mass" to initiate and fund claims and litigation via aggressive law firms that specialize in this particular field. As an interesting sidelight, one of these attorneys once told your editor that in over 600 cases he had never directly sued a builder or a design professional. But of course in suing the developer or similar party, cross-actions that inevitably bring other parties into the suit are swift and certain. Such an expected "shotgun" approach creates a broad base for funding claims with demands being made to individual parties for compromise settlements, regardless of responsibility or culpability, recognizing the inevitable expense and uncertainty of outcome if one remains a defendant.

How can these risks be minimized or even avoided?

**1. Know Your Client** - While claims will usually originate from those who purchase their properties from your client developer or its agent and therefore you have no client relationship with them, the reputation and experience of your client on like projects is something that should be carefully investigated. Do not hesitate to ask around if you do not have successful personal previous experience with the owner/developer. Credit reports are also helpful as are a little used but valuable device of researching court records to see who they have sued and who has sued them over time. These are readily available and may contain a wealth of information to help you make your business decision to proceed (or not).

**2. The Project** - Does it appear to be sound and well conceived? Does it meet the "sniff" test of your experience and intuition? Is financing thin or highly critical? Are there permitting, code, licensing or local political issues?

**3. The Contract** - Is a standard format to be used that fairly balances the risks and rewards of the parties while providing you with an adequate scope of services, (such as AIA, EJCDC, CMAA, AGC, depending upon your role) not unfavorably altered, or rather an owner/developer document that unrealistically attempts to shift risk or limits parties' ability to perform competently? Is the schedule realistic and are parties' roles clearly identified and distinguished? What constitutes "substantial completion"? If the project involves apartments, have you dealt with the prospect of conversion to condominiums, at least for a given number of years? How and under what conditions are you going to get paid?

**4. Claims** - How are "claims" (extras, change orders) v. "claims" (liability claims against the parties seeking damages or services) to be dealt with under the contract? Is a preferred fair form of alternative dispute resolution to be used? As you provide design documents for it or as you build it are your project records documents organized safely and stored for prompt recall in the event of a claim? Do you have good communication with your liability insurer for advice when problems arise in addition to when actual claims are reported.

**5. The External Legal Environmental** - The various States have statutory limitations of varying lengths of time for bringing or perfecting litigation for design and construction defects based upon whether they are patent (observable or obvious) or latent (not readily observable and possibly hidden or concealed). In addition, some States have enacted or are prepared to enact statutory dispute resolution procedures for residential construction defect claims, e.g., California's SB800, the updated, revised "Calderon Act." Would a given project be subject to such? Is the project located in a highly plaintiff-favorable jurisdiction?

**6. Financial Strength and Business Reputations of Project Construction Participants** - Do co-participants in the design and construction of the project have adequate staffing and financial resources to be able to perform their functions upon which others are co-dependant? What quality controls are to be instituted? Are all participants expected to be in business years hence when "long-tail claims" are most likely to arise? Are all parties adequately insured?

These are some of the key issues to deal with when contemplating a residential condominium project. By observing them prudently, one can dramatically reduce, but not eliminate, exposure to design and construction claims that may arise.

### Coming Next Quarter: Liability Insurance: What it really is and why it costs you what it does.

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