



## **2021 CLM Construction Conference**

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San Diego, CA

### **Construction Defect Claims are Stuck on Stucco.**

#### **I. The Catalyst for the Panel Conversation...Construction defect cases in stucco continue to rise.**

Consider the multi-million-dollar settlements for stucco claims in recent memory from homebuilders such as DR Horton, Pulte Group, and KB Home. Claims and litigation surrounding stucco continue to rise in claim value and settlement demand, as well as frequency of such allegations. It is now more commonplace to see new homeowner/condominium associations or newly constructed buildings have multi-million-dollar construction defect claims for stucco damage and repairs. And it would appear, at least in how we talk about stucco claims and litigation, that the volume and the claimed amount continues to rise. Stucco design and installation has evolved through the years, but the requirements have been in the Building Code for decades. By now, it is reasonable to think that most designers and contractors know the nuances of stucco design and installation methods, yet the construction defect claims, and litigation continues.

#### **II. Current and Historical Construction Practices - Vulnerability and Concerns**

##### **Building Codes**

The following general requirements are included within the International Building Code (IBC), which is the model building code for the U.S. and many other countries; moreover, the same general requirements are included within the IBC and state codes as well as their residential counterparts.

- Providing a weather-resistant exterior wall envelope.
- Stucco installation to be compliant with ASTM C926 and ASTM C1063.
- Two or three coats of stucco depending on substrate.
- Metal lath and attachments comprised of corrosion-resistant material.
- Approval process for other materials and alternatives

The building codes remain largely consistent across the country, with the same general requirements governing stucco installation from California to New Mexico, to Florida.



### **Environmental Factors v Performance**

Stucco has been shown to perform well in hot and dry environments; with a reduced severity of resultant damage to underlying structural framing and interior finishes resulting from moisture. A blocked weep screed, reverse-lapped flashing, or deficiently placed scratch coat is more prone to result in damage to underlying components in an environment like Florida given the wet environment. With more moisture comes more opportunities for more moisture intrusion. Moisture stains on drywall and suspected fungal growth (mold) are easily identified by homeowners and plaintiffs; identification of the problem sets the litigation in motion.

### **Increase in Construction Costs, Labor Shortages, and Expectations**

Today's construction market continues to be a driving factor in claims. The cost of materials for construction has risen sharply. On June 1, 2020, the timber commodity was approximately \$300 and one year later was over \$1200. That is in an increase of 300% in just one year. There is no doubt that COVID-19 has had a huge effect on our daily lives and the construction industry was also largely impacted by COVID-19.

Of course, the cost of increase in materials cost is being passed on to the consumer but the increase in material cost also leads to trying to find savings elsewhere to salvage or maximize profit. Labor is one of those areas. According to Dodge Data and Analytics, "Labor and materials shortages may also continue to challenge the industry."

## **III. Common Defects and Where Responsibility Lies**

### **Stucco Installation**

Construct defect cases have included files where there were deficiencies directly with the stucco installation including:

- Surface Preparation
- Thickness
- Mix design and installation
- Installation of accessories (including lath)
- Substitutions
- Joints
- Terminations

### **Other Potential Responsible Party(ies)**

But there are other potential causes of cracks and moisture intrusion that should be investigated to thoroughly understand where the responsibility lies. For example, proper review of the design documents including specifications, design drawings, request for information, change orders, and contracts will provide insight on the interaction of all parties.

For example, cracks in stucco could be a result of thickness or joint installation but could also be a direct result of specified joint spacing (designer of record) and/or settlement of the structure (Geotech, general contractor, designer of record, earthwork contractor, and/or foundation contractor.)

Moisture intrusion into a building could be the result of ineffective stucco installation but could also be attributed to:

- Ineffective moisture barrier in masonry walls
- Vapor barrier below the slab
- Interface between stucco to the fenestration systems (windows/doors) including spacing and sealants.
- Slope of grade
- Design

### **So, Changes Happened – Who Is Ultimately Responsible – Using California as an Example**

A review of an article written by Murtaugh Law revealed that under California Law, the question of who is potentially liable for injuries/damages arising from defects caused by a project's design depends on several factors. The article notes that, "California has a number of cases in which Courts have held that contractors that follow a project's plans and specifications without deviation are not liable for any damages caused by design defects. For example, in *Barnthouse v. California Steel Buildings Co.* (1963) 215 Cal.App.2d 72, the Court found that a grandstand was built by the general contractor in accordance with the plans and specifications that the general contractor was bound to follow because of their contractual obligation..." This discussion can serve as a reminder for contractors to construct what is specified, seek answers when something is not clear, and to avoid inference.

### **Risk Transfer within Construction Projects - and the Law**

Typical projects have a wide variety of interested parties starting with the owner and developer, with inclusion of architects, designers, design professionals, engineering professionals, contractors and/or construction managers, subcontractors, and material suppliers. Discussions between two parties can impart risk, effectively transferring the risk from one to the other.

By contract, the owner and developer generally assume little responsibility and risk in the quality of the construction, with the disclaimer that they continue their roles and set boundaries; this effectively separates them from the design, construction, and material supply. Remaining detached and as a delegator, the risk of imparting opinions and

direction is minimized from claims of Errors and Omissions (E&O) or negligence at a later date.

Design professionals (i.e., architects and engineers) are held to their contract as well as working within established industry standards, and thus their standard of care. Given standard of care is its own topic, it will be briefly touched on herein. Standard of care can be expected to be a center of the discussion in cases where changes occurred during construction – should these changes have been allowed by the design professional? Boiler plate contracts between owners/developers and design professionals generally have been effective in protecting design professionals; however, multiple citations indicate the margin of victory was slim. With the changing dynamic in construction defect claims and litigation, the industry may need to prepare to open a can of worms if a case goes sideways.

By contrast with design professionals, contractors have been less successful in the outcome of litigious cases of this nature. General contractors are required by contract to construct a building or structure in accordance with the contract, plans, and specifications. Allegations of defects typically note deviation(s) from these documents. With general contractors that retain subcontractors, and the defect was a result of a general contractor, wording within the contract documents becomes more relevant. For instance, language might note that the general contractor expressly assumes responsibility to the owner for the actions and omissions of subcontractors. With these implications, the work completed by subcontractors complicates the insurance industry and indemnity obligations.

#### **IV. Current and Historical Claims Handling and Defense**

History has shown there to be a larger number of higher-valued stucco claims. Environmental conditions may be contributory; however, the litigious environment may be driving the discussion as well. Stucco claims have been, and continue to be, a primary culprit for construction defect claims, especially in Florida. The industry recognizes Florida as a state known for its large number of lawsuits and large settlements, often with such cases later presented within the industry for discussion purposes. Examples include:

##### **Case Study - D.R. Horton v. Heron's Landing Condo Association**

A \$9.6 million verdict was awarded in the case of D.R. Horton v Heron's Landing Condo Association in 2016, and upheld in 2020, in part due to alleged stucco deficiencies (266 So. 3d 1201, 1208 (Fla. 1st DCA 2018)).

Note 1: for round-table discussion with risk managers, claims professionals, experts, and attorneys.

Note 2: details for this discussion were found in public documents.

### **Case Study – Office of the Attorney General v. KB HOME**

A Stipulated Consent Decree and Final Judgement was issued in which KB Home agreed to pay \$94.5 million for:

- Repairs. This sum included \$71 million in repair work that had previously been performed in the Waterford, Willowbrook, and Palm River communities (2016-CA-300). KB HOME will make additional repairs as described in the Stipulated Judgement.
- Costs for upgraded materials, improved construction techniques, and additional training (\$17 million)
- Monetary payment. (\$6.5 million *for restitution of consumers affected by KB HOME's conduct, costs of administration of the settlement, attorney's fees and costs incurred in the investigation of KB HOME, future monitoring expenses, and any other purpose permitted by Florida law in the sole discretion of the OAG.*)

### **Case Study - Office of the Attorney General v. PulteGroup, Inc.**

PulteGroup, Inc. entered a Stipulated Consent Decree and Final Judgement in December 2018 for \$78.7 million for:

- Repairs. This sum included \$64 million previously spent to repair homes in the Berkshire Park, Berkshire Place, and Legacy Park communities involving alleged stucco defects (2018-CA-2723). Pulte will make additional repairs as described in the Stipulated Judgement.
- Costs for upgraded materials, improved construction techniques, and additional training (\$10 million)
- Monetary payment. (\$4.7 million *to compensate consumers for the losses relating to property damage to their homes, and to pay costs of administration of the settlement, attorney's fees and costs incurred in the investigation of Pulte, future monitoring expenses, and any other purpose permitted by Florida law in the sole discretion of the OAG.*)

Large awards and settlements are commonplace in cases involving HOA's and COA's, when there are hundreds (or thousands) of building units grouped together. The volume of building units allows for greater investment by the plaintiffs with an inferred end goal of a significantly higher settlement. Moreover, when the owners are part of an Association, the Association's board of directors generally has the ability to speak for all of the owners, instead of the attorney needing to seek permission and written authorization from each owner.

## **V. Hindsight, Foresight, and Lessons Learned**

### **Is the Past a Predictor of the Future?**

Laws and legal precedents regarding construction defects continue to evolve. What have we learned and how do we keep up? The intent is to learn from past mistakes and adopt what was learned into decisions made going forward. Communication and education are a large part of this. Communication between the developer, designers, contractors, and subcontractors goes a long way in preventing issues that have to be dealt with later including construction defects.

### **What Does this Mean for Underwriting, Risk Managers, Claims Professionals, Experts, Attorneys?**

How do we adapt to the "new norm" of stucco claims, from the frivolous to the earnest? Stucco claims may not be avoidable, and they surely are not going away, but we can (and should) be better prepared. Communication and education are just as important on the claims side in prevent missteps as they are on the design and construction side to prevent unwanted construction defects.