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Litigation Impact from Changes During Course of Construction: Future of Defect Litigation

I. The Domino Effect

Changes during the course of construction happen daily; and they will continue to happen long into the future. The impact of such changes can be mitigated with education, knowledge, and preparation on the front end (i.e. underwriting and risk management), during the duration of a project (i.e. design and construction teams), and at the back-end, following allegations of defect (i.e. claims, experts, attorneys). Determining the root cause of any issue helps define what happened and can provide explanations to all that inquire. Changes during construction produce a domino effect and thus, this narrative (and round-table panel), will seek to explain the cumulative effect that is produced by one event (or decision) that sets of a chain of similar events and impacts everything downstream.

Is Communication the Difference?

Communication between design professionals, construction crews, insurers and product manufacturers varies from project to project. Communication is the act of conveying a message from one person to another – whether it's verbal or non-verbal. Effective communication is the cornerstone of completing successful construction projects with clear and direct communication leading to improved teamwork, better project collaboration, and less hiccups on the front end; while bad communication leads to conflicts including construction delays and construction defects. As simple as effective communication would appear to be, it is far too often the source of conflicts. The level of communication across the project team, including but not limited to the owner, developer, designer(s), and contractor(s), may be dependent on the completeness of plans, dictated by the contract, or even the product of direct experience with differing construction methods.

Through the course of construction communication is completed in a number of methods: verbally on site between the design team and construction team, project managers and laborers, between contractors and subcontractors, with material suppliers and manufacturers, and other entities. Documents go back and forth between these parties including electronic correspondence, requests for information (RFI), submittals, and change orders. All of these expectations are spelled out in the contract. However, one question remains – does communication across the project team happen often enough when what is perceived as a

simple change (or omission) creates a domino effect through adjacent and ancillary pieces of the project?

Communication: A Scope Item or Contract Requirement?

On any project where a change occurs during the course of construction, whether a big change or small change, communication across all interested parties aligns directly with the scope of work for the project. Changes to the scope of work can be one of the most contentious areas when addressed properly, but when avoided or ignored, can be one of the most contentious areas. Scope changes generally result in an increase in cost or schedule, which leads to disputes between who is responsible for the change, the delay, or defect. Common causes of these conflicts include a lack of transparency or understanding of obligations under the construction contract(s), failing to document changes during the construction process, and/or simply inferring changes without communicating through the necessary parties.

Mitigating this type of dispute can be a mutual understanding of the scope contained within the executed contracts between all parties; for instance, having a clear understanding what is included and excluded as part of the scope of work. Furthermore, the project owner (and end-client) would expect communication to be ongoing and constant during a project, especially in instances when the scope of work is deviated from for any given reason. Effective communication between interested parties of a project, is, and should be considered a scope item.

II. Changes to Projects During the Course of Construction

Where and Why Do Changes Occur?

Changes in the design or construction occur during construction projects for many reasons – with common reasons including but not limited to value engineering, owner changes, differing site conditions, and other complications. The successful completion of a project hinges on transparency between the design and construction teams; however, what happens when this transparency doesn't often occur when a design professional makes a minor change but doesn't make necessary changes to the means, methods, or products used? This is a "vice versa" hypothetical for a contractor as well. A simple and common response from either side (design or construction) is, "inference." The design professional inferred the contractor would make the proper modifications to make the modification work; while the contractor inferred the design professional reviewed the modification and given the lack of protest, accepted the change.

Dangers of Inference During Course of Construction

The definition of inference must first be established for discussion purposes. The Oxford online dictionary describes an inference as "A conclusion reached on the basis of evidence and reasoning." The Wikipedia article on inference describes inference more precisely, characterizing inference as both the conclusion reached and the process by which it is reached. Per Wikipedia, inferences are steps in reasoning, divisible into three kinds: deduction, induction, and abduction. Deduction is the inference most commonly associated with scientific principles

in the context of construction disputes. Deduction is inference deriving logical conclusions from premises known or assumed to be true.

There are dangers of inference during the course of construction that must be considered; the assurance of inference is the use of reasoning and logic to arrive at a conclusion based on previous experiences (i.e. previous projects). Inference by a design professional or contractor may sometimes be correct; however, inferring another's intent sets a dangerous precedent. All professionals are implored to employ sound reasoning or logic – though the cleanest way to avoid inferring incorrectly would be through communication. The same principle applies in litigation that ensues following an incorrect application of inference (discussed later within this document).

Change Orders and the Law

As introduced previously, changes in the design or construction occur during construction projects for many reasons – rather than inferring the intent of a change, communication of the change between interested (i.e. all) parties is important; same goes for formally acknowledging this change in change orders. Most construction contracts contain a clause allowing for change orders. This clause is a necessity to account for unforeseen circumstances (noted previously) that typically arise during a construction project. Courts of law define change orders as written orders to the contractor signed by the owner, design team, and applicable contractor(s), which is issued subsequent to the execution of the contract; the change order authorizes the change in the scope of work, adjustment in cost(s), and/or contract duration.

An article published by Law Insider notes sample clauses from construction contracts, with the following excerpt for discussion: *“Change Order. A written order which is signed by DESIGN/BUILDER and OWNER which authorizes an addition, deletion or revision in the Work, or an adjustment in the Contract Price or the Contract Times, issued on or after the Effective Date of the Agreement.”* Important to note within this excerpt are the “addition, deletion, and revision” in the scope of work, thus implies transparency and acknowledgement of project changes by the interested parties. Change orders typically occur quickly, require decisions on the fly, and can be approved without due diligence. The purpose of this continued discussion relates to the cases where these changes occur, were known, and were implemented – but, the changes were not vetted entirely resulting in inherent issues in the project and/or resulting defects.

When playing Monday morning quarterback, these changes might be more visible; hindsight is 20:20. However, there are legal implications remaining with the parties that were involved with the changes; and thus, this discussion continues on what's next for the industry.

Changes Originating with the Design Team – Case Study

Note1: for round-table discussion with risk manager, claims professional, expert, and attorney.

Note2: specific identifiable details have been omitted/changed from this discussion for privacy purposes.

A multi-unit, high-end residential building in the Western US was subjected to basement-level water intrusion following the completion of the project. The water intrusion was cyclical and resulted in interior damage to finishes and contents. The following outlines specific details related to the enclosed discussion:

- Previously permitted project proceeded forward with foundation construction taking place during the fall months when the cyclically high water table was lower.
- Excavation was complete and some of the foundation work was already underway when the City rejected the permit drawings depicting a dewatering design which included waterproofing membranes, a sub-slab drainage system, and sump pumps which were to discharge into the city right of way (ROW).
- The City indicated that in order to discharge into the ROW, a stormwater and drainage study was required; of note, these studies took approximately six to 12 months to completed.
- Rather than delay construction, the design team decided to change the waterproofing system to a “bathtub” design – in essence, the basement was to be completely (100%) waterproof relying solely on the waterproofing. This was completed with no additional changes to the configuration and/or construction methods.
- Fast-forward to completion. It was found that when the design was changed, the bathtub waterproofing was incomplete at areas where construction was completed; absent of water stops, foundation admixtures, and other elements that would have worked to seal the basement. Additionally, the waterproofing was on the outside of basement window wells which collected water; as constructed, the inside of the window wells was effectively “inside” the bathtub.

It was determined that the design team and construction team inferred the details to be completed by the other. Litigation ensued.

Changes Happen in Field by the Contractor(s) – Case Study

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A mixed use, high-end condominium and office building in the Western US was under construction and nearing 90% completion. Over 150 exterior balconies serving the residential units were located on the building. A project foreman identified an issue with balcony flooring in contrast to the plans and specifications; oriented-strand-board (OSB) had been used in lieu of plywood. The following outlines specific details related to the enclosed discussion:

- Drawings and specifications stated for plywood to be used at balcony (and other) specific locations.
- The OSB was notably incompatible with the membrane to be used below the balcony floor system.
- The design team had not been notified of material substitutions.
- The subcontractor noted that he opted for a change with one of the general contractors due to costs/schedule; they noted the change of materials would be applicable and standard practice.

It was determined that the construction team inferred the change to be okay without seeking council of the design team. The design team provided an applicable change in design and construction, where possible, to avoid removing the installed materials. The project experienced a timely delay in completion. Litigation ensued.

Negligence/Errors and Omissions

There are duties and obligations created by the courts applying common law which introduces the discussion of negligence; which is alleged in the breach of contract litigation. Applicable in this discussion is whether changes made during a construction project would be defined as negligence or Errors and Omissions (E&O) [Professional Liability] – and where the negligence lands (i.e. who is responsible?).

Negligence is a legally defined term; negligence is a cause of action in Tort that must consist of specific elements including the following:

- one person owes a duty to take reasonable care to another;
- the duty of care has been breached;
- the breach of duty caused injury or damage to another; and,
- the loss sustained was not too remote a consequence of the breach of duty

III. Transferring the Risk

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 *Barnhouse 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

As stated previously, 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 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. Litigation Impacts: Past and Future

Is the Past a Predictor of the Future?

The increase in education of all parties involved in construction is on the rise, with the end-game of minimizing existing and future risks. The intent is to learn from past mistakes and adopt what was learned into decisions made going forward.

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

Risk management techniques and strategies are designed to identify risks and consider how best to protect against risks. Concepts like contract integration and ensuring appropriate commercial insurance policies are in place are often key components of comprehensive risk management systems. However, many companies fail to identify areas of high frequency exposure, high severity exposure, and address them proactively, or to consistently review or audit claims that do arise. This means they're not understanding the "big picture" for the company. A lot of the construction defect cases can really be interpreted through the lens of a lack of comprehensive risk management. This underscores the need to educate from the top to bottom, front-end to back-end.

V. Why Communication Matters – Lessons Learned

Understanding some of the subtle and not-so subtle nuances with risk transfer in construction projects is invaluable for any individuals that are litigating construction defect claims. Knowing what questions to ask insureds, claimants, and others can quickly identify where the breakdown in a project occurred. When the breakdown can be confidently understood, vetted, and confirmed, the root cause and responsible parties is clearer for all interested parties. This transparency subsequently eliminates the gray areas, while determining black and white; in other words, conjecture vs. facts. This provides support to the claims and litigation process and helps eliminate problems that arise downstream between, insurers, insureds, and third party risk transfer.