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Sweeping Changes to Right to Repair: Big Improvement or Big Mess?

I. Sweeping Changes to the Right to Repair (Introduction):

Costly construction defect litigation has been a mainstay of the defense arena for many years with far reaching consequences for builders, subcontractors, insurers, and their counsel. These entities contend the system is broken. As a result, many groups lobbied for change and succeeded. Several states have seen sweeping changes via the enactment of right to repair statutes and subsequent modifications to these statutes. The question is whether or not these changes are what the industry needs? Or, do the changes worsen an already broken system?

The answer to these questions depends on your perspective: insurer, builder, or subcontractor. The answer also depends on where you may do business and which changes are being discussed.

A. *In Arizona*: on March 23, 2015, the governor signed into law H.B. 2578, a bill significantly modifying the Purchaser Dwelling Act ("PDA") (A.R.S. 12-1361 *et. seq*).

B. *In California*, SB 800 (Civil Code sections 895 through 945.5) became law in January 2003, and was designed to be an effective right to repair statute. It was intended to supplant and deter construction defect lawsuits before they even started. But then *Liberty Mutual* (August 28th 2013) and *Burch* were decided.

C. *In Nevada*, on February 24, 2015, Governor Brian Sandoval signed Assembly Bill 125 (AB 125) into law. For the first time since the 1930s the Nevada legislature is dominated by Republicans. In 2015, despite a strong Plaintiffs bar and a strong pro-Plaintiff judiciary, the construction industry in Nevada managed to achieve almost everything they were looking to achieve with the passing of this bill.

D. *In Florida,* HB 87 updates the procedure for filing a notice of construction defect claim in Florida, pursuant to Chapter 558, Florida Statutes. Chapter 558 was originally created in 2003 to provide for an alternative method to resolve construction disputes that would reduce the need for litigation as well as protect the rights of residential property owners. In 2006, Chapter 558 was expanded to apply to commercial construction. Under Chapter 558, before a claimant can file a lawsuit against a contractor, subcontractor, supplier, or design professional, the claimant must serve written notice and provide the party with an opportunity to resolve the alleged construction defect, pursuant to specific statutory requirements. HB 87 was approved by the Governor on 6/16/2015 and becomes law on 10/1/15.

E. *In Colorado*, pending Senate Bill 15-177 will revise CRS 13-20-808 *et seq.*, imposing restrictions on Plaintiffs.

F. *In South Carolina,* the South Carolina Notice and Opportunity to Cure Construction Defects Act, S.C. Code Ann. §40-59-810, *et seq.,* (and corresponding commercial construction Act §40-59-500), has been in effect since 2003. The statute has been increasingly criticized as "having no teeth," although it is framed around the same principles as the right to repair statutes noted above. Future amendments/revisions should be anticipated on this basis.

II. Change and Narrowing of What Constitutes a Construction Defect:

A. *Type of Change:* Progressive narrowing of the definition of what constitutes a construction defect.

In Nevada the prior definition of a "constructional defect" under Chapter 40 was broad. AB 125 changes that. "Constructional defects" will now be limited to defect claims which present an unreasonable risk of injury to a person or property; or which are not completed in a good and workmanlike manner and proximately cause physical damage to the residence or appurtenance at issue.

In California, in order to recover under a negligence theory, a showing of damage has long been required. *Aas v.s Superior Court*, (2000) 24 Cal.4th 627. The effect of *Aas* was changed by SB 800 which undermined *Aas* by creating functional performance standards in many areas that do not require damage in order to be recoverable. Post *Liberty Mutual Insurance Company v. Brookfield Crystal Cove LLC* (2013) 219 Cal.App.4th 98, and *Burch vs. Superior Court,* (2014) 223 Cal. App.4th 1411, claimants are able to avail themselves of both SB800 and common law remedies.

In Arizona, the statute now defines "Construction Defect" to be "a material deficiency in the design, construction, manufacture, repair, alteration, remodeling or landscaping of a dwelling that is the result of one of the following:

- A violation of construction codes applicable to the construction of the dwelling;
- The use of defective materials, products, component or equipment in the design, construction, manufacture, repair, alteration, remodeling or landscaping of the dwelling;
- The failure to adhere to generally accepted workmanship standards in the community."

It also defines "Material Deficiency" as: "a deficiency that actually impairs the structural integrity, the functionality or the appearance of the dwelling at the time of the claims, or is reasonably likely to actually impair the structural integrity, the functionality or the appearance of the dwelling in the foreseeable future if not repaired or replaced."

B. Impact Based upon Perspective:

The narrowing of what constitutes a "construction defect" under right to repair statutes is likely an improvement from a defense perspective, as litigation costs directed at specific disputes over reimbursable damages may be reduced. For example, the prior broad language of Nevada's Chapter 40 promoted protracted expert battles. The revisions should somewhat reduce this area of dispute in Nevada.

One may also argue that certain aspects of the revised language are more closely aligned with traditional notions of property damage. We note in this regard that commercial general liability (CGL) "property damage" language turns upon "physical injury to tangible property" or "loss of use of tangible property not physically injured."

III. Limitations on Builder's Rights to Indemnity and Enactment of Anti-Indemnity Statutes:

A. *Type of Change*:

There has been a wave of anti-indemnity statutes across the country with almost every state having some sort of anti-indemnity statute relating to construction on the books, except Maine, Washington DC, Vermont, and Wyoming.

With the implementation of AB 125, the Nevada Legislature followed suit. The new law essentially invalidates any indemnity provision that requires a subcontractor to indemnify and defend the general contractor or the developer for their own negligence or intentional acts.

California already has a statute right on point enacted long ago and expanded many times. California CC sections 2782 and 2782.05. Nevada's AB 125 goes on to specifically allow for indemnity provisions that require indemnity for damages arising out of the subcontractor's scope of work. So this statute now mirrors California law in residential construction only. California has far more reaching anti-indemnity statutes not limited to residential construction alone.

The Colorado statute, C.R.S.A. §13-21 *et seq.*, is consistent with the statutes described above and also specifically prohibits a construction agreement provision that requires a party provide additional insured coverage for "damage to property from any acts or omissions that are not caused by the negligence or fault of the party providing such additional insured coverage," as such is void against public policy.

Note that recent changes in ISO additional insured endorsements (2013) also attempt to reinforce anti-indemnity statutes that specifically prohibit additional insured status where an indemnitee is negligent by stating that additional insured coverage, apart from other limitations, is only provided "to the extent permitted by law."

B. Impact Based Upon Perspective:

The increase in anti-indemnity statutes should be helpful to insurers from an underwriting/risk transfer perspective. They may provide a check on expansive additional insured coverage that was not otherwise intended through the underwriting process (California specifically exempts additional insured coverage by statute).

As a practice pointer for insurance professionals, it is important to always keep in mind that the underlying indemnity agreement does not govern available additional insured coverage, the policy language does. Similarly, anti-indemnity statutes are not dispositive for purposes of evaluating an insurer's potential defense obligation to an additional insured. A potential defense obligation to an additional insured must be evaluated based on the pleadings, facts and applicable policy language, in the same manner as a direct named insured claim.

IV. Changing Landscape on Plaintiffs Rights to Attorney's Fees:

A. *Type of Change*:

Attorney fees have probably been the single most prevalent factor driving construction defect cases throughout the country. In Nevada, prior to AB 125 attorney's fees were a recoverable item of damage in a Chapter 40 case (construction defect litigation) and made all of these cases far more expensive to litigate. But the tide has turned. Now, homeowners can still recover the reasonable cost of repair, loss of use, and interest, but they cannot recover attorney's fees.

So Nevada now mirrors CA in this regard, namely there is no right to recover attorney fees unless enumerated by statute or provided for by way of contract. (Please note that attorney fees may still be recovered by a homeowner or general contractor if provided for in a written contract).

To make things better for contractors, insurers, builders and subcontractors in Nevada, the new law also limits the recovery of expert fees and costs to those reasonably incurred for construction defects actually proven to exist not merely alleged.

In California claimants are entitled to what are called are Stearman fees (*Stearman v. Centex Homes* (2000) 78 Cal.App.4th 611), which are essentially reasonable expert fees and costs, as a recoverable item of damage in construction defect litigation.

In Arizona, the new bill enacted in 2015 also eliminated a right to attorney's fees. The prevailing party is no longer statutorily entitled to recover its attorneys' fees, experts' fees and costs (Repeal of A.R.S. 12-1364).

B. Impact Based Upon Perspective:

In Arizona, the elimination of recovery of attorneys' fees under 12-1364 is a victory for builders and may have a chilling effect on some Plaintiff's lawyers' willingness to bring these claims. While this provision eliminates mandatory recovery, a court could still exercise its discretion under ARS 12-341.01 and award attorneys' fees to a prevailing party for homes owned by original purchasers.

The same can be said about Nevada. Many firms will simply drop out of this area of litigation when the upside changes. This is also a significant improvement for insurers of Nevada contractors and subcontractors, who have been subject to excessive damages demands based, in part, on claimed accrued attorneys' fees. Attorneys' fees demands have served as an effective hammer in Nevada to draw insurers in and prompt settlements at the early stages of a given claim.

V. Limitations on the Statutes of Repose:

A. Type of Change:

California has long had a set 10 year statute of limitations for construction defect. SB 800 changed the statute of limitations when it set certain functional standards and actually lengthened some of those statutes by specifying longer statutes of repose for certain types of defects.

California still has separate statutes of limitations for patent and latent defects, as well as different statutes of limitations for claims that arise under the right to repair act. Prior to AB 125, Nevada had a confusing statute of repose scheme for construction defect claims. Nevada imposed a different statute of repose based on whether the defect was patent, latent, known to the contractor, or caused by "willful misconduct" of the contractor. To make matters worse, each statute had a provision whereby, if damage occurred in the last year of the statute of repose, the homeowner had an extra two (2) years to bring the claim.

AB 125 now creates a single statute of repose, 6 years for all actions. In other words, all actions for construction defect must now be commenced within six (6) years of the substantial completion of the home, unless tolled. In any event, the statute applies retroactively to actions where substantial completion of the home occurred prior to February 24, 2015 (with a one year grace period for certain homeowners).

The Nevada legislature went on to limit those instances of tolling as well. Under the old version of Chapter 40, notice tolled the applicable statutes of limitation basically until the conclusion of the required mediation. The problem was there was no force behind the statute because there was no requirement for the homeowner to diligently pursue the pre-litigation process. So it has not been uncommon in Nevada for a case to languish in the Chapter 40 process for years. The new bill changes that. Now, AB 125 limits tolling to no more than one year, with one exception. The tolling period can exceed one year if a homeowner commenced an action after the expiration of the statute of repose or limitation, and the homeowner can show good cause for the tolling to last for a longer period.

Arizona attempted to follow suit in shortening the statute of repose in 2015. The original House Bill contemplated a reduction of the Arizona statute of repose to six years plus one. That portion of the House Bill did not make it through the Arizona Legislature. Thus, the statute of repose in Arizona remains eight years plus one if the defects are discovered in the eighth year.

Florida submitted its own legislation in this arena. HB 501 was aimed to decrease the statute of repose provided in Section 95.11(3)(c) on actions founded on the design, planning, or construction of an improvement to real property from 10 to 7 years. Consequently, any such action would need to be commenced "within 7 years after the date of actual possession by the owner, the date of the issuance of a certificate of occupancy, the date of construction if not completed, or the date of completion or termination of the contract between the professional engineer, registered architect, or licensed contractor and his or her employer, whichever date is latest." However, this bill was killed at the judiciary review level.

B. Impact Based Upon Perspective:

One practical consideration as to enforcement of statutes of repose that comes up frequently for insurers pertains to disparities in state and local procedures for issuing a certificate of occupancy ("COI") for a residential dwelling. Specifically, while the governing statutes and/or regulations may indicate that a county or municipality is responsible for a COI, there may be flexibility in the statutes or regulations to delegate this responsibility to certain governmental or quasi-governmental entities. In plain terms, the issuance of a COI can be somewhat random from county to county such that an insurer's investigation as to a statute of repose issue or a trigger of coverage issue can become much more complex. The practice pointer here is, once you develop a base of information for claims from a certain state and/or county within that state as to how the COIs are actually issued, you should track that information for claims investigation purposes and in order to avoid "reinventing the wheel" on this type of an issue.

VI. Changes to Pre-litigation Procedures:

A. *Type of Change*:

In Nevada, under prior law, contractors saw the same notices go out in every case with a laundry list of all conceivable defects. AB 125 eliminates the common constructional defect notice procedure, i.e. a notice given by one or more homeowners for themselves and other 'similarly situated' homeowners in their community. The new Chapter 40 notices require a homeowner to identify in specific detail each and every defect and the associated damage and injury, including the exact location of each defect, damage, and injury. Moreover, the notices must contain a signed verification from the homeowner stating that he or she has verified the defect. If the notice is given by the Home Owners' Association (HOA), it must be signed by a board member under penalty of perjury.

Under the new bill, a homeowner is required to be present during Chapter 40 inspections and is required to identify the exact location of each alleged construction defect specified in the notice. Furthermore, if the notice contains expert information, the expert is also required to be present to provide the contractor with the same information.

In Florida's changes to the right to repair statute, the bill amends requirements for filing a notice of claim. HB 87 initially amended the language of Section 558.004(1)(b) to require more

detailed information to be contained in a notice of claim. However, the latest Committee Substitute reduced the specificity required.

At present, the notice must describe the claim in reasonable detail and must sufficiently identify the location of each defect to enable the responding party to locate the defect without undue burden. It does not however require destructive or other testing.

It is also noteworthy that Section 558.004(15) provides for the exchange of documents concerning alleged defects, and does so in broad fashion. The parties are specifically allowed to assert that documents are privileged under this section.

The bill goes on to provide that a written response to a claim must include one or more offers or statements that the respondent disputes the claim, or that the respondent will remedy the claim, compromise and settle the claim by means of a combination of repairs and monetary payments, or await a determination by an insurer.

HB 87 also amended Section 558.004(4) to provide a requirement that the written response "include one or more of the offers or statements specified in paragraphs (5)(a)-(e), as chosen by the responding contractor, subcontractor, supplier, or design professional, with all of the information required for that offer or statement."

Florida law also changed the definition of the term "completion of a building or improvement" under Section 558.002(4). The statute has been revised to include the issuance of a temporary certificate of occupancy. Under Chapter 558, the notice and cure process requirements under Chapter 558 do not take effect until the building or improvement has been "completed." Prior to 2015, completion of a building or improvement means "issuance of a certificate of occupancy for the entire building or improvement, or the equivalent authorization to occupy or use the improvement, issued by the governmental body having jurisdiction . . . ." Under the new language, "completion" would occur upon the issuance of a certificate of occupancy, "whether temporary or otherwise, that allows for occupancy or use of the entire building or improvement . . . .", thereby allowing the right to repair process to begin earlier.

B. Impact Based on Perspective:

The Nevada AB 125 revision is beneficial to both contractors and their insurers to the extent that it will operate to provide specific information on defects on a "per home" basis. This will assist in investigating claims from multiple homeowners in a single development more efficiently. The change also should reduce the ease with which costs have been driven up for a residential development by simply claiming that certain homes and/or homeowners are "similarly situated."

The Florida revisions go in a different direction, essentially relaxing more burdensome requirements that previously called for a great deal of specificity in identifying particular construction defects. It remains to be seen whether these changes will strike a balance that will enable construction defect (CD) claims to be resolved pre-litigation without protracted and costly proceedings.

The Florida document exchange provision may present interesting issues because it raises the bar for parties in terms of identifying privileged, or potentially privileged, documents up front. This may not only impact underlying liability, but to the extent that potentially privileged information is mistakenly disclosed, it could also impact the coverage outcome.

VII. Limitations on HOA Standing:

A. Type of Change:

California law and statute enable an HOA to bring claims only for those defects which affect the HOA's duties to repair (which for the most part include only common areas). Practically speaking HOAs have been bringing claims in CA for years for defects to the individual units by claiming that those defects affect the common areas. But under CA law the HOA does NOT have standing to bring a suit for construction defects to individual units. Only the unit owners have this standing.

Pre AB 125, a number of Nevada decisions gave HOA's the ability to sue for defects to the individual units. AB 125 now changes that and expressly prohibits homeowners associations from pursuing claims for anything other than construction defects to the common areas thereby mirroring CA law in this regard.

B. Impact Based on Perspective:

The Nevada change as to HOA's, which brings it in line with a majority of jurisdictions, should be a positive development for contractors and their insurers. As with many of the other AB125 changes, this revision should be helpful in reducing CD litigation costs incurred by those parties, either by cutting down on frivolous litigation, as a general matter, or by cutting down on costs actively incurred in investigating or pursuing discovery directed at identifying actual defects and associated damages.

VIII. Recognition of Insurers Involvement in the Right to Repair Process:

A. Type of Change:

One of the numerous changes seen in the right to repair legislations seems to be recognition of the insurer role in the process. For the first time we are seeing legislation impacting insurer rights and duties in the right to repair process.

In California one of first states to implement a right to repair protocol in 2003, insurers were not considered or addressed in the legislation. In fact some of the very short timelines set up on the SB 800 process gave little to no time to insurers to respond to notice of a claim or to provide any substantive response. Legislation in other states appears to recognize and attempts to address these issues.

For example, in Florida, Section 558.001 was amended to reinforce the fact that settlement negotiations conducted during the notice and cure process are confidential. But it also expressly recognizes the right of the insurer of an involved "contractor, subcontractor, supplier, or design professional" to be involved in the notice and cure process, thereby extending the opportunity to resolve claims without legal process to insurers of a contractor, subcontractor, supplier, or design professional.

On the other hand, the new law also specifies that providing a copy of a notice of claim to a person's insurer does not constitute a claim for insurance purposes unless the insurance policy specifies otherwise. The effect of this provision is to ensure that an insurer has the ability to be involved but not necessarily the duty under the policy to respond to a claim during the pre-litigation process.

Even though the notice amendment to Section 558.001 has not been signed into law yet, the question of whether a 558 notice triggers an insurer's duty to defend has already been the subject of litigation in federal court in Florida. In *Altman Contractors, Inc. v. Crum & Forster Specialty Ins. Co.,* Case No. 13-80831-CIV-MARRA ("Altman"), a GC sued its general liability insurer claiming that the insurer's participation in the 558 process pursuant to notice under the amended provision triggered that carrier's duty to defend. The court rejected the GC's argument based on the specific language in the insurer's policy, concluding that the Chapter 558 mechanism is not a "suit" for purposes of potential CGL coverage. In so holding, the court distinguished the Florida statute from California's Calderon Act (Civil Code Section 1375), on various grounds, including the fact that Calderon requires that the parties involved select a "dispute resolution facilitator." *Altman* is presently on appeal to the 11th Circuit.

In Nevada, AB 125 says that the subcontractor's duty to defend under contract arises when a Chapter 40 notice containing a claim of construction defect that implicates the subcontractor's work is sent to the subcontractor by the contractor. But, it goes on to state that before the subcontractor can be pursued for a defense they must first ascertain and pursue the subcontractor's general liability insurer pursuant to an additional insured (AI), if one exists.

B. Impact Based Upon Perspective:

It will be interesting to see how the statute in Nevada dealing with insurer vs insured duties plays out because it appears to mix duties. The duty to defend under an AI endorsement is an insurer duty, whereas the duty to defend under a contractual indemnity provision is a duty owed by the insured. One is a duty created by the insuring agreement (essentially a contract between an insurer and its insured) and one is a duty created by a written contract between a general contractor and a subcontractor.

The bill AB 125 in Nevada does contain the proviso that if AI issues are not resolved at the time of trial or settlement of the action that the general contractor can still pursue the subcontractor contractually. This provision could ultimately be a distinction without a difference.

In considering an insurer's participation in the Florida right to repair statutory process, it is important to keep in mind that an insurer is not entitled to file suit for defense cost contribution against other co-insurers under present Florida law pursuant to *Argonaut Ins. Co. v. Md. Cas. Co.,* 372 So.2d 960 (Fla. 3rd DCA 1979). Thus, as an insurer participating in the Section 558 process, consideration should be given to early evaluation of underlying contractual indemnity issues and pursuit of other available insurance by way of the underlying contractual claim. This same concept applies in South Carolina, which is aligned with Florida in terms of contribution as to defense costs.