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Paradise Lost? A Road Map to Handling Hawaii CD and Construction Litigation

I. Construction Related Litigation in Hawaii

CD litigation has been thought of as a mainland phenomenon; Hawaii has long been ignored. But recently, construction and CD litigation initiated by mainland firms has trended upward in Hawaii. Plaintiff firms are pursuing multi-unit CD and products cases as class actions in Hawaii with increasing success. The uptick of CD and construction claims will likely inspire the involvement of an increasing number of carriers and risk managers. This panel will provide basic information to claims professionals and risk managers tasked with the management of claims in Hawaii and inform those that may be similarly tasked in the future.

II. Construction Disputes

One of the reasons for the uptick in construction defect cases is the understanding that Hawaii State Courts will grant class status in multi-unit cases. California plaintiff CD attorneys are starting to take notice. Many western states have been through a "CD life cycle" and the courts have determined how to best manage these cases. Most state courts eventually figure out that the factors necessary to support class status in CD cases are absent due to a multitude of factors. But the infancy of CD in Hawaii combined with the legal climate and plethora of multi-unit development may provide the perfect incubator for ongoing class certification.

There are a number of high-rise luxury condominiums that have recently been built and/or are in the process of being built in the Ward Village area in Kakaako, which overlooks Honolulu Harbor. The large majority of the buyers of the luxury

condominiums are non-Hawaii residents, and there are an increasing number of cases where mainland counsel is brought in to work in conjunction with Hawaii counsel to handle large construction defect and product liability cases.

One of the most aggressive developers has been Howard Hughes, who has already developed three luxury condominiums in the Ward Village Area. Howard Hughes has been involved in large litigation, which typically begins with mechanic's lien proceedings initiated by the general contractor and subcontractors for most, if not all, of the projects. These claims bring down a counterclaim for workmanship issues, leading to full blown CD disputes.

Mechanics Liens and Related CD Litigation

Under Hawaii Revised Statutes ("HRS") ç 507-42, persons furnishing labor or materials for improvements of real property may obtain a mechanic's lien. HRS $ 507-42 provides in relevant part that:

> Any person or association of persons furnishing labor or material in the improvement of real property shall have a lien upon the improvement as well as upon the interest of the owner of the improvement in the real property upon which the same is situated, or for the benefit of which the same was constructed, for the price agreed to be paid (if the price does not exceed the value of the labor and materials), or if the price exceeds the value thereof or if no price is agreed upon by the contracting parties, for the fair and reasonable value of all labor and materials covered by their contract, express or implied.

There are associated statutory limitations on the ability of a contractor to file a mechanics lien. HRS $ 507-49(b) limits mechanic's liens so that **no** general contractor or subcontractor that are required to be licensed pursuant to chapter 444 shall have lien rights unless such contractor was licensed pursuant to chapter 444 when the improvements to the real property were made or performed.

Hawaii's mechanics lien statute involves a two-step process. First, a lien application must be filed with the court requesting that a lien attach to the subject property.

Second, assuming all proper procedures (as discussed below) are completed and the lien attaches, the mechanics lien holder may then ask the court to sell the property and obtain payment for labor and materials from the sale proceeds. HRS $ 507-43 lists specific information that should be included in a lien application and notice. In essence, the application and notice must set forth the factual basis for the lien claim including a description of the property, the names of parties with an interest in the property and all contracting parties, the contract pursuant to which work was performed, performance of the work, and the amounts due therefor. The application and notice should name and give notice to all persons who have interests in the same property, such as mortgagees or lessors. The application must be filed no later than 45 days after the date of completion of the improvement, which is normally the date of filing the notice of completion, or if no such notice is filed, within one year after actual completion. If the application is not filed in time, the person will have no right to a lien. *HRS $ 507-43(b) and (g).*

The application for a mechanics lien and notice must be served upon all persons named therein. Hawaii's lien statute has very specific service requirements, which courts strictly enforce. An application must be served in the manner permitted within the statute's "window period," that is, the return date hearing must be held "not less than three, nor more than ten days after service." *HRS $ 507-43(a).* At the return hearing, the respondents admit or deny the allegations. If a denial is entered, a probable cause hearing is set according to standard court procedure.

At the probable cause hearing, the lien applicant must establish "probable cause" that the labor or materials have been provided to, and are incorporated in, the property. The court will also establish at the probable cause hearing the amount of the lien, normally equal to an agreed upon price or the reasonable and fair value of the labor or materials provided. *HRS $ 501-42*. **During the determination of the reasonable value of services, the Owner may assert claims of setoffs for faulty work or materials provided by the Contractor**. This provision in the relevant statute, of course, sets the stage for CD litigation, as the Owner will counterclaim for defective workmanship.

If probable cause is contested, the applicant must call witnesses and present proof to the court to establish its right to a lien, subject to cross-examination. Probable cause and attachment of the lien may be the subject of a stipulation in lieu of a hearing. In preparation for the probable cause hearing, a lien applicant should be ready to prove

the performance of the work and/or the provision of the materials, the amounts due, and the reasonableness of such amounts. If the court finds probable cause, the court will order the lien to "attach" to the property. This means the applicant obtains a lien. *HRS $ 507-43*.

Pursuant to HRS $ 507-45, a mechanics lien may be discharged by filing a bond for twice the amount of the sum for which the claim for the lien is filed:

Any mechanics' and materialmen's lien may be discharged at any time by the owner, lessee, principal contractor or intermediate subcontractor filing with the clerk of the circuit court of the county in which the property is located or with the assistant registrar of the land court (if registered land is affected), cash or a bond for twice the amount of the sum for which the claim for the lien is filed, conditioned for the payment of any sum for which the claimant may obtain judgment upon the claimant's claim.

Generally, a mechanics lien will rank equally in priority with all other mechanics liens with a few exceptions. *HRS $ 507-46*. The lien relates back in time and takes effect from the "time of the visible commencement of operations for the improvement." Mechanics liens have priority over all other liens of any nature except for government liens, liens for wages for labor, previously recorded mortgages, liens or judgments, and certain construction mortgages (if certain conditions are met). *HRS $ 507-46*.

Due to the rapid pace in which these new high rise projects were built, there is a high likelihood that CD claims are forthcoming after the residents move in and begin to notice defects.

Local building codes that contemplate the impact of a tropical climate on building assemblies create opportunities for crafty plaintiff firms and their experts to find technical violations of the code and exploit them. The failure to use the proper materials form basis for counterclaims in mechanic's lien proceedings or actions for breach of contract for failure to pay. For example, a major area of litigation centers on hurricane straps related to residential subdivisions.

III. Job Site Injury Claims

Hawaii's system of fault is centered on a hybrid of comparative fault and contributory negligence. Hawaii follows a version of the Uniform Contribution Among Tortfeasors Act (UCATA).

In a nutshell, the Court in a bench trial, or a jury utilizing a special verdict form, first determines the amount of damages irrespective of contributory negligence, and then second, determines the degree of negligence of each party. If the amount of negligence of the plaintiff exceeds the defendant, or a combination of fault of multiple defendants, the plaintiff is barred from recovery. However, the mere fact that a plaintiff is at fault does not bar recovery as long as the plaintiff is less at fault than the defendant, or sum of the fault of multiple defendants. *HRS 663-31*.

Damages in a personal injury case must be generally alleged. *HRS 663-1.3*. A legal representative may bring an action for loss of consortium. *HRS 663-3*. All rights of action arising out of physical injury to the person or death of a person arising out of the neglect of another shall not be extinguished by reason of the death of the injured person; the cause of action shall survive in favor of the legal representative of the person and damages recovered shall form part of the estate of the deceased. *HRS 663-7*. Non-economic damages generally include pain and suffering, which is defined as the actual physical pain and suffering that is the proximate result of a physical injury, mental anguish, disfigurement, loss of enjoyment of life, loss of consortium, and all other non-pecuniary claims. *HRS 663-8.5*. Future earnings are recoverable in a wrongful death claim minus the impact of taxes. *HRS 663-8; 8.3*.

IV. Risk Transfer in Hawaii

Third party practice is part of the system of recovery in Hawaii. HRS 663-17 provides several mechanisms, depending on the particular circumstances of the case, for fault distribution and allocation. A party can file third party complaints, cross claims or move for a separate judgment for contribution for non-parties. Typical parties include the owner, general contractor and subcontractors.

V. Litigation versus Arbitration and ADR

There are three main methods of alternative dispute resolution (ADR) utilized in construction cases, which are often times practiced in combination with each other. During the process of exploring ADR, it is common to hold off on full-blown discovery (i.e. in the litigation context, depositions, written interrogatories etc.) to attempt to resolve the matter.

Staying discovery may even be used as leverage in settlement discussions with the participant's acknowledgement that considerable resources will be saved if settlement is reached prior to discovery. Expert witnesses may be used to assist in the dispute resolution process by requesting their positions on various matters be informally learned thru letters or statements that are protected by Rule 408 of the Hawaii Rules of Evidence. Oftentimes, discovery of an expert's investigation in an informal manner during ADR is key to resolution.

Negotiation is the preferred method of resolving any conflict. If the parties involved in the dispute can discuss the relevant issues and resolve their differences by compromise before the dispute escalates, there would be tremendous cost and time savings involved. Good negotiation of construction disputes assumes that the parties understand the risks and/or liabilities involved in the consequences of the decision and are making the best business decision under the circumstances. However, because of numerous factors including lack of communication, delay, even personality conflicts between the individuals involved, an adequate resolution of the dispute may not be reached.

Partnering is a dispute prevention process, utilized primarily in the construction industry to help the parties involved in the project avoid conflict and resolve problems before they become disputes. The partnering process may start at a retreat that is normally held in the early stages of the project and is facilitated and managed by a neutral. The neutral helps the participants develop a team charter, project milestones and develop an evaluation process. The neutral meets periodically with the participants to measure progress and revise goals and milestones as needed. If the goals are not being met, the neutral will lead the parties in fact finding and work with increasingly higher levels of management on all sides to get the project back on track. In most cases, the neutral will assist the parties on coming to a mutual understanding. However, if necessary, the neutral will review the positions of the parties and issue a non-binding recommendation to help them to regain their commitment to each other and to the project goals. Because of the success of partnering, it is being implemented in a growing number of industries and multi –party project settings. The following is an example of a partnering provision in the contract:

> In order to achieve effective and efficient completion of this project, the project stakeholders agree to conduct a Partnering Retreat workshop within [select 10/30/60 days] of the issuance of the Notice to Proceed. The Partnering

Retreat shall be attended by key personnel of the Contractor, the Owner, the Designer, the subcontractors, major suppliers, and any other significant project participants. The project stakeholders intend to create a spirit of cooperation and cohesiveness utilizing partnering techniques. The Partnering Retreat shall be conducted at a neutral facility and shall be facilitated by [insert name of partnering entity] of Honolulu, Hawaii. The cost of the Partnering Retreat shall be (borne equally among all key project stakeholders, borne equally by the Contractor and Owner, borne solely by the Owner, borne solely by the Contractor, borne initially by the Contractor and then passed along to the Owner as a nominal cost of the project.)

Follow up mini-retreats or workshops may be held on a periodic basis as agreed to by the project stakeholders.

Mediation is a method by which the participating parties settle their dispute with the help of a "neutral" in a non-binding process. The mediator does not have the power to compel a decision but is used to guide the parties to a mutually acceptable resolution of an existing dispute. Mediation can be scheduled very quickly, and the process itself can also be very fast. It is private and confidential and protected by Rule 408 of the Hawaii Rules of
Evidence (communications of compromise may not be used in court). Mediation for construction disputes works particularly well because the parties are often used to practical problem solving, understand the complexities of the issues, understand the critical nature of cash flow and the value of time. As such, mediation is always a viable option to resolve construction disputes whether it is specifically written into the construction contracts or not. However, if the mediation alternative is not specifically stated in the contract, all parties must agree to do it. If mediation is the preferred alternative, it should be specifically stated in the
contract along with the forum (AAA or an agreed upon neutral mediator) and agreement as to the applicable rules. Pursuant to Rule 12.2 of the Rules of the Circuit Courts of the State of Hawaii, the Court, in its discretion or upon motion by a Party, may order the parties to participate in an ADR process (except binding arbitration) subject to conditions imposed by the Court.

Further, Rule 12 of the Hawaii Rules of Circuit Courts states that Pretrial Statement must verify that lead counsel has met face-to-face with the opposing party to discuss ADR options. Rule 12(b)(6). Further, the parties must identify the ADR process to which the parties have agreed, or if any party objects to ADR, indicate which party and the reasons for objecting. Rule I2(b)(7).

Arbitration is an adjudicatory process in which a neutral third-party is empowered to render a decision that is final and binding upon the parties. The construction industry was one of the first to turn to arbitration; an approach now so well established that more than 6,000 construction industry arbitrations are administered each year by private alternative dispute resolution agencies. In arbitration, parties submit their evidence to an impartial neutral Arbitrator or panel whose decision is final and enforceable in court. Arbitration can be economical if the contract provision provides appropriate limitations on discovery, arbitration is designed to be private and informal (with relaxed rules of evidence). Construction contracts may include an arbitration clause requiring binding arbitration.
Arbitration clauses should clearly set out the agreed upon forum (i.e. Dispute Prevention and Resolution or American Arbitration Association); whether the arbitration shall be with a single mutually-agreed upon arbitrator or a panel of arbitrators. Some arbitration clauses provide for the appointment of two party-appointed arbitrators and a third neutral Arbitrator appointed by those two. The arbitration clause should also set forth the applicable arbitration rules.

VI. Applicable Attorney's Fees Statutes

Attorney's fees can be awarded by the court in the event of a contract, or in a case where the court deems a party's claims or defenses to be frivolous:

§607-14 Attorneys' fees in actions in the nature of assumpsit, etc. In all the courts, in all actions in the nature of assumpsit and in all actions on a promissory note or other contract in writing that provides for an attorney's fee, there shall be taxed as attorneys' fees, to be paid by the losing party and to be included in the sum for which execution may issue, a fee that the court determines to be reasonable; provided that the attorney representing the prevailing party shall submit to the court an affidavit stating the amount of time the attorney spent on the action and the amount of time the attorney is likely to spend to obtain a final written judgment, or, if the fee is not based on an hourly rate, the amount of the agreed upon fee.

The court shall then tax attorneys' fees, which the court determines to be reasonable, to be paid by the losing party; provided that this amount shall not exceed twenty-five per cent of the judgment.

Where the note or other contract in writing provides for a fee of twenty-five per cent or more, or provides for a reasonable attorney's fee, not more than twenty-five per cent shall be allowed.

Where the note or other contract in writing provides for a rate less than twenty-five per cent, not more than the specified rate shall be allowed.

Where the note or other contract in writing provides for the recovery of attorneys' fees incurred in connection with a prior debt, those attorneys' fees shall not be allowed in the immediate action unless there was a writing authorizing those attorneys' fees before the prior debt was incurred. "Prior debt" for the purposes of this section is the principal amount of a debt not included in the immediate action.

The above fees provided for by this section shall be assessed on the amount of the judgment exclusive of costs and all attorneys' fees obtained by the plaintiff, and upon the amount sued for if the defendant obtains judgment.

Nothing in this section shall limit the recovery of reasonable attorneys' fees and costs by a planned community association and its members in actions for the collection of delinquent assessments, the foreclosure of any lien, or the enforcement of any provision of the association's governing documents, or affect any right of a prevailing party to recover attorneys' fees in excess of twenty-five per cent of the judgment pursuant to any statute that specifically provides that a prevailing party may recover all of its reasonable attorneys' fees. "Planned community association" for the purposes of this section means a nonprofit homeowners or community association existing pursuant to covenants running with the land. [L 1872, c 29, §5; RL 1925, §2551; RL 1935, §3800; am L 1935, c 26, §1; RL 1945, §9754; RL 1955, §219-14; HRS §607-14; am L 1972, c 88, §5(q); am L 1993, c 200, §1; am L 1994, c 74, §1; am L 1997, c 132, §2]

§607-14.5 Attorneys' fees and costs in civil actions. (a) In any civil action in this State where a party seeks money damages or injunctive relief, or both, against another party, and the case is subsequently decided, the court may, as it deems just, assess against either party, whether or not the party was a prevailing party, and enter as part of its order, for which execution may issue, a reasonable sum for attorneys' fees and costs, in an amount to be determined by the court upon a specific finding that all or a portion of the party's claim or defense was frivolous as provided in subsection (b).

(b) In determining the award of attorneys' fees and costs and the amounts to be awarded, the court must find in writing that all or a portion of the claims or defenses made by the party are frivolous and are not reasonably supported by the facts and the law in the civil action. In determining whether claims or defenses are frivolous, the court may consider whether the party alleging that the claims or defenses are frivolous had submitted to the party asserting the claims or defenses a request for their withdrawal as provided in subsection (c). If the court determines that only a portion of the claims or defenses made by the party are frivolous, the court shall determine a reasonable sum for attorneys' fees and costs in relation to the frivolous claims or defenses.

(c) A party alleging that claims or defenses are frivolous may submit to the party asserting the claims or defenses a request for withdrawal of the frivolous claims or defenses, in writing, identifying those claims or defenses and the reasons they are believed to be frivolous. If the party withdraws the frivolous claims or defenses within a reasonable length of time, the court shall not award attorneys' fees and costs based on those claims or defenses under this section. [L 1980, c 286, §1; am L Sp 1986, c 2, §13; am L 1992, c 47, §1; am L 1999, c 237, §3]