

From Dream Home To Nightmare

Risk Management from the
Perspectives of the Homeowner
and the Home Builder



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This article discusses various methods to ensure that the construction of a new home does not become a quagmire of problems and litigation. We will address first what homeowners should do to make sure they get the dream home they want. We will then address what builders should do to ensure that they end up with happy homeowners and not a lawsuit.

RISK MANAGEMENT FOR HOMEOWNERS

First, vet your contractor. Beyond interviewing contractors and reviewing their bids, learn more about your builder. Do not simply choose a builder based on price. Make sure your contractor is licensed in the local jurisdiction in which you are building, and ask the building officials about their reputation. Look through the building department's files and inspection records for your builder's past projects, paying special attention to failed inspections and other red flags. Check with the Better Business Bureau and talk with the builder's past clients. Ask your builder how long it has been using its subcontractors (the longer the better), and ask to interview those subcontractors.

Regardless of whether you are hiring the design professionals directly or the builder hires them, consider hiring a third party to perform a plan review. Also, consider hiring the architect on a full-service contract, not just for the design. The additional work should include contract administration and construction oversight. If you will not be hiring the architect to

perform these services, use a third-party, independent, inspection company to ensure that the construction complies with the plans, specifications, applicable codes, manufacturers' installation instructions, and applicable standards of care.

Do not blindly sign the builder's form contract. Rather, consider hiring an attorney to review the contract for you. [Note that this is not a pitch for our firm as we do not perform this service for homeowners, it is just a really good idea.] If your budget is an issue, consider alternate forms of delivery in addition to the standard cost of the work plus a fee arrangement, such as guaranteed maximum price contracts.

Require that your builder carry both builders' risk insurance, which protects you from damage during construction, and commercial general liability insurance, which protects you after. Also, require your builder to carry its CGL coverage through the statute of repose, eight years being a good rule of thumb. Obtain the insurance information from your builder and its subcontractors and maintain those records through the statute of repose. To protect yourself from onerous exclusions on those policies, talk with your insurance agent about using insurance compliance forms, to be completed by the insurance brokers for your builder and its subcontractors, which will highlight information not elicited in the typical Accord forms, such as whether there is an exclusion for new residential construction, subsidence, mold, and other exclusions which may negatively impact your ability to get repairs should something go wrong.

Finally, make sure your builder pulls a permit for all work where required. This will ensure that the local building department knows precisely what construction is going on and that it will be involved in performing its own plan review and construction inspections. Also, make sure that

you have a complete list of the builder's subcontractors, and that your builder and its subcontractors are regularly providing lien releases for the work performed and for which you have paid. This will ensure that you do not get any surprise liens at the end of the project.

Following these guidelines will not guarantee that you have a trouble free project, but will put you in the best position possible and will greatly reduce your risk in building your new home.

RISK MANAGEMENT FOR HOME BUILDERS

Residential construction presents a Residential construction presents a builder with unique risks for a lawsuit. While in commercial construction, contract terms share risk among the parties, residential builders and subcontractors owe duties to homeowners independent of contract. A residential construction lawsuit will include claims based on breach of contract as well as negligence, breach of express and implied warranties, and others.

A breach of implied warranty claim has been likened by Colorado courts to strict liability for construction defects. For any violation of the applicable codes, manufacturer's installation instructions, or standards of care, a builder-vendor is liable for the cost of bringing the construction into conformance, regardless of whether it is actually causing damage. Following the Homeowner Protection Act of 2007, a builder-vendor cannot disclaim an implied warranty in favor of express written warranties, limit consequential damages, or sell a home "as-is, where is."

Homeowner-plaintiffs have an advantage in a jury trial. A jury is made up of homeowners or people who want to be homeowners, and may share common ground with the plaintiff.

With respect to multi-family construction, the homeowners association will have

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standing to pursue claims on behalf of homeowners for issues affecting two or more units within the common interest community. A homeowners association may seek recovery for alleged defects throughout common areas and individually owned units, so long as the problem affects two or more units. Such a case will not be limited to a few dissatisfied owners, but the entire development.

Despite the ever-present threat of construction defect litigation, a builder can institute procedures to lessen risk of a lawsuit, but must follow the procedures consistently to be effective.

Hire vetted subcontractors, and maintain oversight of subs throughout the project. Ensure that construction is in compliance with all applicable codes, plans, specifications, engineering recommendations, and manufacturer installation instructions. Consider using a third-party inspector, and follow through on its recommendations.

Get all subcontractors to enter into written contracts, which should incorporate the prime contract (so that the sub is bound to the builder just as the builder is bound to owner), and include a well-defined scope of work, a warranty provision, an arbitration clause, and an agreement to be joined in arbitration.

Indemnity agreements can only go so far. A subcontractor can only indemnify if it still has insurance or assets. Colorado anti-indemnity legislation makes it is no longer permissible for a contractor to require another party to indemnify for the contractor's own negligence.

Obtain proof of insurance from subcontractors, and recognize the limitations of a certificate of insurance. Require your subcontractors to provide insurance which names you as an additional insured for both ongoing and completed operations. Follow up to ensure that they have done so. Require your subcontractors to keep this insurance in place through the statute of repose, eight years is a good rule of thumb. Become familiar with the endorsements

and exclusions referenced on a certificate or policy. Otherwise, consult an insurance broker or an attorney for assistance. Too often a builder discovers (after it was sued) that a sub's insurance coverage ended when its work was complete, or included multi-family, subsidence, or other exclusions. Require your subcontractors' insurance producers to complete compliance forms, which check for such exclusions.

Put everything in writing and keep those records on hand throughout the statute of repose. Retain contracts, scopes of work and payment information showing who performed what work, and where. Keep RFI's on file, and record any decision to

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stray from plans, specifications, or soils report recommendations. Document a subcontractor's failure to perform and evidence of corrections.

Even after completion of a project, continue to maintain documents (including insurance). Address warranty issues timely and completely to prevent a minor issue from becoming a lawsuit. If you are not equipped to provide timely and effective

warranty service, consider hiring a third-party warranty administrator.

Finally, do not rest on the fact that you have a risk management procedure, signed contracts, or proof of insurance on file. Stay on top of those procedures and keep records up to date. These are methods to manage risk, but the potential for exposure may not be eliminated.

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The firm is highly regarded for their expertise in construction law and the litigation of construction claims. They represent a wide variety of construction professionals, from individuals, to small businesses, to Fortune 500 companies.