The Hidden Dangers of Construction Defect Litigation

By David M. McLain, Esq.
Higgins, Hopkins, McLain & Roswell, LLC

By way of introduction, my legal practice has been almost entirely devoted to representing Colorado's construction professionals, mostly in defense of construction defect ("CD") cases brought by homeowners associations ("HOAs"). In this article, I will discuss some of the problems faced by HOAs and their boards, which are inherent in construction defect litigation. These are important issues and there is seemingly no one out there discussing them.

The point of this article is not to suggest that dealing with construction defects is a simple issue, or that HOA boards should not seek legal and engineering advice when problems in construction come to light. The point is to suggest that HOA boards should be leery of taking the ready, fire, aim approach to resolution of construction defects issues. Filing a lawsuit should be the last resort of any HOA.

The main problem facing HOAs and their boards is the lack of communication to, and lack of consent to the filing of a CD claim by, individual owners within a common interest community. At this point, it is important to understand that most plaintiffs' CD attorneys work on a contingency fee, usually 33.3% of the gross recovery if a case settles and 40% of the gross recovery if the case is tried. In typical CD cases, plaintiffs' firms represent the HOA, not the individual members of an HOA, and have only to deal with the board. This is much easier for the plaintiffs' counsel because it has to report only to a handful of people and not every owner in a community. It is this dynamic that causes potential problems for the HOA and its board.

One of the first steps in a CD case is to amend the HOA's CC&Rs to remove any impediment to filing a lawsuit, such as arbitration clauses. This is likely the only chance individual members of the HOA have to weigh in on the lawsuit and the only reason they are involved at this point is that amending the CC&Rs requires a vote of the owners. After amendment, the HOA board rarely seeks input from the individual members regarding whether to file suit. HOA boards rarely inform individual owners that if they have problems in their homes, they have the right to bring an action against the builder themselves and that if they do so, they will have additional claims not available to the HOA, including claims for personal injury damages such as aggravation, annoyance, discomfort, etc. In some cases, individual owners would be better off asserting their own claims.

There is also a conflict of interest with individual owners who attempt to opt out of the case. This can lead to shocking strong-arm tactics on the part of plaintiffs' attorneys. In one instance, a plaintiffs' attorney sent a letter to an individual homeowner that stated that as a

1/58th owner of the common elements, if he refused to go along with the suit, and there was ultimately a finding in favor of the HOA which was in any way limited by his refusal to participate, he would be personally liable for 1/58th of the HOA's total damages. In another instance, a different plaintiffs' attorney sent a letter to a homeowner who wanted the builder to perform warranty repairs, informing the owner that if he let the builder perform any repairs, the attorney would bill the HOA according to the fee agreement entered by the HOA board (without knowledge or consent of non-board members) and that the HOA would assess the homeowner for that expense. These are just two examples of conflicts which may arise between the HOA board and individual homeowners when the HOA pursues CD cases.

Another example of a conflict which will arise as a result of CD litigation occurs post-settlement. When an HOA settles for less than 100% of the amount necessary to fund all repairs outlined by its experts, plus attorneys' fees and litigation costs, there will obviously be a shortfall in the amount necessary to fix the development. The HOA board must then choose to impose a special assessment to cover the shortfall or to make some, but not all, of the repairs outlined by its experts. In choosing the latter, the conflict arises with respect to which homes get fixed and which do not. In this situation, the HOA board has acted as the attorney-in-fact for the individual owners by bringing claims on their behalf, and has compromised those claims without their knowledge or consent. If, after the fact, the HOA board decides not to make certain repairs, that will have a negative effect on the property values of the individual owners who may then bring a claim against the HOA for acting in a manner not in their best interest, and in doing so without their knowledge or consent. A bigger problem exists if the members of the HOA board get their homes fixed and others get no repairs. In a situation like this, each of the owners must then disclose to potential purchasers that the suit was brought and that the experts identified defects which were left unrepaired. This again will have a negative impact on the value of the property, which will have occurred without the knowledge or consent of the individual owners. Further problems arise when the HOA board has repairs performed under no-bid contracts or when sufficient controls are not put in place to protect the HOA's resources during the repair process.

Under Colorado's existing statutory and case law, it is almost impossible for an HOA to recover all the money necessary to fund the repairs outlined by their experts. HOA boards must be aware of this and must engage in honest and open dialogues with its membership about the hidden dangers of CD litigation. Finally, HOA boards should get the approval from the individual owners prior to filing suit and prior to making any decisions regarding what to do with any amounts received in settlement or judgment. Not to do so may expose the HOA to liability.

David M. McLain is a founding member of Higgins, Hopkins, McLain & Roswell, LLC. HHMR represents a wide variety of clients, from individuals to small businesses to Fortune 500 companies.