Construction Defects Lawsuits Are Avoidable

Homeowners and Builders Can Take Mutual Steps to Avoid Costly Litigation

David M. McLain, Esq.
www.hhmrlaw.com

By way of introduction, let me explain my background. I have spent the length of my legal carrier, spanning 12 years now, litigating construction defect claims, almost exclusively on behalf of developers, general contractors, and other construction professionals. During this time, I have seen a few "bad apples" among the building community, to deny that any exist would be incredulous. That said, most of the individuals and companies I have represented have tried to do the right thing, want to stand behind their homes, and find themselves involved in litigation despite their best efforts to avoid it.

THE SETUP

Most of the construction defect litigation occurring in Colorado involves homeowners associations (HOA) as the claimants. Most of these cases begin in the following way: The individual homeowners express a concern to the HOA board regarding problems they are noticing in the community or there are discussions among the owners regarding what has happened in nearby communities or in other communities developed by the same builder.

The property management company then calls the plaintiffs' construction defect attorneys to visit the community, typically with their forensic experts. These experts investigate the community and develop a long list of "construction defects."

Armed with this list, the plaintiffs' attorneys explain to the board members that they have a fiduciary obligation to the HOA to investigate and repair any construction defects and that if they do not, the board members may breach their fiduciary obligations to the HOA and, therefore, be individually liable for any and all repair costs.

The attorneys further explain that the board members can discharge their fiduciary obligations by hiring the firm, which will represent the association on a contingency fee basis, fronting all of the investigation costs. The contingency fee agreement is usually for 33.3 to 40 percent of the gross recovery, with the reimbursement of expenses coming out of the HOA's take. While HOAs could previously take care of all needed repairs under this scenario, this may no longer be the case.

HISTORICAL CONTEXT

Prior to 2003, a claimant in a construction defect suit that prevailed on its claim for breach of the Colorado Consumer Protection Act was entitled to treble damages, plus attorneys' fees. Going back to the 1990's and early 2000's, HOA's would cover the attorneys' fees, expert fees, and litigation costs through an award of treble damages and prejudgment interest. In a hypothetical example, assume that a jury awarded an HOA

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$1 million as the necessary cost of repairing construction defects in a community. In such a case, the judge would treble that award to $3 million and would also award attorneys' fees against the builder. Additionally, prior to 2008, homeowners and HOAs typically received an award for prejudgment interest in the amount of 8% per year, compounded annually on the cost of repair. This ran from the date of closing through the date the claimant filed its statutory notice of claim, which precedes the initiation of a lawsuit by 75 days.

In light of these potential damage awards, homeowners associations were typically able to force very lucrative settlements without the need to go to trial. In the above hypothetical, the HOA would typically demand $1.5 million, plus litigation and expert costs, to settle the case. The builder, knowing that the ultimate award against it may be 2-3 times higher, most of which would not be covered by insurance (as CGL policies do not cover CCPA awards), would then settle the case. This settlement amount would be sufficient to cover the litigation costs and the contingency fee for the plaintiffs' attorneys, leaving the HOA with $1 million to fix the $1 million worth of defects.

In 2003, the Colorado legislature capped damages under the CCPA to $250,000, inclusive of attorneys' fees. In 2008, the Colorado Supreme Court ruled that prejudgment interest was no longer recoverable in cases where the claimant is seeking the cost of future repairs. For builders now, there is very little incentive to settle cases for anything more than a reasonable cost of repair, plus some amount for the HOAs litigation costs. The problem with this in the typical scenario is that the HOA cannot afford to settle for this amount, and still have enough to pay of its attorneys, experts, litigation costs, and the actual repairs needed.

If the same hypothetical case were today, the best the HOA could hope for would be the $1 million cost of repair, $250,000 under the CCPA, and litigation costs. After paying for the litigation costs, experts' fees, and attorneys' fees, the HOA would be left with less than the $1 million necessary to fix the $1 million in defects. Clearly, this shortfall grows exponentially as the size of the repair cost increases. Assuming that the cost of repair is $10 million, the net take for the HOA would be approximately 55-60% of the amount needed to make repairs.

The problem for the HOA that does not have enough money to make repairs is that they must either perform a special assessment to make up the difference, or they must choose to not make certain repairs. If the decision is to not make certain repairs, the individual owners within the community will have to disclose that fact when they sell their homes, potentially decreasing the value of the home.

OPTIONS UNDER TODAY'S LAW

In short, litigation should be the absolute last resort. I strongly encourage homeowners and homeowners associations that believe their home or community suffers from construction defects to call their builders. Obviously, the HOA will have to engage in an extraordinary amount of due diligence to work through this situation to ensure that a builder properly investigates and repairs and problems. This can be done without hiring a plaintiffs' construction defect attorney on a contingency fee. I have seen situations in which an HOA has called me or one of my clients and said: "If the builder hires a specific engineer to investigate, design, and oversee the repairs, we will not hire an attorney." Builders, given this choice and assuming that the engineer selected is reputable, may very well go along with the proposal. The HOA would probably also want to engage an attorney familiar with Colorado law to ensure that it does not lose any rights to sue the builder, up to, and through the point when all needed repairs are properly completed.

I have seen very few builders during my career that are unwilling to make it right. If you live in a home or in a community where the builder is not willing to make it right and refuses to stand behind its homes, there may be no choice but to engage a plaintiffs' construction defect attorney to represent you. Given the difficulty of the situation presented above, however, this should absolutely be your last choice. If you do have to go down this road, I would take the time to have a candid conversation with the plaintiffs' attorney regarding his or her strategy for dealing with the problems set forth in this article.

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ABOUT THE AUTHOR: *David M. McLain is a founding member of Higgins, Hopkins, McLain & Roswell, LLC, a firm which specializes in construction defect and general civil litigation throughout Colorado. Mr. McLain received his undergraduate degree from Colorado State University, graduating cum laude, and his law degree from the University of Denver, College of Law. Mr. McLain is an AV® Preeminent™ Peer Review Rated attorney by Martindale-Hubbell and is a regular speaker at seminars regarding construction defect litigation in Colorado. Mr. McLain can be reached by telephone at (303) 987-9813 or by e-mail at mclain@hhmrlaw.com.*