

## HANDLING CONSTRUCTION DEFECTS CASES

-----  
Joseph Marion Allen, J.D., Ph.D., P.E.  
2205 Fourth Street, Suite 25  
Tuscaloosa, Alabama 35401

Representing the Owner. No construction project is perfect. Every one has defects. Owners should, and do, accept some defects in structures. No project is complete without its punch list items. If the relationship between the owner and the contractor breaks down, it is highly likely that the owner can point to at least some items of work done by the contractor that are defective, or not done in a workmanlike manner. While that makes construction defects cases very winnable for owners, the cost in time and money required to prosecute these cases dictates that the alleged defects must be substantial in order to justify the investment.

A contractor may believe he has insurance coverage for a construction defects complaint. That will depend upon the allegations in the complaint. It is important that the complaint contain allegations that will trigger coverage. This is called "pleading the coverage." Negligence, wantonness and fraud claims are typically covered by a contractor's policy, but breach of contract claims are not. Warranty claims may or may not be. "The Work" performed by the contractor is typically not covered, but conforming work that has to be torn out to correct underlying defective work likely is covered.

There are several types of warranties that may be involved in construction defect litigation. Most construction contracts, whether they come from an architect, engineer or the contractor, contain an express warranty from the contractor to the owner. There are builder's warranties which are implied by the courts such as an implied warranty of workmanship. "It is a general rule in contracts for work and services that there is implied a duty to perform with that degree of skill or workmanship which is possessed by those of ordinary skill in the particular trade for which one is employed." *C.P. Robbins & Associates v. Stevens*, 301 So.2d 196, 199 (Ala.Civ.App. 1974) While the court in *Robbins* construed this workmanship warranty to exist

appurtenant to a contractor's express warranty, it is likely that such a warranty will be implied absent an expressed warranty. There is also an implied warranty of fitness and habitability. *Sims v. Lewis*, 374 So.2d 298 (Ala. 1979) This implied warranty applies only to new residences. A key element of this warranty is that there were defects in the residence that impaired its intended use, being inhabitation. This certainly does not mean that the owner cannot live in the residence because economic reality requires most owners to continue living in the residence, notwithstanding the defects.

For tort counts, the proper measure of damages due to an owner in a construction defects case is the difference in value of the structure with the defects and without. For contract counts, it is the cost to complete in conformance with the plans and specifications. Mental anguish and emotional distress damages are typically not allowed for cases involving property loss only and for breach of contract. There is an important exception to that rule in cases involving residential construction. Due to the unique and sensitive nature of subject matter of the action ("A man's home is his castle"), mental anguish damages are recoverable by owners of residences in construction defects litigation, *Kohn v. Johnson*, 565 So.2d 165 (Ala. 1990); *B & M Homes, Inc. v. Hogan*, 376 So.2d 667 (Ala. 1979), but not to contractors. This fact is a major advantage that a residence owner has over a contractor in these cases.

Many construction defects cases involve damage to structures caused by water intrusion, be it from topography, grade or flashing. Others involve foundation settlement problems caused by inadequate preparation of the subgrade supporting a building. While cases involving water intrusion might be addressed by measures such as diverting water away from a foundation or reflashings openings, structural foundation issues are much more challenging to address. Foundation Behavior and Repair, Third Edition, Robert Wade Brown, McGraw-Hill, 1997. Others involve construction materials or products that are defective. These cases can involve many claimants and might be class actions or mass tort cases. Products previously involved in this type of litigation include asbestos, synthetic stucco, "biodegradable" PVC, and Chinese drywall.

A home builder may have a general contractor's license or an Alabama Home Builders license. If a contractor has an

Alabama Home Builders license, an owner who obtains a judgment, other than by consent, against the builder may be able to access the Alabama Home Builders Licensure Recovery Fund up to \$20,000.00. *Code of Ala., 1975, §34-14A-15(2)* As a prerequisite to this recovery, the owner must file a complaint with the Board and an investigation by the Board will ensue. This procedure is frequently used by owners suing contractors. The plaintiff's counsel should be careful not to encourage the filing of such a complaint in every instance. While it may be good evidence for the plaintiff if the Board issues a fine or other punishment against the builder based on the complaint, it can backfire if the investigation clears the builder and that evidentiary shoe will be on the other foot.

Expert Testimony. The necessity of expert testimony on behalf of the plaintiff is one of the factors that drives up the complexity and cost of prosecuting construction defect cases. Even a simple case might involve multiple experts per party. It is likely that a structural engineer will be required. If the alleged defects involve foundation deficiencies, it is likely that a geotechnical expert will be needed, as well. Testimony by an third party contractor is important. A real estate appraiser may be needed to prove aspects of the plaintiff's damages. When construction product defects are litigated, there are forensic engineering groups that specialize in certain types of these cases.

The admissibility of expert testimony in Alabama has recently undergone changes. Long ago, expert testimony was liberally allowed under the notion that certain knowledge was "beyond the kin" of the jury. Judges let it all in and let the jury sort it out by "weighting" the testimony. That has markedly changed. For a long time Alabama followed the "general acceptance" doctrine in determining the admissibility of expert testimony. *Frye v. United States*, 293 F. 1013 (D.C. Cir. 1923) In 1993, another federal case revolutionized the way that judges determined the admissibility of such evidence. *Daubert v. Merrill Dow Pharmaceuticals, Inc.*, 509 U.S. 579 (Sup.Ct. 1993) Under *Daubert*, judges became the "gatekeepers" as to the admissibility of expert testimony and the putative testimony had to pass muster by the judge before it could be presented to the jury. There was a listing of things in *Daubert* that the judge might consider in determining whether or not to allow the testimony to be heard. That listing was perceived as too

onerous by many plaintiff's counsel. While denying that Alabama had abandoned *Fyre*, Justice Harwood wrote an opinion tracking the logic in *Daubert*, but without the list. *Bagley v. Mazda Motor Corp.*, 864 So.2d 301 (Ala. 2003) As a practical matter, Alabama was then aligned with *Daubert*, meaning that motions to exclude expert testimony became commonplace in Alabama courts.

Finally, in 2012, the Rule 702 of the Alabama Rules of Evidence was amended to the following:

**Rule 702. Testimony by Experts**

(a) If scientific, technical, or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education may testify thereto in the form of an opinion or otherwise.

(b) In addition to the requirements of section (a), expert testimony based on a scientific theory, principle, methodology, or procedure is admissible only if:

- (1) The testimony is based on sufficient facts of data;
- (2) The testimony is the product of reliable principles and methods; and
- (3) The witness has applied the principles and methods reliably to the facts of the case.

Section (a) of the rule is the old "assist the trier of fact" standard from long ago and section (b) is viewed to have incorporated the *Daubert* rational into Alabama law. Many causes of action require expert testimony for a plaintiff to establish a prima facia case. If, upon motion prior to or at trial, the defendant can succeed in having a critical expert's testimony excluded, the plaintiff's case is over.

Representing the Contractor. As was said above, no construction project is perfect. The good news for the contractor is that its performance is not required to be

perfect. If the contractor's non-conforming performance was unintentional, and the owner received essentially that thing for which he bargained, then the contractor can recover for that performance, less any required setoff, even though it has technically breached the contract. *Jacob & Youngs v. Kent*, 129 N.E. 889, (Ct. of App. of N.Y. 1921) This equitable doctrine is called Substantial Performance and is based upon the potential economic waste of a contractor having to tear out conforming work to correct an insignificant underlying defect. This doctrine apparently applies in Alabama with the contractor's breach having to be "in good faith" as opposed to "unintentional." Christopher Lyle McIllwain, *Building Contractor's Recovery for Incomplete Performance*, 50 Ala. Law. 230, 233.

A lawyer may be retained as private counsel by a contractor even though its insurer has retained counsel to defend a litigation. A contractor's most important battle in a construction defects litigation may be with his own insurer. The duty of an insurer to defend its insured is greater than its burden to indemnify. *Acceptance Insurance Company v. Brown*, 832 So.2d 1, 14 (Ala. 2001) Insurers regularly provide a defense for its insured under reservation of rights, meaning that the insurer does not initially agree that it would indemnify any judgment against the contractor even though a defense is provided. This can be particularly devastating to a contractor if its insurer instigates a declaratory judgment action to determine coverage. The contractor, already a defendant in one litigation, finds that it is a defendant in a separate, and distinctly different, litigation. Obviously, since the insurer is an adverse party to the contractor in the declaratory judgment action, it owes no duty to defend in that separate action so the contractor must retain other counsel at its own expense to handle the coverage case. Typically, construction defects cases involving residential construction are in state court because there is no diversity of citizenship. The parties in the coverage case would be the contractor and its insurer, so there is a high likelihood that there would be diversity and the declaratory judgment action may be brought in federal court.

Often contractors have not been paid in full by the owner after the relationship has deteriorated. If it is found that the contractor has substantially performed its contract, the non-payment of the owner gives rise to a counterclaim on behalf

of the contractor. Counterclaims are common in construction defects cases because the best defense may be a strong offense. If an insurer agrees to settle a construction defects case for a contractor, it is likely that the counterclaim will be required by the owner to be dismissed with prejudice. A contractor may have hired a subcontractor to perform the work made the basis of the construction defects litigation. While that does not relieve the contractor of its contractual duties, a third party action under Rule 14 of the Alabama Rules of Civil Procedure may be instigated against the subcontractor basically seeking indemnification if contractor is found liable. There might be language in the subcontract that would require indemnification of the general contractor if the negligence of the subcontractor causes exposure of the general. *Stone Building Company v. Star Electrical Contractors, Inc.*, 796 So.2d 1076 (Ala. 2000)

An unpaid contractor can file a lien against a property on which the contractor has performed work or labor in constructing or repairing any building or improvement thereon. *Code of Alabama, 1975*, §35-11-210 Mechanic's liens are of two types, being with, or without, prior notice by the contractor to the owner. Without prior notification by the contractor seeking the lien, the lien shall extend only to the amount of any unpaid balance due the contractor by the owner. As to subcontractors this likely means that, without prior notice to the owner, it can enforce the lien only to the extent of any unpaid balance from the owner to the general contractor. With prior notification by the contractor to the owner, the contractor shall have a lien for the full price of the work or labor performed. Where the claimant is a contractor, or supplier, other than the original contractor, it must fulfill three primary conditions to perfect its lien: (1) it must give the owner written notice of its intent to claim a lien on the owner's property; (2) it must file a verified statement in the appropriate records of the probate court claiming the lien (See *Code of Alabama, 1975*, §35-11-213); and (3) it must bring an action to enforce the lien within six months after the debt has matured (See *Code of Alabama, 1975*, §35-11-215). *Harper v. J. & C. Trucking and Excavating Co., Inc.*, 374 So.2d 886 (Ala.Civ.App. 1978)

Bonds common in the construction industry include bid, performance and payment bonds. All of these bonds are acquired by the general contractor for a project and are intended to

protect the owner from various possible malfeasances by the general contractor. These bonds are common on large commercial projects, but not so much for light commercial or residential construction. Since the liens discussed above are not available on public works contracts because the government is the "owner," bonds are statutorily required on public works projects. The federal law requiring the bonds is the Miller Act. Alabama requires these bonds for public works projects and that legislative enactment is commonly referred to as the Little Miller Act. *Code of Alabama, 1975, §39-1-1, et seq.* The payment bond may prove very helpful to unpaid subcontractors and material suppliers. An unpaid subcontractor can maintain a direct action against the bonding company for an unpaid balance after the passing of forty-five (45) from a written notice by certified mail to the surety from the claimant. *Code of Alabama, 1975, §39-1-1(b)* This is helpful because defaulting general contractors are often insolvent. Bonds are issued by insurance companies and it is good for the claimant/plaintiff to have an insurance company as a named party defendant. Great leverage to resolve a dispute with a general contractor is brought to bear when its bonding company gets involved. If the bonding company pays, it can recover those funds from the contractor. If the contractor wishes to continue bidding projects requiring bonds, it does not want to estrange a bonding company. The successful claimant/subcontractor can also recover its reasonable attorney's fees incurred in civil actions on the bond. *Code of Alabama, 1975, §39-1-1(a)*

While ironic, one of the most effective ways by which a contractor may protect itself in a construction defects case is through its own express warranty to the owner. There are New Home Limited Warranties, which border on unconscionability, that give the owner little, but take away much. They are Trojan Horses, stripping the unsuspecting owner of all causes of action it might have against the contractor, including those for negligence, wantonness, fraud and breach of contract, in return for a few superficial warranty items. Such warranties place notice requirements on the owner which are onerous, requiring written notice on a short term during which time potential defects might not yet have manifested, or been reasonably noticed and/or appreciated by the new home owner. The Alabama court has held that these warranties are to be enforced as written under the notion that one is free to enter the bargain,

even if it is a bad one. *Stewart v. Bradley*, 15 So.3d 533 (Ala.Civ.App. 2008)

The passage of time or the occurrence of certain events bar litigation against a contractor in a construction defects dispute. The sale of a residential property will extinguish the liability of the original contractor because of lack of privity of contract with the subsequent purchaser. The doctrine of caveat emptor applies to the sale of used residences. *Druid Homes, Inc. v. Cooper*, 131 So.2d 884 (Ala. 1961), *Cochran v. Keeton*, 252 So.2d 313 (Ala. 1971) The statute of limitations for breach of contract is six years from the time of substantial completion. *Mitchell v. Richmond*, 754 So.2d 627 (Ala. 1999) As a practical matter, the issuance of a Certificate of Occupancy may indicate substantial completion. The statute of limitations for negligence is two years from the reasonable discovery of the negligence by the claimant. *Rumford v. Valley Pest Control, Inc.*, 629 So.2d 623, 627 (Ala. 1993) There may be situations where the reasonable discovery by the owner of contractor negligence may extend the time to file even beyond the statute for breach of contract. The statute of repose for architects, engineers and contractors in Alabama is seven years. *Code of Alabama, 1975, §6-5-221* To be under the statute, the contractor must have "... constructed.. an improvement to real property designed by and constructed under the supervision.. of an architect or engineer, or designed by and constructed in accordance with plans and specifications prepared by an architect or engineer.." *Code of Alabama, 1975, §6-5-221(a)* This is not an issue for large commercial or public works construction, but it might for a residential contractor building a house in accordance with house plans either from plan services or draftpersons. There is other explicit language in the statute that "All civil actions in tort, contract, or otherwise.. shall be commenced within two years next after the a cause of action accrues or arises, and not thereafter." *Code of Alabama, 1975, §6-5-221(a)* It would seem that, for matters under this statute relating to architects, engineers and contractors, the statute of limitations for both negligence and breach of contract is two years from substantial completion.

Summary. Communication between and among the parties to a construction contract is the best way to avoid construction defects disputes. Every project has defects. Timely attention by contractors to reasonable issues raised by an owner or

architect will forestall most litigations. Of course, there are situations where the defects are too egregious to address, or an owner is just plain impossible to please. Civil litigation, or arbitration, should be a last resort in construction defect dispute resolution. Construction is an industry where two weeks is a long time. Two years is not a long time at law. A benefit of arbitration is that disputes can be resolved in months, rather than years. The point for owner and contractor alike should not be to prevail at trial or arbitration, but to avoid them altogether.