

TOP 10 CONTRACT TIPS TO AVOID CONSTRUCTION DEFECT CLAIMS IN COLO.

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It has been widely reported that Colorado is in a “housing squeeze” due to the lack of “for sale” affordable housing. In October 2013, the Denver Regional Council of Governments published a comprehensive study identifying the factors influencing the shortage of affordable housing in the Denver metro area, and determined that the most significant impact on the construction of for-sale attached product has come from costs related to construction defect litigation. Such litigation continues to have a chilling effect on the owner-occupied, multifamily housing market. The Homeownership Opportunity Alliance (HOA) has been actively working for several years to obtain legislative reform to the current Colorado construction defect laws. The HOA has reported that in 2016 condos represented just 3.4 percent of new housing starts in the Denver metro area, compared to 20 percent in 2007.

As of the date of writing this article, a bipartisan bill (HB17-1279) that provides some reform for developers was just passed 64-0 by the Democratic-controlled House and is headed to the Senate for approval. HB 1279 requires a majority approval by the owners of homes in a common interest community allegedly affected by the construction defect to approve construction defect litigation — as contrasted with current law that requires only majority approval of the board of the homeowners association (typically three owners in the community). HB 1279 also requires prior notice by the association to the owners as to potential costs, attorneys’ fees, impacts on the owners, including possible adverse effects on market value and issues related to financing during the pendency of a construction defect lawsuit, among other matters.

HB 1279 appears to be helpful to developers of residential projects by requiring notice to owners, a meeting and a majority vote of the affected owners before construction defect litigation can be commenced by the association. The bill also provides an opportunity for the developer to attend the meeting and address the owners regarding the construction defect. However, HB 1279 does not protect the alternative dispute resolution provisions in the homeowners association declaration from being amended out of the declaration, which protection is contained in most of the local construction defect reform ordinances passed by approximately 12 cities and counties in Colorado during the last few years. Many developers fear that without binding arbitration as the dispute resolution process that insurance costs will not decrease and it will continue to be economically unfeasible to construct multifamily for-sale product in Colorado.

Can a developer of residential projects in Colorado stop worrying about the risks of construction defect litigation if HB 1279 passes? Without additional reform to the Colorado construction defect laws, a developer will need to continue to implement a number of strategies to mitigate its risk of litigation. One of the most important strategies is to negotiate the construction contract to protect the developer. The

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standard forms of construction contract — such as the [American Institute of Architects \(AIA\)](#) or ConsensusDocs — are more beneficial to the contractor (GC) than the owner in many respects. The owner's attorney should be aware of, and address, a number of issues in the construction contract to attempt to mitigate or limit the risk of construction defect litigation.

In particular, the following top 10 key issues should be addressed:

1. **Scope of Work** — The scope of work should be well-defined, accurate, comprehensive and identify the basic components of the project. All pertinent attachments, specifications, drawings and plans should be attached or referenced. The scope should not be based solely on the drawings and specifications, which are never 100 percent complete, and the contractor should agree to be required to reasonably infer the scope of work from the contract documents to produce the intended work. If there is an inconsistency in the contract documents or between the drawings and specifications and contract documents, the contract should require that the contractor provide the better quality or quantity of the work or materials. The contractor should be required to report any errors, omissions or inconsistencies in the contract documents to the owner. The contractor's work should be subject to inspection by the owner, applicable city, county or governmental entities, and any third-party forensic construction inspectors retained by the owner or as required by the owner's construction lender or insurance company for quality assurance and quality control. The contractor should give advance notice to the owner as to specified key system installations — such as soil, foundation, acoustical, exterior, building wrap and waterproofing, HVAC and structural components to allow review and inspection by such third-party inspectors. The contractor should be required to perform any and all corrective work and services directed by such third-party inspectors, at the contractor's cost and expense.

2. **Change Orders** — The construction contract should not allow material "field changes" from the approved plans and specifications. If there is a question as to the proper way to construct any aspect of the project, such change must be documented through a request for information process by the contractor. If there are changes or selections not specified in the plans or specifications, any change should be documented and approved by the architect, the owner and third-party inspectors, if appropriate. The contract should require that all changes be documented through a written change order. No verbal changes should be allowed, and if necessary due to an emergency, should be fully documented as soon as possible. In addition, the owner's third-party inspectors should be allowed to document the change process.

3. **Indemnification** — The contract should include a well-written and thorough indemnification and defense obligation by the contractor for the benefit of the owner and its designees as to all construction defect claims and costs, damages, actions, liabilities, judgments and obligations, including investigative and repair costs, attorneys' fees and costs and consultant fees and costs. The indemnity and defense should apply to all negligent or willful acts or omissions of the contractor. The indemnification and defense obligations should survive the expiration or termination of the construction contract through the applicable statute of repose and limitations (currently, a total time period of

eight years in Colorado). The indemnification should comply with applicable law, as many states have anti-indemnity laws that render unenforceable and void as against public policy indemnifications in construction contracts that extend to liability caused by the negligence or fault of the person being indemnified.

4. Warranties — The contractor should warrant that its work is free from defects and that it will be completed in a good and workmanlike manner. The warranty should commence upon substantial completion of the work and continue through the period of the statute of repose and limitations. The warranty should include any specific warranty provided to residential purchasers by the owner. The contractor should be required to comply with warranty requests by the residential purchasers as required by the owner's warranty.

5. Subcontracts — The contractor should incorporate the terms of the GC contract into the subcontracts with its subcontractors, and provide a copy to the owner. In particular, the subcontractors should have the same indemnification, defense, warranty and insurance obligations to the GC that the GC has to the owner. Subcontractors should be required to be joined in the same arbitration or litigation action as the owner and any homeowner or homeowners association. Subcontractors should be qualified and approved by the owner.

6. Insurance — The contract should specify the amounts, types and term of insurance required, and be reviewed by an expert in residential construction insurance. An owner controlled insurance program (OCIP) or contractor controlled insurance program (CCIP) known as "wraps" are preferred. In wrap policies, the owner, contractor and subcontractors are named insureds under a single general liability policy. The OCIP or CCIP should be reviewed to determine if it covers design and construction or only construction. If only construction, the design professionals will need to have proper insurance coverage and limits. The OCIP or CCIP should not contain any exclusions for multifamily, condominium or residential use. Insurance coverage should be maintained from the start of the project through the statute of repose and limitations. The contractor should be required to maintain products and completed operations insurance coverage and other coverage, including endorsements, as required by the owner's OCIP wrap insurance. The insurance provision in the contract should not limit or affect the contractor's obligations to defend and indemnify the owner under the contract. If a CCIP wrap insurance policy is used, the contractor must be obligated to satisfy the requirements of the insurance company, which may entail timely reports, safety guidelines and administrative procedures related to bid award, contract administration and closeout of the project.

7. Dispute Resolution — The contract should specify binding arbitration by a single arbitrator pursuant to the AAA Construction Industry Arbitration Rules or other arbitrator such as DeMars & Associates. However, if a homeowner or homeowners association brings a lawsuit against the owner, then the GC and the subcontractors should be obligated to join such proceedings at the owner's request to resolve the dispute. An express waiver of right to a jury trial should be included in the contract.

8. Compliance with Laws/Environmental Matters — The GC and subcontractors should be obligated to comply with all applicable laws, rules, codes and regulations, which may include the Americans with Disabilities Act of 1990, and all applicable environmental laws related to hazardous substances, storage and disposal of hazardous

materials. The contract should require that the work be completed free of mold or fungi or unacceptable moisture levels. No work should be closed in until moisture levels have reached acceptable levels. The contract should also require compliance with any homeowner association and master developer rules and regulations as to hours of construction, parking, recycling of waste materials, site clean-up and similar requirements. In addition, due to potential homebuyer allergies and similar potential claims, strict no-smoking rules in the home or unit under construction should be specified.

9. Construction Lender — The contractor should be required to satisfy requirements of the construction lender including payment schedule, lien waivers, affidavits and inspections. Inspections could include walk-throughs, video recording and drone photography by the inspectors. The contractor should be obligated to submit all documentation required by the lender, which may include invoices, construction progress reports, conditional and unconditional lien waivers and similar documents. The contractor should consent to any assignment of the contract to such lender.

10. Damages/Attorneys' Fees — The owner should not waive its right to consequential damages, even if the waiver is “mutual” in the contract. Such a waiver is not “mutual” because it harms an owner, who has mainly consequential damages, more than a contractor, who has mainly direct damages. Consequential damages include lost profits, loss of use, delay damages, financing costs and similar damages that are a consequential result from the injury, damage or negligent or intentional act of the other party. Direct damages include cost to repair defective work, unpaid contract amounts and similar damages. Don't be fooled by the “mutual” language in the contract. A waiver of consequential damages may also adversely impact insurance coverage recovery for lost profits and other consequential damages by the owner. In addition, owners should consider whether to add a provision to the contract providing the prevailing party in any action under the contract to its costs and expenses, including attorneys' fees and consultants' fees and experts' fees arising out of any claim or action associated with the contract, and be applicable to trial or arbitration and appeals.

This article is not intended to be an all-inclusive list of revisions that should be made to a construction contract for the benefit of an owner/developer. Owners/developers should consult with an attorney well versed in construction contracts.

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