

REAL ESTATE

FINANCE

Volume 25, Number 4

December 2008

When A Building Leaks Or Has Other Defects: A Step-By-Step Guide To Recovery For The Property Owner

By Robert Alfert, Jr.

Robert Alfert, Jr., a partner in the Orlando office of Broad and Cassel, is a member of the firm's Construction Law and Litigation, Commercial Litigation, and Appellate Practice Groups. Mr. Alfert, who also is a construction arbitrator for the American Arbitration Association, can be reached ralfert@broadandcassel.com.

This article is intended as a guide for property owners to follow in the context of a construction, design or maintenance deficiency that has surfaced during normal use or operation of the property. The same steps apply irrespective of the type of defect, whether it involves water leaks, condensation, mold germination or a structural condition, say skylight fasteners or glass panes loosening and falling during normal vibrations. These same steps also apply regardless of the type of property, whether it is an airport terminal, an apartment complex, an office building or a residence.

All of the actions recommended in this article should be undertaken with due regard to four basic legal principles. First, suit on any discovered defect must be brought within the applicable statutes of limitation; in Florida, that is four years of actual possession, or if the defect is latent, within four years of discovery or when the defect should have been discovered through reasonable due diligence. Second, suit in any event must be brought within the applicable period of repose; in Florida, that is 10 years of actual possession. Third, once a defect is discovered, the owner must move with some reasonable diligence to prevent the problems from worsening (known as "mitigation"). Fourth, any measures to repair should be undertaken only with notice to potentially responsible

parties and an opportunity to inspect and test, so that critical evidence is not destroyed (known as "spoliation of evidence").

STEP ONE: GATHER ALL KEY PROJECT RECORDS

While the universe of documents on a construction project is typically vast, the key records to gather for review in reference to defects involve the following:

- Contracts
- Warranties
- Bonds
- Insurance policies
- Construction plans
- Specifications
- O&M Manuals
- Repair and maintenance records
- Service call records (if apartments, commercial property, etc.)
- Prior inspection/testing reports

It is surprising given the importance of these project records that so many cases involve missing, destroyed, incomplete or damaged records. Property owners should strongly consider reducing key project records to digital copies which facilitates storage and minimizes loss or damage. Consideration should also be given at

When A Building Leaks Or Has Other Defects

contracting stages to require close-out records to be produced in electronic format.

STEP TWO: EVALUATE RIGHTS, REMEDIES AND OBLIGATIONS UNDER THE PROJECT RECORDS

While an attorney is generally more adept at handling this task, the initial review of the project records can be accomplished by the property owner.

In terms of the contract documents, which should be the starting point, the owner should be looking for the following, though not necessarily only, provisions:

Notice—Is there a provision that requires the owner to “notify” the contracting party of the potentially defective condition? If so, it is advisable to comply fully with this provision. The owner should pay particular attention to the timeframe and the manner within which notice is required.

Right to Cure—Some contracts require an owner to provide the defaulting party with an opportunity to cure, i.e., remedy the default before the owner takes the matter into his or her own hands. That means before the owner unilaterally removes a building component to repair a deficiency, the defaulting party must have been accorded a right to remedy the defective condition. This does not necessarily mean that indeed the owner must permit the defaulting party an unequivocal right to repair as there may always be circumstances where perhaps the defaulting party simply cannot be trusted to repair the condition correctly.

Right to Inspect—Some contracts also require an owner to provide the defaulting party an opportunity to inspect and perhaps even test defective conditions.

Remedies—Most contracts articulate the remedies available to the owner in the event of a default, such as a design or construction defect. The owner should be advised to pay attention to words of limitation or disclaimers; for example, many contracts attempt to disclaim certain damages such as consequential damages, which could include loss of profits (rent, business interruption, etc.), loss of use or relocation costs. Some contracts also limit damages to a certain amount. These provisions will educate the owner on the best case recovery scenario. Absent words of limitation or disclaimers, owners will typically be permitted to recover, assuming causation is established, actual damages and consequential damages that were reasonably foreseeable at time of contracting.

Dispute Resolution—These provisions outline the procedures and the venues for claim adjudication. An owner should expect

to find, and hopefully would have negotiated, provisions that dictated whether claims should go to arbitration or litigation. Some more progressive contracts are now requiring mediation or other informal dispute resolution procedures be completed before right to suit or arbitrate arises. Comply fully with these pre-suit procedures. Also, the owner should pay particular attention to provisions dealing with governing law, venue (*i.e.*, the location where legal action must be commenced) and attorneys’ fees. Absent provisions permitting recovery of fees, this expense may be out of the owner’s pockets.

Insurance Bonds—Determine whether the contract required performance bonds and certain types of insurance coverage. Recourse may be possible against third parties with arguably far greater resources to remedy the defects.

The review of any performance bonds, insurance policies and warranties should follow a similar format. Most significant is the notice provision, again making sure that notice follows the timeframe and manner expressly called out. It is also important to review these documents for scope of coverage. Typically the owner will learn that each document will accord a scope of coverage or remedy that is different than the other.

STEP THREE: INVESTIGATION

The owner should retain a forensic consultant with a high degree of experience and expertise in the particular subject matter at issue to conduct an *initial* investigation into the defects. Emphasis is placed on the term *initial* as this exercise is for the owner to obtain an overview of the problem, including the following:

- The nature of the defect
- The potentially responsible parties
- The scope of the damage
- Whether additional consultants are necessary
- Whether any emergency repairs or actions are necessary

The consultant should document the conditions with a written report, photographs, videotapes, if necessary, and any necessary laboratory results. Ultimately this written product may be used in conjunction with the statutory notice to potentially responsible parties, which is required by Florida law, as set forth below.

One advantage to having this investigatory process handled by an attorney is that a work-product privilege could apply to protect against the dissemination of this report should the owner ultimately decide not to disclose it. Such

a circumstance could arise if the report is erroneous, not favorable or contains some other deficiency.

STEP FOUR: NOTICE TO RESPONSIBLE PARTIES

Once the owner has gathered all relevant project records and reached some level of familiarity with the key provisions noted above, and conducted some initial investigation into the problems, it is time to provide proper notice to all potentially responsible parties.

In Florida, in addition to the express requirements of the project documents, it is also important for the owner to comply with Florida's new construction defect statute. This statute has very detailed requirements on notice, inspection and testing rights and other obligations, with a detailed timeframe for the performance of these conditions.

Some basic guidelines are as follows:

The owner must provide notice to potentially responsible parties, which describes the claims in reasonable detail sufficient to determine the general nature of the alleged defects and a description of the damages. Notice should be within 15 days of discovery of the defect, if reasonably possible, and at least 60 days before filing suit (or 120 days on association suits involving more than 20 parcels).

The potentially responsible parties are entitled to a reasonable inspection of the property and an opportunity to conduct destructive testing. The time for inspection and testing is within 30 days of notice (or 50 days with association suits).

Within 45 days of receiving notice of the defect (or 75 days for association suits), the potentially responsible party must serve a written response to the owner, which can include: an offer to repair, cash offer or some combination thereof; a written statement disputing the claim; or a written statement that the potentially responsible party's insurer will respond within 30 days.

An owner that receives a timely written offer to settle must accept or reject that offer within 45 days of receipt.

An owner may bring suit immediately against the potentially responsible parties if such parties dispute the claims or do not respond to the claim within the timeframe set forth in the statute.

Upon request, the owner and the potentially responsible parties receiving notice of a claim shall have a mutual duty to exchange available discoverable evidence relating to the defects, including but not limited to, expert reports, photographs and videotapes.

STEP FIVE: ADDITIONAL TESTING

If the dispute cannot be settled in the dispute resolution process outlined above, it is time to prepare for litigation. It is fairly typical for additional testing to be undertaken, either in connection with expected settlement discussions or pre-suit ADR requirements, in preparation for litigation or after the litigation has commenced. Some basic guidelines are as follows:

The owner should assemble the best team of experts/consultants possible with documented experience and expertise in the various subject matters at issue. Involving legal counsel at this stage may offer two major advantages. First, skilled construction counsel can recommend, not only consultants with expertise in the subject matter at issue, but experts that are skilled in trial proceedings as well. Second, a consultant can initially be retained as a trial consultant whose work is privileged from discovery until the owner or lawyer decides to designate the consultant as a testifying expert witness. This approach gives the owner the luxury of rejecting a report that is not favorable or persuasive, without repercussions of that report coming back to haunt the owner at trial.

The owner should ensure that the team of assembled experts adequately test and inspect all representative conditions, and adequately document all conditions, findings, observations and opinions on causation and damages. This work should be well-documented as well with photographs, videotapes and testing/laboratory data, with reference to plans, specifications and building codes, and emphasis should be placed on preservation of representative pieces of evidence for trial purposes. Experts can be impressive as witnesses when it is clear that they have done their homework.

The owner should also have its team of experts present during every inspection and all testing performed by the potentially responsible parties. First, they should be present to make sure no evidence is contaminated or altered. Second, they should be present to observe all findings and results. Third, they will become versed in the protocols adopted by the adverse parties, which may translate into the discovery of key information on how to challenge the testing data and the ultimate opinions formulated by the adverse experts. Photographic and videotaped evidence should be obtained. It is fairly typical to learn that an expert reported that it followed a certain testing protocol, say an ASTM process for water testing of windows, only to learn through observation that the expert missed one step in the process, something that may not have been learned had the owner's team not been present.

STEP SIX: DISPUTE RESOLUTION

Each construction dispute is unique. Equally unique are the interpersonal relationships between the parties. It is not surprising, therefore, that each dispute dictates a dispute resolution strategy that is more customized. Not all disputes are best resolved or most suited for resorting straight to litigation.

The owner shall explore with its legal counsel what approaches to dispute resolution make best sense for the issues involved. These approaches could involve one or more of the following dispute resolution strategies: structured negotiations, early mediation, binding or non-binding arbitration, dispute resolution boards or other independent panels, or litigation.

Reprinted from *Real Estate Finance* December 2008, Volume 25, Number 4, pages 22-25,
with permission from Aspen Publishers, Inc., Wolters Kluwer Law & Business, New York, NY,
1-800-638-8437, www.aspenpublishers.com