



**WHEN BAD THINGS
HAPPEN TO
GOOD COMPANIES**



KOLETSKY MANCINI FELDMAN & MORROW ATTORNEYS

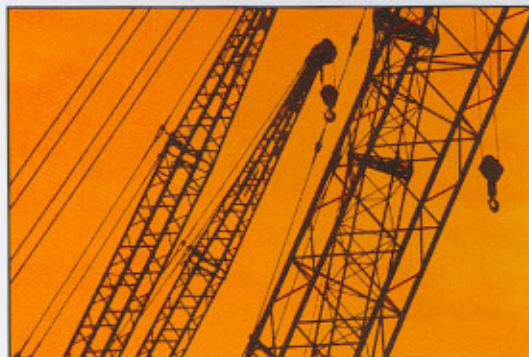
HOW PREPARED WILL YOUR BUSINESS BE?

CONSTRUCTION RISK MANAGEMENT FROM KOLETSKY, MANCINI, FELDMAN & MORROW

Koletsky, Mancini, Feldman & Morrow brings its expertise in construction litigation to the risk management field, offering a risk management program tailored to the varied needs of residential builders. For 20 years, KMFM has been one of the premier construction defect firms in the state, with 40 attorneys providing legal services from offices in Los Angeles and Oakland.

The program, developed by lawyers who specialize in construction defect litigation, is designed to assist in reducing or eliminating the risks associated with construction projects. Our attorneys have put together a comprehensive program based on what we have learned from handling thousands of lawsuits. We know how mistakes made at all stages of construction can lead to litigation. Better still, we know how to avoid them.

Risk Management is an ART
Assessment, Reduction, and Transfer



RISK ASSESSMENT

As early as the selection of the site, builders can take steps to avoid risk. Obtaining geotechnical evaluations, researching the growth of neighboring communities and commercial areas, and evaluating the weather patterns in the region are just a few of the practical considerations that may help to avoid future problems.



Architects and design professionals should be evaluated not only for their compatibility with the project, but also for their availability throughout construction to answer questions from your on-site supervisors. Is your architect local, or is construction going to stop while you wait for him to get to the site and solve a major design problem?

Selection of subcontractors is crucial. When soliciting and considering a bid, consider the subcontractor's track record. Do you know what other projects the subcontractor

has worked on? Do you know whether that company uses regular employees, or does it hire day laborers, and does that in any way threaten the quality of the work?

Careful consideration of the potential pitfalls of hiring the wrong subcontractor or selecting the wrong site can assist builders in avoiding risk altogether, before building even begins.

RISK REDUCTION

There are numerous ways to reduce both the potential financial exposure of homeowner claims and the chances of facing litigation over a project.

The project might require unusual work from certain subcontractors, and that should be considered when drafting the scope of work portion of subcontracts. For example, sloped lots may have to be evaluated for drainage issues by the grader, the concrete flatwork subcontractor, the drain installer, and the landscaper.

Construction supervisors must have the experience to not only recognize potential problems as they arise, but they must have the ability to communicate effectively with the subcontractors to ensure errors are corrected, and design problems are solved. Also, the size of the project and the number of trades working simultaneously may require that your superintendent has one or more assistants who can help him control sequencing and the quality of the construction at every stage.

Disclosures can provide builders with a powerful defense to claims made by homeowners. Obviously, disclosures will vary from project to project, and evaluating the need for particular disclosures requires careful consideration and some foresight. Common disclosures relate to geotechnical issues, building and development in areas surrounding the project, noise from airports and highways, and environmental forces unique to the area. Develop effective sales materials with these issues in mind.

But, without a doubt, one of the most effective methods of risk reduction is effective customer service. Prompt responses to homeowners' complaints and warranty fulfillment can build

goodwill and reduce the likelihood that a homeowner will become disenchanted with the product and sue for issues that may arise years after the sale. Often, homeowners complain that they were ignored, stalled, or received "lowball" offers when complaints were made. The resentment this can cause often drives litigation. So important is this component of customer service that in California Title VII of the *Civil Code*, forces builders to engage homeowners in a "fix it" dialogue before claims go to suit. This encourages builders to avail themselves of the process whenever possible.

RISK TRANSFER

All too often, builders are forced to utilize their own resources or tap into expensive insurance policies to settle claims. Transferring the risk to subcontractors is key to reducing a builders' exposure when a claim is made, and, in turn, keeping insurance premiums as low as possible.

Subcontracts must include the proper insurance, indemnification, and attorneys' fees provisions. Most standard form contracts do not include enough protection for builders, but a

few simple modifications can result in huge savings.

Nowadays, most builders require that their subcontractors maintain liability insurance, or even participate in contractor or owner controlled insurance programs, or WRAPS. But, given the wide range and frequent changes in coverage and exclusions, it is important to consult with counsel when drafting insurance requirements in subcontracts.

Almost every standard form subcontract contains insurance



requirements, but many do not require the subcontractor to maintain insurance after completion of the project. Given that as many as ten years of insurance coverage can be triggered by a construction defect claim, including a future insurance provision in your subcontracts is a good way to be sure that the subcontractors have the funds to contribute their fair share to a settlement or trial judgment.

Additional insured endorsements are an extremely powerful tool in transferring the risk to subcontractors, by providing additional protection against claims arising from construction projects. Specifically, when a subcontractor's work gives rise to claims for construction defects and resultant damage, an additional insured endorsement can give the builder additional coverage, including a defense to the claim.

As you hire your subcontractors, it is critical that you require them to provide you with additional insured coverage on their policies, and provide you with a copy of the certificate proving that they have obtained that coverage. We recommend you include these requirements in the contract, and assign the task of following up with the subcontractors to



ensure that you receive your copies.

Most form contracts address the insurance issue in vague terms. They state that subcontractors must obtain a commercial general liability policy, worker's compensation coverage, and they must name the developer and/or general contractor as an additional insured.

While this is a start, we recommend that you go a step further and add provisions to your subcontracts that explicitly state

the sort of additional insured coverage required.

Indemnity provisions are also included in nearly every subcontract. But, indemnification obligations are ever-evolving in the law resulting in frequent changes to the application of contractual indemnity.

Indemnity provisions fall into three categories, identified as Type I, Type II, and Type III. Type I, the most desirable of the three from the builder's standpoint, provides that the subcontractor will indemnify the builder for any claim arising from the work, whether the subcontractor was negligent or not. This sort of indemnification is ideal for builders, but courts are sometimes hesitant to enforce them, as they put too much of a burden on subcontractors. Type II and Type III indemnification provisions offer less protection for builders. The law regarding indemnification agreements changes often, and consultation with counsel is recommended to ensure that the subcontract is effective and enforceable.

Builders should make sure the subcontractors obtain insurance that provides coverage for contractual indemnity obligations ("insured contracts").



While including effective insurance and indemnity provisions in subcontracts is key to sharing the financial burden of a claim, builders must follow up to make sure the subcontractors are living up to their end of the deal. Most builders require subcontractors to produce insurance certificates and additional insured endorsements before a subcontractor begins work. But that is only the first step in assuring that the subcontractors will pay their fair share of a claim. We recommend "electronically warehousing" documents to ensure all your files are complete. Collecting

insurance certificates from the subcontractors is useless if the certificates can not be found when a claim is made.

In fact, document control and records management on every job is an essential element of any risk management program.

THE HOME BUILDERS RIGHT TO FIX THE LAW

California law now requires that homeowners notify home builders of any defects, and allow the builder the opportunity to repair the defects, prior to filing a lawsuit. This new law could save builders thousands of dollars in defense fees, and prevent the headaches that come with homeowner lawsuits.

The law does have strict time requirements, and if the builder fails to meet the deadlines, the homeowner is free to file a lawsuit. KMFM Consulting Group can assist you in taking advantage of the benefits the law provides.

DOCUMENTS THAT EVERY JOB FILE SHOULD HAVE

One of the biggest pitfalls in the building process is poor document control. The adoption of effective procedures for job file retention will aid in the identification, investigation, and favorable outcome of construction defect claims. The following records should be retained for 10 years.

SIGNED SUBCONTRACTOR AGREEMENTS (WITH TYPE I INDEMNITY PROVISIONS)

You must define the exact scope of the obligations between your company and your subcontractors in a formal written agreement. This ensures that everyone is clear on the scope of work to be performed.

Also, a written agreement can also be written to shift the risk of future liability for defect claims associated with subcontractor work from your company to the subcontractors that did the work.

All Subcontract agreements must contain an indemnity provision

that provides your company with the most protection allowed under California law. This is commonly known as a "Type I" indemnity provision.

Inclusion of a Type I indemnity provision within your subcontract agreement will ensure the subcontractor who actually performed the defective work will be contractually obligated to:

1. Provide you with a defense (or reimbursement for all fees and costs associated therewith); of litigation resulting from subcontractor work;
2. Provide you with compensation for any settlement or judgment obtained on your behalf for damages arising out of the subcontractor's work.

CHANGE ORDERS

The retention of change orders is essential in order to identify which subcontractor performed work related to future defect claims.

Change orders can also provide a paper trail for design changes or deficiencies, and can serve as evidence in builder-homeowner conflicts.

CERTIFICATES OF INSURANCE FROM ALL SUBCONTRACTORS, WITH DECLARATION PAGE

A certificate of insurance is issued by an insurance broker or agent indicating that the subcontractor has obtained the policy of insurance required by the subcontract. The subcontract should include a requirement that the subcontractor provide you with a copy of the certificate.

The certificate of insurance is not insurance. You need to ensure that in addition to the certificate, you obtain a copy of the actual insurance policy including all endorsements.

ADDITIONAL INSURED ENDORSEMENTS

An additional insured endorsement is part of the insurance policy and states that your company is named as an additional

insured under the policy of insurance obtained by the subcontractor.

Be wary of coverage which is limited to "ongoing operations" which limits your coverage under the policy to those damages that are claimed to have occurred during the construction of the project only and do not cover completed operations property damage (defects).





PRIMARY INSURANCE COVERAGE HISTORY FOR YOUR COMPANY AND YOUR SUBS

Once presented with a construction defect claim, a builder\contractor must “tender” the claim to its insurance carrier in order to receive coverage under an insurance policy. Depending upon the periods of coverage afforded, a builder\contractor may be provided insurance coverage from multiple policies for losses arising from the same project.

Every builder\contractor should have a written list or “history” of its insurance coverage in order to maximize tender efforts and insurance coverage.

In addition, a written history of insurance coverage for every retained subcontractor will ensure due diligence in retaining a properly insured subcontractor, and will also maximize tender efforts and additional insurance coverage through subcontractor insurance policies.

ACCOUNTING RECORDS FOR PAYMENTS TO SUBS

Retention of accounting records for payments made to subcontractors is important to defeat claims related to non payment or other payment issues and the release of mechanic’s liens.



FIELD NOTES

Similar to change orders above, field notes are important to memorialize deviations from the plans, changes in materials used, additional or unmemorialized scopes of work, and other variations from formal contract documents.

PLANS / SPECIFICATIONS

Often times, the “as-built” construction will differ from what is specified in the plans and specifications, and will form the basis for future defect claims.

Retention of the plans and specifications allows the builder to determine if the subcontractor performed work in accordance with the plans and specifications, and whether any deviation was warranted.

NOTICES OF COMPLETION

These documents are utilized in determining when the statute of limitations for certain defects begin to run.

PERMITS

Often times, the lack of proper permits will form the basis of defect claims, particularly related to structural issues. The retention of all permits allows the builder to defend against structural defect claims.

INSPECTION REPORTS

Certain aspects of construction require inspections by building inspectors who verify that construction is proper, or advise that certain corrections need to be made.

Retention of the inspection records may assist in the defense against future defect claims when used to show the work was inspected and properly approved.

DESIGN PROFESSIONAL REPORTS

Many aspects of construction require the retention of design professionals to prepare reports or recommendations which are to be followed by the subcontractors whose scope of work is related thereto.

Retention of design professional reports allows the builder to determine if the subcontractor performed work in accordance with the design professional reports, and whether any deviation was warranted.

ALL CORRESPONDENCE

Retention of construction correspondence is necessary for reasons similar to the taking of field notes.

Project correspondence can serve to memorialize events during construction, which can be used to divide liability among subcontractors.



YOUR BOTTOM LINE

It should come as no surprise that increased construction defect litigation has resulted in higher costs and increased risks to developers and general contractors. The cost of litigation is seen not only in a company's bottom line, but also when renewing necessary commercial liability insurance. The resulting higher premiums, deductibles, and self insured retention limits in connection with these policies can have a devastating impact on companies of all sizes. Increased deductibles and self insured retention limits means increased legal costs borne by your company when defending claims within the parameters of these limits. The goal of KMFM Consulting Group is to eliminate or significantly reduce these costs and risks.



OUR SERVICES

Our attorneys are available to work with your management team to:

- Observe site conditions to identify special risk concerns.
- Work with your team at the outset of the building process to ensure subcontractor agreements are in place with proper indemnification and mandatory insurance clauses in effect.
- Provide staff training and instructive seminars in prevention and management of defect-related risk including the right of builders to avail themselves of California's "Right to Fix Statutes" (Title 7 of the Civil Code formerly SB800).
- Provide training relating to claims handling and early resolution procedures.
- Assist in the effective identification, investigation, documentation and file retention of potential losses in order to maximize effective claim evaluation and resolution.
- Assist in working with claimants in order to facilitate early resolution of claims prior to the institution of formal legal proceedings through the enhancement of customer satisfaction and brand relations.

These are just a few examples of the construction risk management services provided by KMF Consulting Group. We invite you to contact us to learn more about how our program can benefit your construction business.

KMFM CONSULTING GROUP
RISK MANAGEMENT SERVICES

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