

If You Build It, They Will Sue: a White Paper on Condominium Projects

by

Trevor O. Resurreccion, Esq.

Peter L. Stacy, Esq.

Weil & Drage, APC¹

I. Introduction

Do architects owe a “duty of care” to the homeowners of a condominium project with whom the architects have no contractual privity? According to the California Supreme Court, they do. What does this mean in practical terms? The answer is that architects are now more than ever exposed to potential future claims and lawsuits brought by homeowners and the homeowners’ associations years after the project has been completed even where the architect’s design decisions are trumped by those of the project developer, and the architect’s role in the construction phase of the project is limited.

The purpose of this paper is to provide background on an architect’s potential liability to its client and third parties on condominium projects as well as guidance on how to prospectively address the concerns highlighted by a recent California Supreme Court decision and many other lawsuits in which architects have been sued by third parties. Specifically, we address the

¹ Weil & Drage, APC has offices in Laguna Hills, CA, Henderson, NV, and Phoenix, AZ. Trevor Resurreccion is a partner with Weil & Drage, APC and is licensed to practice law in California and Nevada. Peter Stacy is the co-managing partner with Weil & Drage, APC and is licensed to practice law in California.

The views expressed in this paper are those of the authors and do not necessarily reflect the views of the AIA Trust. This paper is for general informational purposes only. The authors make no warranty, guarantee, or representation as to the accuracy or sufficiency of any such information. The authors assume no liability to any party for damages arising out of or in connection with the implementation of any recommendations suggested in this paper.

following topics: assessing your owner client, important contract provisions, and insurance issues. The intent is to provide a roadmap for architects in assessing their risks on condominium projects and a practical approach to addressing those risks. While it may not be possible to fully insulate architects from all risks, it is certainly a good practice to have a firm understanding of those risks and to address the risks up front. Benjamin Franklin is attributed with the statement: “In this world nothing can be said to be certain, except death and taxes.” For architects who design condominium projects, unfortunately, lawsuits should be added to that list.

II. The *Beacon* Case – A Bellwether for Future Court Decisions?

In July 2014, the California Supreme Court declared that an architect owes a duty of care to future homeowners where the architect is a “principal architect” on the project. (*Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP, et al.*, 59 Cal.4th 568, 327 P.3d 850 (2014) (“Beacon”).)² The Court held that this duty applies “even if the architect does not actually build the project or exercise ultimate control over construction decisions.” (*Id.* at 581, 327 P.3d 850, 859.) Shocking? Yes! The more significant question is whether YOU are prepared to provide design services on a condominium project in light of the California Supreme Court’s recent decision. The *Beacon* case is particularly apropos to this paper because it involved a condominium project.

It is important to understand the context and facts upon which the *Beacon* case was decided before we address best practices for providing design services for condominium projects. The plaintiff was a homeowners’ association, which sued the project developer and various other parties, including two project architects, for alleged construction defects that

² The Court defined “principal architect” as an architect, in providing professional design services, who is not subordinate to any other design professional. (*Id.* at 581, 327 P.3d 850, 859.)

purportedly make the homes unsafe and uninhabitable during portions of the year due to high temperatures. According to the Association’s complaint, the architects “played an active role throughout construction, coordinating efforts of the design and construction teams, conducting weekly site visits and inspections, recommending design revisions as needed, and monitoring compliance with design plans.”³ (*Id.* at 572, 327 P.3d 850, 853.)

The architects filed a motion challenging the plaintiff’s complaint with the trial court on the grounds that the architects did not owe a duty of care to the Association or its members under the facts alleged. Although the architects prevailed on their motion, the Association appealed and the Court of Appeal reversed the trial court’s decision, holding that the architects owed a duty of care to the Association. The case eventually percolated its way up to the California Supreme Court. The Court framed the legal issue as follows: “Here we consider whether design professionals owe a duty of care to a homeowners association and its members in the absence of privity [of contract].” (*Id.* at 573, 327 P.3d 850, 854.) In answer to this question, the Court noted that the importance of contractual privity “has been greatly eroded over the past century.” (*Id.* at 574, 327 P.3d 850, 854.) In other words, the California courts have recognized that even in the absence of contractual privity, architects *may* owe a duty to a non-client such as a homeowners’ association.

In particular, the Court focused on three factors: (1) the closeness of the connection between the architects’ conduct and the Association’s injury; (2) the limited and wholly evident class of persons and transactions that the architects’ conduct was intended to affect; and (3) the

³ For purpose of the motion, the Court accepted as true the facts as alleged in the Association’s complaint. Importantly, the architects would have the opportunity to challenge the factual allegations at a later stage in the lawsuit, including trial.

absence of “private ordering” options that would more efficiently protect homeowners from design defects and their resulting harms. (*Id.* at 581, 327 P.3d 850, 859.)

With respect to the first factor, the Association’s complaint alleged that the architects’ primary role in the design of the project bore a close connection to the Association’s injury. The Court agreed with the Association that, “even if an architect does not actually build the project or make final decisions on construction, a property owner typically employs an architect in order to rely on the architect’s specialized training, technical expertise, and professional judgment.” (*Id.* at 582, 327 P.3d 850, 859.) As such, the architects could not avoid liability concerning their professional judgment on architectural issues such as adequate ventilation or code-compliant windows on the grounds that the client made the final decision.

Perhaps more alarming was the Court’s pronouncement that, “it would be patently inconsistent with public policy to hold that an architect’s failure to exercise due care in designing a building can be justified by client interests at odds with the interest of prospective homeowners in safety and habitability.” (*Id.* at 582, 327 P.3d 850, 859.) The Court characterized the architects’ services as taking a “lead role” in both the design and implementation of the design for the project. Notably, the Court acknowledged the architects’ claim that the developer’s independent decision and authorization of the alleged defect may prove to be a defense as to whether the architects were the cause of the Association’s claim injury, but *not* whether the architects owed a duty to the Association. (*Id.* at 583, 327 P.3d 850, 853.)

The second factor the Court considered is the class of persons the architects’ services were ultimately intended to benefit or affect. The Association alleged that the architects knew their services were being provided on a project intended to be sold as condominiums and used as

residences. Accordingly, the Court concluded that the architects were well aware that the architects' services would necessarily affect the homeowners. (*Id.* at 584, 327 P.3d 850, 854.)

The third and final factor the Court considered was the prospect of so-called private ordering (hiring a third party professional to provide an independent assessment of the structure and its component parts) as an alternative to negligence liability. The Court analogized the average homebuyer to the "presumptively powerless consumer" in a product liability case. (*Id.* at 584, 327 P.3d 850, 861.) The Court explained:

A liability rule that places the onus on homebuyers to employ their own architects to fully investigate the structure and design of each home they might be interested in purchasing does not seem more efficient than a rule that makes the architects who designed the homes directly responsible to homebuyers for exercising due care in the first place. This seems especially true in 'today's society' given the 'mass production and sale of homes' . . . such as the 595-unit condominium project in this case."

(*Id.* at 585, 327 P.3d 850, 862.)

The Court in *Beacon* summarized its conclusion as follows:

1. The architects' work was *intended to benefit the homeowners* living in the residential units that the architects designed and helped construct;
2. It was *foreseeable* that these homeowners would be among the limited class of persons harmed by the negligently designed units;
3. The Association's members *suffered injury* because the design defects made their homes unsafe and uninhabitable during certain periods;
4. Based upon the nature and extent of the architects' role as the sole architects on the project, there is a *close connection* between the architects' conduct and the injury suffered;

5. Significant “*moral blame*” attached to the architects’ conduct because of their “unique and well-compensated role” in the project in addition to their awareness that future homeowners would rely on the architects’ specialized expertise in designing safe and habitable homes; and
6. The *policy of preventing future harm* to homeowners reliant on architects’ specialized skills supports recognition of a duty of care.

(*Id.* at 586, 327 P.3d 850, 862.)

In light of the *Beacon* decision, architects are forewarned regarding the potential minefield of liability issues they may face if they choose to provide architectural services on a condominium or other residential project, including exposure to claims by future homeowners and the homeowners’ associations (HOA). The following are a few tips for taking a proactive approach when considering taking on the inherent liability risks involved in designing a condominium project:

- An iron-clad scope of services, clearly designating the roles of owner, contractor, architect and other consultants, may prove helpful in educating a court on how broad a prime consultant’s services really are. We are all very aware that lead consultants on a project can only do so much. Your contract becomes the first line of defense in articulating how much control you really have.
- An indemnity and/or limitation of liability provisions that includes third party claims are generally enforceable. You can negotiate reasonable language with your client that will protect both parties fairly, and require your client to protect you from third party claims, or provide insurance to cover such claims. Even if that protection has its limits, it is worth fighting for. Better yet, insist that the indemnity obligations are

with the parent company developer as opposed to the subsidiary/LLC that only owns the one development property.

- As lead consultant, you are generally the scrivener of meeting minutes, responses to inquiries and change order requests, etc. Use these opportunities to include notations as to the parties involved in certain discussions and decision-making. These documents may become key in a subsequent lawsuit, as they will likely shed light on how much power a “principal architect” really has throughout the course of a project.
- Propose contract provisions to your client requiring language in the Purchase and Sales Agreements and CC&Rs, (Covenants Conditions and Restrictions), that force the HOA and homeowners, if they are to be considered legitimate third party beneficiaries, to be subject to any and all contract defenses that you have within your agreement with your client.
- Insist upon additional, protective contract language that has your client agree to write into the Declaration, the Bylaws and Purchase & Sales Agreements a requirement that the recommended maintenance be the responsibility of the HOA, and that homeowners undertake additional maintenance measures for their own residences.

With *Beacon* as our starting point, let’s now turn to more specific contractual and other liability considerations to assist architects who are considering designing a condominium project.

III. Assessing Your Owner Client

In light of the *Beacon* decision, client selection/evaluation could not be more important for a condominium project. The client that you execute a contract with is looking to transfer ownership to a HOA and individual unit owners as soon as possible. This means that instead of just the client as a likely claimant against the design professional for project delays and/or

defects, you now also have the HOA and individual unit owners as potential plaintiffs that can sue the design professional directly. Is the client developer going to be there when the claims of the HOA and/or unit owners arise? Often times, a single purpose entity is formed by the client developer for the particular project. The contract may very well limit your remedy only against this single purpose entity that has little if any assets once the project is complete and units sold. Will the client developer even be in existence at the time of a claim? You may heavily negotiate an owner indemnity provision for HOA/homeowner claims. However, unless there is some parent company guaranty to such an indemnity obligation, this may be a hollow provision. What is the client developer's litigation history and/or track record in addressing HOA and unit owners' claims? Will the client developer entertain making repairs to mitigate the damages, or at least have hired reputable contractors and required such contractors to carry appropriate insurance to cover HOA and unit owner claims? Is the client developer willing to address maintenance obligations of the HOA and unit owners in the drafting of the HOA's CC&Rs, bylaws and other documents? Reputation of your client developer in this regard should not be overlooked. All of the above should be carefully considered in addition to the specific key protective contract provisions discussed below.

IV. Important Contract Provisions

A. Indemnity, Indemnity, Indemnity!!!

In the real estate business the often-touted phrase is "location, location, location." In the design and construction industry, the most important contract provision is *INDEMNITY*. Indemnity is an agreement to assume a specific liability in the event of a loss. It may mean a shifting of risk from one party to another. More often than not, it is the client saddling the design professional with an onerous indemnity provision. Many articles have already been written

about addressing the client-drafted indemnity. Avoid an express duty to defend (and in California especially, negate this duty). Tie the indemnity obligation to a determination of negligence. However, in the context of agreeing to perform professional services on a condominium project, you must not only be wary of the indemnity provision imposing a contractual obligation on the design professional, but serious consideration should be given to obtaining express indemnity language from the client developer and/or the client developer's contractor and subcontractors. Since the design professional may be sued directly by an HOA or individual unit owners, express indemnity running in favor of the design professional is equally important.

B. Waiver of Consequential Damages

These damages are the "indirect damages and expenses" claimed by plaintiff(s) allegedly relating to asserted design and construction defects. Often, consequential damages include damages relating to delays, loss of use, lost profits, etc. It is a balancing provision in that it should recognize, much like a limitation of liability (discussed further below), that there are relative risks and rewards for each party's participation on the project. As was commonplace during the recent recession, some client developers pursued claims against design professionals and contractors for missed market opportunities to sell their individual units before the housing bubble burst. The design professional has no control over such market factors. A properly-worded, mutual waiver of consequential damages is an appropriate way to address this.

C. Limitation of Liability

Given the increased risk of being sued on a condominium project, a limitation of liability (overall cap) of the design professional from the client developer is essential. A limitation of liability provision can be tied to the amount of available insurance, the architect's total fee, or

some other amount as negotiated between the parties to the contract. The limitation of liability provision should be negotiated at arm's length such that both parties have the opportunity to accept, reject or modify the provision.

D. No Third-Party Beneficiaries

It has long been a recommendation that design professionals include a “no third party beneficiaries” clause in their contracts to eliminate the possibility of third parties (i.e., parties not in privity of contract with the design professional) to avail themselves of contract rights and claims in litigation. Generally, this is still the case. However, with the *Beacon* decision, since the HOA and individual unit owners may be deemed third party beneficiaries as a matter of law, attempts should be made to tie them to be bound by the affirmative defense and limitation provisions of the contract that are there to protect the design professional. This necessarily requires the cooperation of the client developer through a contractual obligation.

E. The Certificate of Merit

Many states have a statutory certificate of merit requirement as a condition precedent to suing a design professional. While these statutes vary in effectiveness, it is at least some minimal stumbling block that plaintiffs must navigate. Design professionals should also consider strengthening the certificate of merit requirement and conditions through their contracts. Require that anyone pursuing a claim against a design professional not only obtain a certificate of merit but also support the certificate with a detailed report by the expert upon whom the certificate is based. Expressly require a certificate of merit regardless of the forum (e.g., civil courts, arbitration, judicial reference).

F. Provisions Requiring the Developer and Subsequent Owners to Include Maintenance Requirements and Manuals in CC&Rs and Purchase Agreements

A lack of proper maintenance of common areas, landscaping, drainage, roofs, decks, etc. have long been at the heart of most common interest development/condominium lawsuits. Accordingly, it is important for both the design professional and the client developer to craft maintenance obligations and requirements binding upon the HOA and unit owners. Such provisions not only serve to mitigate the actual damages but work as affirmative defenses if the HOA and/or unit owners fail to abide by them. The following provisions are recommended:

1. General Maintenance. The Owner agrees that the bylaws of any Homeowners' Association established for the residential portion of this Project will require that the Association will perform, as recommended in the CC&Rs, Bylaws and/or Maintenance Manual, all necessary routine maintenance, maintenance inspections and any other necessary repairs and maintenance called for as a result of these maintenance inspections. The Bylaws shall also contain an appropriate waiver and indemnity in favor of the Owner, the Architect, all Consultants and the Contractor if the maintenance recommendations contained in the CC&Rs, Bylaws and/or Maintenance Manual applicable to the Association are not performed.

2. Homeowner Maintenance Obligations for any Residential Portion of Project. The Owner agrees that the CC&Rs established for the residential portion of this Project will require that the Homeowner will perform, as recommended in the CC&Rs, Bylaws and/or Maintenance Manual, all applicable and necessary routine maintenance, maintenance inspections and any other necessary repairs and maintenance identified. The CC&Rs shall also contain an appropriate waiver and indemnity in favor of the Owner, the Architect, all Consultants and the Contractor if the maintenance recommendations contained in the CC&Rs and Maintenance Manual applicable to the Homeowner(s) are not performed.

3. Maintenance Manual. Owner shall retain and utilize an independent third party consultant to prepare a fully detailed Maintenance Manual to be provided to the Homeowner Association. Such Maintenance Manual will contain all the information necessary for the Homeowner Association to maintain the Project. The Maintenance Manual will contain specific requirements for:

1. Why the maintenance is required
2. What maintenance tasks are required

3. Where (which locations) the maintenance tasks will be performed
4. When (and how often) the maintenance tasks will be performed
5. How the maintenance tasks will be performed
6. Who is the best entity to perform the maintenance tasks
7. The estimated costs associated with each of the maintenance tasks
8. Logs documenting the status of all maintenance tasks

4. Owner's Obligation to Retain Third Party Construction Inspection Service. The Owner shall retain and utilize an independent third party construction inspection service to perform a technical review of the final Construction Documents and observe and document construction of the project and report any defects, disparities, errors or omissions to the Owner. The Owner will insure that all recommendations for repairs, corrections or changes are accomplished.

5. Waterproofing Consultant. The Owner shall retain and utilize an independent third party waterproofing consultant to provide advice, oversight, and performance evaluations to ensure that all components of a building's exterior perform. The waterproofing consultant shall be involved in the preparation of roofing, waterproofing, and exterior wall systems specifications, drawings, and construction inspection of the waterproof installation.

6. Independent Property Inspector. The Owner will assure that the Purchase and Sale Agreements for all units sold will require that each purchaser must retain an independent property inspector to inspect the purchased property for defects prior to closing.

7. Indemnity with respect to claims by HOA or Homeowners. The Owner acknowledges the risks to the Architect inherent in condominium projects and the disparity between the Architect's fee and the Architect's potential liability for problems or alleged problems with such condominium projects. Therefore the Owner agrees, to the fullest extent permitted by law, to indemnify and hold harmless the Architect, its officers, directors, employees and subconsultants (collectively, Architect) against all damages, liabilities or costs, including reasonable attorney's fees and defense costs, arising out of or in any way connected with the services performed under this Agreement, except for the Architect's sole negligence or willful misconduct. This indemnity obligation shall be binding upon Owner's successors, assigns, legal representatives and any subsequent owners of the Project and/or Property, and this indemnity obligation shall inure to the benefit of Architect, and its successors, assigns and legal representatives. Owner shall obtain the express written agreement of any subsequent owner and/or purchaser of the Project and/or Property to be bound by this provision, and shall provide Architect with a copy of such agreement. Should the Owner fail to obtain the express written agreement of the successor Owner(s) or Purchaser(s) or such successor Owner(s) or Purchaser(s) fail to perform the

obligations herein, then Owner shall remain responsible to indemnify, defend and hold harmless as set forth above.

8. Waiver. In consideration of the substantial risks to the Architect in rendering professional services in connection with this Project, the Owner agrees to make no claim and hereby waives, to the fullest extent permitted by law, any claim or cause of action of any nature against the Architect, its officers, directors, employees and subconsultants (collectively Architect), which may arise out of or in connection with this Project or the performance, by any of the parties above named, of the services under this Agreement.

9. Third Party Beneficiaries. Nothing contained in this Agreement shall create a contractual relationship with or a cause of action in favor of a third party against either the Architect or Owner, except as otherwise imposed by law. The Architect's services under this Agreement are intended as being performed solely for the Owner's benefit, and no other party or entity shall have any claim against the Architect because of this Agreement or the performance or nonperformance of services hereunder.

10. WRAP or OCIP (Owner Controlled Insurance Program) policy for Project. Prior to commencement of construction, the Owner agrees to obtain or require that the Contractor obtain a WRAP (or OCIP if the WRAP is unavailable) policy of insurance for the Contractor and its subcontractors for the Project, and provide Architect with proof of such insurance prior to the commencement of construction. Architect and its consultants shall be named as Insureds with the WRAP or OCIP insurance for the Project. The WRAP or OCIP policy shall include coverage for the negligent acts, errors and omissions of Architect and Architect's consultants in the amount of \$5,000,000 per claim and aggregate, subject to \$50,000 deductible per claim. The WRAP or OCIP policy and limits (1) shall be primary to any similar insurance carried by Architect and Architect's consultants and not excess; (2) shall apply as if each Named Insured were the only Named Insured; (3) shall apply separately to each insured against whom claim is made or suit is brought ;(4) shall have a fully paid ten (10) year discovery and extended reporting period. The failure to secure and maintain the WRAP or OCIP shall be considered a material breach of this Agreement and entitle Architect to immediately terminate this Agreement.

11. OPPI (Owner Protective Professional Indemnity) policy for the Project, Project Specific Excess. Prior to commencement of construction, Owner agrees to obtain or cause to be obtained an OPPI policy to supplement the Architect's professional liability insurance limits in the amount of at least \$__,000,000. The policy shall be purchased and fully paid for a discovery and extended reporting period of ten (10) years following substantial completion of the Project. The Owner shall provide Architect with proof of such insurance policies. The Owner and the OPPI Insurer shall waive subrogation, and shall have no claim against the Architect, Architect's consultants and their employees,

owners, officers and directors and insurers. If the Owner decides not to procure an OPPI Policy, then the Owner shall pay/reimburse the Architect the cost of securing and maintaining project specific excess insurance in the amount of \$____,000,000.00 for a period of ten (10) years following substantial completion of the Project. The project specific excess must also be secured prior to the commencement of construction. The failure to secure and maintain the OPPI or project specific excess policy shall be considered a material breach of this Agreement

12. Contractor Indemnity. The Owner shall require in its agreement with the Contractor that the Contractor shall indemnify and hold harmless the Owner, Architect, Architect's consultants, and agents and employees of any of them from and against claims, damages, losses and expenses, including but not limited to attorneys' fees, arising out of or resulting from performance of the Work, provided that such claim, damage, loss or expense is attributable to bodily injury, sickness, disease or death, or to injury to or destruction of tangible property (other than the Work itself), arising out of or relating to the negligent acts or omissions of the Contractor, a Subcontractor, anyone directly or indirectly employed by them or anyone for whose acts they may be liable, regardless of whether or not such claim, damage, loss or expense is caused in part by a party indemnified hereunder.

13. Specific HOA Obligations. The Owner shall include in the Project's "Declaration of Covenants, Conditions and Restrictions" the by-laws applicable to individual residential condominium units, individual residential condominium unit purchase agreements, or similar documents, provisions providing that the Project's Home Owners Association ("HOA") and individual unit owners (singly, "Unit Owner" and collectively, "Unit Owners") to the following effect:

- a. The HOA shall be responsible for (a) proper and timely maintenance of all portions of the Condominium Portion of the Project not the direct responsibility of a Unit Owner (the "Common Areas"), and the Unit Owners shall be responsible for the proper and timely maintenance of all portions of their individual units, in each case such maintenance to include, at a minimum, the routine maintenance, maintenance inspections and any other necessary repairs and maintenance called for as a result of such maintenance inspections as described in the Maintenance Manual referred to above in this Agreement, and (b) establishing reasonable requirements for adequately funding, on a continuing basis, a maintenance program to satisfy the HOA responsibilities;
- b. Neither the Architect nor its consultants nor their respective officers, directors and employees, shall be responsible to the HOA or the Unit Owners for the proper and timely maintenance of the Common Areas or the individual units;

- c. The HOA and each affected Unit Owner shall first consult with construction experts knowledgeable and experienced in the matters concerning the HOA and such Unit Owners prior to initiating any dispute resolution proceedings involving any allegations of deficiencies in the performance of or asserting any claims against the Architect or its consultants in connection with the Condominium Portion of the Project;
- d. The HOA, in contemplating the pursuit of any claims, must also survey Unit Owners, and send out questionnaires to individual Unit Owners concerning the actual or potential claims of any individual Unit Owners, and evaluate whether the HOA may pursue both the claims of the association as to common areas and the claims of Unit Owners as to the interiors of individual units whether any claims of Unit Owners must, in the interest of judicial economy, be brought by the Unit Owners individually concurrently with any claim brought by the HOA but joined, as required above; and
- e. The Unit Owners and the HOA will obtain adequate insurance to protect the Unit Owners' and HOA's respective interests in the property. .

14. Architect Shall Be Allowed to Review Documents. The Owner shall afford the Architect the opportunity to comment upon draft copies of the various documents referred to in this Section prior to their finalization.

V. Insurance Issues

No discussion regarding protecting yourself from third-party claims is complete without a discussion regarding professional liability insurance policies. The AIA Trust recently published a summary report of the 2014 professional liability insurance carrier interviews.⁴ According to the report, there is a trend amongst owners requesting higher limits for insurance coverage. The insurance carriers which reported on this trend noted: "These requests for higher limits are not necessarily tied to the value of the project or increased exposure from the design professional, but rather are an attempt to increase the overall insurance proceeds available to the owner to respond to claims. As a result, carriers are seeing an increased use of project specific policies to

⁴ Available at www.theaiatrust.com/filecabinet/PLI-Interview-Summary-2015.pdf

respond to these requests.”⁵ Further, *the total claim cost amounts have increased* while the total number of claims has reduced.⁶ However, the general expectation amongst carriers is that the frequency of claims will increase over the next year based upon increased in work activity for their insureds.⁷

With respect to claims based upon project type, the insurance carriers reported that claims involving multifamily residential, condominiums, and schools/universities were reported to be approximately 25% of total claims.⁸ As many architects are aware, many developers are making the decision to convert rental apartments to condominiums. By doing so, architects and others involved in the design and construction of multifamily residential projects are increasingly faced with the prospect of a new pool of potential third-party claimants, including individual homeowners and homeowners’ associations. “Add that to the scope and quality variations caused by contractor and owner value engineering substitutions, and the fact that the ultimate third-party condo owners are not always happy with the finished product. The result has been increased claims by the condominium owners against developers, contractors and design professionals.”⁹ For those architects whom regularly or are considering providing design services for condominium projects, consider the following: “Several insurers interviewed indicated that they take a more detailed look at firms that provide condominium design when they quote policy rates. Over 40% of the insurers interviewed reported that they have policy

⁵ *Id.* at p. 2.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* at p. 5.

restrictions on condominium work, and almost 60% interviewed stated that condominiums may lead to higher rate increases in the coming years.”¹⁰

The client developer should be required to obtain WRAP or OCIP insurance to cover general liability claims of the contractor and subcontractors. Such policies should be in place from commencement of construction through completion and be “occurrence based.” It is one thing to require that a WRAP or OCIP be obtained in the contract but it is vitally important to make sure one of these policies is actually obtained. The failure to obtain should be a material breach of the design professional agreement, and grounds for termination. There have been too many cases where the design professional becomes the main target in litigation due to the fact that a WRAP or OCIP – although contractually required – was not obtained and the design professional is the only party with insurance.

You would think that there would be a specific insurance product for design professionals performing condominium projects. There currently is not. The availability of project specific professional liability insurance to cover the design team is rare if non-existent for such projects. Therefore, it is the design professional’s practice policy of professional liability that remains at risk. It is important to ensure that there are no exclusives in your policy regarding condominium projects. Many policies prohibit more than a certain percentage of your annual revenue to be generated from services on such projects. You may also want to look at project specific excess insurance to cover the risks associated with specific condominium projects, and the design professional should seek the cost of the same as a reimbursable cost from the client developer.

Lastly, an OPPI policy should be discussed as offering the client developer some protection as opposed to requiring the design professional to raise its overall practice policy to

¹⁰ *Id.* at p. 6.

higher limits at increased premium cost. The OPPI does not directly offer any insurance protection for the design team. It generally sits in an excess or secondary position to the design professional(s)' practice policies. In other words, the OPPI protects the Owner for the design professional errors and omissions once the design professional's practice policies have been exhausted.

VI. Conclusion and Recommendations

The bottom line is that condominium projects remain high risk. There is no absolute protection that a design professional can negotiate with its client to avoid the very real possibility of HOA and/or individual unit owner claims and lawsuits. Some states have adopted statutory pre-litigation schemes to address residential construction and design defects and "right to repair." Unfortunately, the statutory language has created rights for HOA and/or homeowners to pursue contractors and design professionals directly, regardless of contractual privity. The *Beacon* decision has taken it even farther. The best defenses remain a good set of plans and specifications, used by competent general contractors and subcontractors, with appropriate third party observation and inspection (especially of the building envelope/waterproofing). Having a client that will be there at the time of a claim is no guaranty so past performance and litigation history are worth investigating. Both you and your client should explore all of the various insurance products. Consult your insurance broker. Both you and your client should be united in making sure that HOA and unit owner maintenance requirements are mandated in the project CC&Rs, declarations and manuals. Lastly, if defect and deficiency issues do arise, a well-drafted protocol to address the same may lead to a more efficient and economical resolution of the same. The money may be good and the projects plentiful but the risks are real. Thoughtfully

approaching each and every project, from contract negotiation to the purchase and sale of individual units, is key to both you and your client.

Copyright © 2015 Weil & Drage, APC. All rights reserved. Weil & Drage, APC is located at 23212 Mill Creek Drive, Laguna Hills, CA 92653.