

# CONSTRUCTION LAW



## COMMERCIAL CONSTRUCTION DEFECTS LIABILITY

### A Primer for Colorado Developers

By Jeremy P. Syz

Construction defects law in Colorado has been the source of much consternation and debate among developers, homeowners, lenders, and lawmakers in recent years. Most of the recent attention has focused on the residential arena, with a heavy emphasis on the profound effects of defect litigation on affordable condominium production. However, commercial construction is not immune from construction defects issues, and commercial developers face their own set of concerns and risks. Indeed, due to the dollars involved in a commercial context, the stakes can be much greater than those of residential defects claims.

#### How Long Do I Need to Worry?

A developer's potential liability for a project is not limited to the construction period or even the time that the developer owns the project. Rather, Colorado law provides in C.R.S. §13-80-104 for both a two-year statute of limitations — which runs from the time the first manifestations of the defect are discovered by the owner/claimant — and a statute of "repose," which creates a time limit after which all claims are barred, regardless of when they are discovered. The statute of repose provides that no claim may be brought more than six years after "substantial completion of the improvement to real property" (or if the claim is discovered in the fifth or sixth year, then within two years of the date the claim arose). Thus the total period of time that a developer is potentially liable for a construction defect claim is effectively eight years.

#### Limited Liability What?

So, you may ask, "Why does that matter to me, since my construction company is a limited liability company?" Doesn't that mean my liability is limited? The short answer is probably not. A slightly longer answer is that an entity can only act through its people, and the act of an employee or principal that causes

damage to another typically results in liability both for that individual and for the entity for which they work. In fact, in a development context, the standard for individual conduct that may trigger liability is often low. There is a high potential for direct claims against owners and managers arising from a host of construction decisions they may have made, under the legal theory of respondeat superior, or "let the master answer" for the deeds of his employees. Indeed, courts have imposed liability on the manager of a limited liability company in cases where he or she approved of, directed, actively participated in, or cooperated in the negligent conduct, and courts have also imposed liability on a company's principal for negligent misrepresentation even though misrepresentations may have been unintentional.

#### Buying Protection Against Liability

The best protection against construction-defects liability is to obtain and maintain targeted, effective insurance. While a developer may not be able to entirely avoid liability, it can cushion the impact of potential claims with properly designed and implemented insurance strategies. The following are a few of the rules of the road of insurance coverage that may help protect a developer from potential construction defects liability.

1. Buy Insurance First, Start Building Later: Before a project begins, developers need to consider who might be the potential targets of a liability case. As a general rule, plaintiffs' counsel will name not only the development entity, but an affiliated construction, brokerage and management company, and officers, directors, and owners. To maximize protection, the developer's liability coverage should name not only the principal entity, but everyone else in harm's way who is affiliated with the developer. Often, the additional coverage cost is not significant.

2. Experience Counts: Make sure that the insurance broker has actual experience in the construction context. There is a shrinking group of insurance companies and brokers in Colorado who specialize in construction insurance, and actually understand what developers need. These advisors, with the help of experienced insurance counsel, can recommend the appropriate policies that should be obtained for all the right insured parties. Gaps in coverage are easy to close with good advice; unclosed gaps in coverage can be very expensive.

3. See the Policy, Read the Policy: A certificate of insurance at one time was sufficient to prove what coverages were in place. However, the certificate of insurance no longer has any legal significance. Now, the standard insurance certificate repeatedly states that it cannot be relied on as a representation of coverage. Insureds should insist on receiving an insurance "binder" or the actual policy, and thoroughly read them to make sure the necessary coverages are being provided.

4. Exclusions for Multi-Family Construction: Commercial or multi-family apartment construction or mixed-use construction must beware of potential exclusions for multi-family, residential and/or condominium construction contained in the insurance policy. Where such an exclusion exists, there may be no coverage for the developer or any contractors, subcontractors, or design professionals.

5. Completed Operations Coverage: Commercial General Liability (CGL) coverage is effective for contractors and subcontractors while they are on the job, but not when the job is complete. Of course it is when the job is complete that a construction defect claim may arise. Owners and developers must obtain "completed operations" coverage as additional insureds on contractors' and subcontractors' policies, bearing in mind that these policies have a definite term. Given Colorado's statute of repose, a policy term of at least eight years for completed operations coverage is advisable (or at least a commitment to renew the CGL policy for that period).

6. Design Professionals: In most construction defect cases, the disputes typically involve issues, and liability for design is generally not covered under the typical CGL policy. This is a lurking and stealthy problem, particularly where projects are increasingly "design-build." The developer must ensure not only that contractors who are performing some design function as part of their construction work have adequate design-professional coverage, but that the architects, engineers, and other design consultants have adequate professional liability coverage both during the project and after its completion. This can be accomplished by ensuring that the primary contractor has professional liability coverage for all professional subcontractors, being named as an additional insured on subcontractor policies, or requiring that the individual policies of subs be maintained through the period of the statute of repose.

This article touches on only a few considerations for a developer in Colorado related to construction defects and insurance. As additional parties are added to the equation, such as construction lenders, the issues can expand exponentially. The best approach is to act early and with great care in structuring an entity, hiring good employees, and implementing a comprehensive insurance strategy.

*The author is an Associate at Holland & Hart, LLP. He advises clients on transactions involving the acquisition, financing, sale, and development of real property. He can be reached at [jpsyz@HollandHart.com](mailto:jpsyz@HollandHart.com) or 303.473.2708.*

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