Nevada Residential Construction Defects
AB 125 Quick Summary

Michael Hoy
Michael Kimmel
HOY CHRISSINGER KIMMEL VALLAS, PC

Introduction

On February 24, 2015, the Governor signed AB 125, a bill containing comprehensive changes to litigation of construction defects. Because many provisions are effective immediately, practitioners should immediately study the new law and identify its impact on pending litigation and pre-litigation Chapter 40 proceedings.

Definition of "constructional defect"

Prior law defined "constructional defect" very broadly. NRS 40.615. Any code violation, whether or not the condition was dangerous or damaged property, fell within the definition. That broad definition, combined with ambiguous provisions in building codes, created claims where the only "damage" was to change a condition that caused no harm.

AB 125, section 6 changes the definition of "constructional defect." To qualify as a "defect," work must now either: (1) present an unreasonable risk of injury to a person or property; or (2) not be completed in a good and workmanlike manner and "proximately cause physical damage to the residence, an appurtenance or the real property to which the residence or appurtenance is affixed."

Counsel and courts will study this definition for years. In many cases, the first prong (unreasonable risk of physical injury) will be difficult to prove without a trial. The language of the second prong seems to suggest the cost to repair the work itself is not sufficient to trigger liability. The defective work must actually cause damage to some other improvement.

Attorney fees

Section 15 of the bill eliminates attorney fees as an element of recovery under NRS 40.655.

The original intent of Chapter 40 was to reduce litigation by giving builders an opportunity to repair defects, and giving homeowners the incentive to accept repairs rather than seeking a monetary award. AB 125 proponents have argued (for many legislative sessions) that the so-called "entitlement" to attorney fees subverts the original purpose of Chapter 40 by incentivizing monetary settlements and judgments. In several highly-publicized cases, the courts have awarded attorney fees that are disproportionate to the monetary award. In mediation, attorney fees have become a barrier to resolving cases with repairs and have been serious stumbling blocks for monetary settlements.

AB 125 opponents have argued (for many legislative sessions) that lawyers for the homeowners cannot afford to finance litigation unless they have a guaranteed "entitlement" to attorney fees, and that most homeowners lack the ability to finance litigation. Therefore, they argue, eliminating attorney fees as part of the remedy in NRS 40.655 reduces or eliminates access to justice for aggrieved home buyers.

AB 125 does not remove every basis for recovery of attorney fees.

Justice Court claims up to $10,000. A claim to recover up to $10,000, exclusive of interest, may be commenced in Justice Court. NRS 4.370(1). In Justice Court, the prevailing homeowner can recover attorney fees as costs. NRS 69.030.

District Court claims up to $20,000. A claimant who recovers up to $20,000 in District Court may recover attorney fees under NRS 18.010(2)(A).

As we read NRS 18.010(2)(a), we believe that the $20,000 ceiling would be applied on a claimant-by-claimant basis. If a case included owners of 50 homes, but less than $20,000 were awarded for each home, NRS 18.010(2)(a) would authorize an award of fees for each homeowner. It will be important for claimants' lawyers to carefully document and allocate attorney fees to each home or plaintiff.

Unreasonable defenses. During debate in the Legislature, opponents of AB 125 argued that, in some cases, the courts have awarded homeowners fees in excess of the principal because the defense was unreasonable. The District Court's ability to award attorney fees against a party as a sanction for an unreasonable claim or defense is preserved in NRS 18.010(2)(B).

Offers of judgment. Both claimants and defendants have the right to make offers of judgment. (In fact, section 3 of the bill provides both sides the ability to make an offer of judgment during the Chapter 40 pre-litigation process.) A homeowner who makes an offer of judgment and then beats the offer will be entitled to recover reasonable attorney fees.

Contractual fee-shifting provisions. In our experience, several national homebuilders include fee-shifting provisions in their contracts. We are not aware that the builders have ever attempted to enforce these provisions against home buyers. Because of the previous "entitlement" to attorney fees, it would be impractical for homeowners to seek enforcement of a contractual fee-shifting provision.

Statutes of Repose

Legislative debate makes clear that law makers do not fully appreciate the differences between statutes of limitations and statutes of repose. *See Allstate Ins. Co. v. Furgerson*, 104 Nev. 772, 775 n. 2, 766 P.2d 904 n. 2 (1988). AB 125 does not change statutes of limitations.

Statutes of repose begin to run upon substantial completion of an improvement. Under existing law, statutes of repose for claims against the builders and designers depends on whether the deficiency: (1) resulted from willful misconduct or was fraudulently concealed, NRS 11.202 (no limitation); (2) was a known deficiency, NRS 11.203 (10 years); (3) was a latent deficiency, NRS 11.204 (8 years); or (4) was a patent deficiency, NRS 11.205 (6 years). In cases where claims were brought more than six years after substantial completion, there was often considerable discovery and motion practice devoted to characterizing the defect as patent, latent, known, or arguing fraud.

Section 22 repeals NRS 11.203, 11.204, and 11.205. Section 17 amends NRS 11.202 to provide a single, six-year statute of repose for all defect claims, regardless of the nature of the defect or the allegation of fraudulent concealment or other willful misconduct.

Application of new statutes of repose to existing claims. The repeal of NRS 11.203, .204, and .205 is effective upon passage. Section 17 "applies retroactively to actions in which the substantial completion of the improvement to the real property occurred before" enactment. Section 5. However, there is a one-year grace period so that actions commenced before February 25, 2016 will be controlled by the old statutes of repose.

The notice of defect

AB 125 specifically targets certain practices that have evolved in Chapter 40 cases in which claimants' counsel send very simple "shotgun" notices of defect that fail to particularize the claims of defects. These "shotgun" notices are designed to reduce the up-front investigation expense and begin tolling the statutes of limitations and statutes of repose. *See* NRS 40.695. AB 125 amends NRS 40.645 (notice of defects) to require a statement that

> Identif[ies] in specific detail each defect, damage and injury to each residence or appurtenance that is the subject of the claim, including, without limitation, the exact location of each such defect, damage and injury…

Section 8. Additionally, the notice must now…

> Include a signed statement, by each named owner of a residence or appurtenance in the notice, that each such owner verifies that each such defect, damage and injury specified in the notice exists in the residence or appurtenance owned by him or her….

This provision is designed to address a very specific litigation abuse. Under NRS 40.688, a claimant has a duty to disclose to subsequent purchasers: (1) notices of defect related to the residence; (2) expert opinions received by the claimant; (3) terms of any settlement or judgment; and (4) a detailed report on repairs made to the residence as a result of a defect claimed in a notice of defects. Certain lawyers were deliberately insulating homeowner claimants from these disclosure requirements by keeping them in the dark about defects claimed for their homes. Thus, this "verification"[1] creates a paper trail to enforce the disclosure requirement of NRS 40.688. Theoretically, this amendment encourages repairs that improves the housing stock and confidence in the building industry.

In addition to the notice requirements, AB 125 now requires that the claimant must be present an inspection to identify the exact location of each alleged defect. Section 11. Additionally, if the notice of defect includes an expert opinion, the expert must also be present at the inspection. *Id.* These provisions address frustration by the builders and subcontractors with existing inspection practices. Often, homes were opened for inspection, but the defendants could not find the claimed defects. This process will now aid the builders and subcontractors identify the defects so that

[1] The use of the term "verified" is unfortunate. The "verified" statement in this section is not a sworn statement in the sense that a pleading is verified. As introduced, AB 125 required that the claimant's statement be sworn under penalty of perjury. Legislative history reflects that the penalty of perjury concept was removed by amendment.

they can more readily propose a repair or monetary settlement. In many cases, the practical impact will be more time-consuming inspections.

These changes to the notice of defect requirements are effective immediately. Section 21(3).

Representative lawsuits by homeowner associations

Under existing law, home owner associations may bring claims for defects in improvements owned by individual unit owners. *D.R. Horton, Inc. v. Eighth Judicial District Court*, 125 Nev. 449, 125 Nev. 449 (2009). An HOA could pursue claims on behalf of individual members and unit owners in a representative capacity, even though there was no certification of a plaintiff's class under NRCP 23. *Oxbow Construction v. Eighth Judicial District Court*, 130 Nev. Adv.Op. 86, 335 P.3d 1234 (October 16, 2014).

An HOA's ability to sue in a representative capacity led to well-published abuses in which gangs of lawyers, consultants, and contractors hijacked HOA board elections in order to gain control and pursue defect claims without permission from the individual unit owners. This imposed the individual unit owners with the disclosure requirements even though the individuals never received cash or repairs to their units.

Under Section 5, the definition of "Claimant" is amended to eliminate the HOA's standing to sue for defects in improvements for which the HOA is responsible. Section 22 makes clear that the HOA has standing to sue only with respect to improvements that are owned by the HOA:

> The association may not institute, defend or intervene in litigation or in arbitration, mediation or administrative proceedings in its own name on behalf of itself or units' owners with respect to an action for a constructional defect pursuant to NRS 40.600 to 40.695, inclusive, and sections 2 and 3 of this act unless the action pertains exclusively to common elements.

"Common elements" is defined in NRS 116.017. Section 8 provides that a notice of defects given by an HOA must be signed under penalty of perjury by a member of the HOA's executive board or an HOA officer.

These amendments are all effective upon enactment, including pending cases. We have not studied the constitutional issues that may arise from the retroactive application of these changes.

Common defect notices.

Under prior law, a single claimant could allege a defect common to similarly-situated homes. NRS 40.645(4). A claim of common defect had to be supported with an expert opinion that, based on representative sampling, the defect would exist in homes that were not specifically identified in the notice. NRS 40.645(4)(b). The owners of homes so situated would then be deemed "claimants" under NRS 40.610(3). After receipt of a notice of common defect, the builder must provide the notice to all the unnamed owners of similarly-situated homes. NRS 40.6452. The scheme effectively makes the named claimants representatives to negotiate a pre-litigation settlement on behalf of the unnamed claimants. The entire procedure for common defect notices is in NRS 40.645, 40.646, 40.6462, 40.648,

AB 125 eliminates the common defect procedures and representative standing. See sections 5 [deleting NRS 40.610(3)], section 8 [deleting NRS 40.645(3), (4)], section 9 [deleting NRS 40.646(4)], section 10 [deleting NRS 40.6462(2)], and section 13 [deleting portions of NRS 40.648(2)].

Exhaustion of home warranties

Under prior law, a claimant must "diligently pursue" a claim that is covered by a warranty before sending a Chapter 40 notice of defect to the builder. NRS 40.650(3). The "homeowners warranty" addressed here is a form of insurance policy defined in NRS 690B.100. The exhaustion of warranties concept did not extend to written warranties given by the builder, subcontractors, or suppliers and manufacturers.

AB 125 now mandates that a homeowner cannot give a Chapter 40 notice of defects until she has first submitted the claim to the insurer on the warranty and the insurer has denied the claim. Section 14. The claimant may include in a notice of defects only defects for which the insurer has denied the claim. Further, the statutes of repose and limitations for a claim that is submitted under the warranty are tolled until 30 days after the denial of the claim by the insurer.

Note that AB 125 does not require exhaustion of warranties in the sales contract or otherwise offered by subcontractors and suppliers/manufacturers.

Pre-litigation offers of judgment

Under prior law, the builders had the right to make an offer to settle before litigation. If the claimant unreasonably rejected the written offer, the court could shift fees and costs. NRS 40.650(1). Nothing in Chapter 40 prohibited an offer of judgment under NRCP 68 or NRS 17.115.

AB 125 now makes the offer of judgment rule applicable between the notice of defects and commencement of the lawsuit. Section 3.

Before enforcing an offer of judgment under NRS 17.115 or NRCP 68, the courts "must carefully evaluate the following factors: (1) whether the plaintiff's claim was brought in good faith; (2) whether the defendants' offer of judgment was reasonable and in good faith in both its timing and amount; (3) whether the plaintiff's decision to reject the offer and proceed to trial was grossly unreasonable or in bad faith; and (4) whether the fees sought by the offeror are reasonable and justified in amount. *Beattie v. Thomas*, 99 Nev. 579, 588-89, 668 P.2d 268, 274 (1983). We predict that courts will apply these "Beattie" factors to an offer of judgment made under AB 125, section 3.

Relations between builders and subcontractors: indemnity and insurance

During the 2013 legislative session, there was much discussion about onerous indemnity provisions in subcontracts and purchase orders. Many legislators (and the trial lawyers) touted reforming indemnity contracts as Chapter 40 reform. During 2014, a work group formed to negotiate and draft a bill on subcontractor indemnity. That work group also created language related to certain insurance policies, including OCIP and WRAP policies. This language was originally offered as AB 1, then moved to AB 125, section 2.

Section 2 creates a new section in Chapter 40 that invalidates "type one" indemnity provisions as void and unenforceable. Section 2, § 1(a) - (d). Also, if the indemnitee is also an additional insured under the indemnitor's policy, the indemnitee must exhaust the AI coverage. These provisions only apply to express indemnity contracts formed after enactment of the bill.

Our colleague Craig Marquis is the the principal architect of the new provisions governing WRAP policies and other insurance matters. We will leave it to Craig to summarize these changes.