

REAL ESTATE FINANCE

Volume 25, Number 3

October 2008

Caveat Emptor—Florida’s Pre-Litigation Defect Notice Scheme Creates Significant Risk for Mid-Stream Project Investors

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The recent sub-prime mortgage crisis and resulting real estate financing crunch has created unique investment opportunities for speculators and institutional investors alike, especially in the traditionally attractive South and Central Florida markets. Because the torrents of investment capital previously flowing into construction markets has diminished to a trickle, many developers are marketing commercial and residential projects for purchasers while they are mid-construction, or immediately after completion of construction. These “mid-construction” projects can be attractive to purchasers because a lot of the “dirty work” of project development, such as permitting, design approval, and selection of contractors and subcontractors, has already been completed. Acquiring financing to reinvigorate a project can be complicated, and these transactions come with their own unique risks, including:

- Integrating and transitioning management teams;
- Controlling construction costs (including re-mobilization and frequently escalating materials costs);
- Coordination in order to remobilize subcontractors and construction crews; and

- Finding mid-tier financing for unanticipated cost overruns.

Among the unknown, and often unconsidered risks in the acquisition of a mid-construction or immediately post-construction project is the risk of construction defects, which can turn what appears to be a ready-for-market project into a money drain.

In 2004, Florida’s legislature enacted Chapter 558 of the Florida Statutes to provide a pre-litigation notice of, and opportunity to cure construction defects to contractors who build residential construction projects, including individual homes, high-rise and multi-unit projects. The statute was amended in 2006 to expand the procedures to all construction projects, including commercial properties. The statute was intended to provide a pre-litigation opportunity for an aggrieved owner to notify the builder of defects in the work and facilitate extra-judicial resolution of construction defects or payment by the builder for the defects to the owner. The process was intended to appeal to both owners of real property and contractors, as a potentially time saving and cost-efficient solution for remediation of defects. However, a closer look at the statute reveals

its pro-contractor and pro-builder bias, to the detriment of owners.

Section 558.001, Florida Statutes, announces the intent behind the statute:

The legislature finds it is beneficial to have an alternative method to resolve construction disputes that would reduce the need for litigation as well as protect the rights of property owners...

In reality, however, Chapter 558 complicates the drafting of construction contracts, empowers contractors to create significant delay in resolution of defect claims, enables bad faith litigation tactics, and in practice, defeats the stated purpose of the statute. In the context of the investor who purchases a project and finds defects, the broad range of applicability and delay associated with Chapter 558 gives reason for pause.

BRIEF SUMMARY OF CHAPTER 558 PROCEDURES

Chapter 558 requires a claimant¹ who seeks to assert claims for construction defects² against a contractor, subcontractor, supplier, or design professional (Contract Recipient) to first provide notice to the contractor, supplier, or design professional and allow an opportunity for inspection, including destructive testing, of the alleged defective condition. After the notice is served and all inspection/testing is complete, the statute contemplates that the builder will choose to either:

- Repair the condition;
- Make financial restitution to the owner;
- Provide a combination of repairs and payment;
- Issue a statement disputing the claim; or
- Provide a statement that the claim will be forwarded to the contractor, subcontractor, supplier, or design professional’s insurer.

If the claim is disputed, or the builder fails to timely respond, the claimant may file suit for that specific defect. Chapter 558 allows for exchange of “discoverable evidence” among the claimant and builder upon request. Where the statute applies, a claimant may not file a claim for relief from a construction defect before instituting the procedures described.

WHAT IS THE SCOPE OF CHAPTER 558?

Initially, Chapter 558 was intended to pertain solely to residential development, but in 2006 the statute was revised to include an expanded definition of “real property.” As a result, the statute

now applies to specified contracts for improvements to “land that is improved and the improvements on such land, including fixtures, manufactured housing, or mobile homes and excluding public transportation projects.”

A “Contractor” is defined in the 2006 revisions as “any person...that is legally engaged in the business of designing, developing, constructing, manufacturing, repairing or remodeling real property.” Note that this definition expressly carves out contractors who are working without licenses. Whether doing business with an unlicensed contractor will take the contract outside of the scope of Chapter 558 is unclear.³

The impact of the modification of those definitions on the scope of Chapter 558 is immense. Aside from obviously extending the statute to apply to commercial property, the statute now may apply to contractors who prepare land, (i.e. install sewers and perform grading services) before improvements are constructed upon the land itself, as well as installers of fixtures, such as hurricane shutters, hot tubs, and awnings, manufacturers and installers of mobile homes, and even landlords who remodel units for their tenants.

CHAPTER 558 DELAYS ACCESS TO COURTS FOR LITIGATION OF DEFECTS CLAIMS

Conceptually, the statute seems to provide a simple, well tailored approach to the resolution of defect claims. However, §558.004 imposes an inconsistent, but strict time schedule for the performance of each predicate step of the statute which leaves an owner vulnerable to significant delay in resolution of the defect claim. The statute sets up a two-tiered system imposing lengthened deadlines for responses for claims pertaining to associations representing more than 20 parcels compared to other claims.

Statutory Timeline for General Claimant

A claimant must serve a written notice of claim to the builder at least 60 days before filing suit. Typically, the notice will be delivered to the general contractor, but the statute allows for that notice to be delivered to any subcontractor or supplier or designer. Within 30 days of receipt of the notice of claim (Notice of Claim), the Contractor Recipient receiving the notice of claim is entitled to perform a “reasonable inspection” of the “property or each unit” subject to the claim. Within 10 days of the receipt of the Notice of Claim, the Contractor Recipient may forward a copy of the Notice of Claim to each subcontractor, supplier, or design professional (Secondary Recipient) who the Contractor Recipient believes is responsible for each claimed defect, and those Secondary Recipients may inspect the defects, and have

15 days from their receipt of the Notice of Claim to issue a response to the Contractor Recipient. Within 45 days after receiving a copy of the Notice of Claim, the Contractor Recipient of the Notice of Claim must serve a written response to the claimant indicating the elected response. If the Contractor Recipient disputes the claim or does not respond timely, the claimant may file its action after the expiration of the initial 60 days; however, if the claimant receives a settlement offer in response, the claimant must provide written notice either accepting or rejecting the settlement offer to the Contractor Recipient within 45 days of receipt.

The above scheme creates the potential for extreme abuse by the Contractor Recipient.⁴ Consider a hypothetical situation where a condominium association, governing a 15-unit condominium, as a claimant, seeks to assert a claim against the general contractor for defective window installations found in each unit of the condominium to be permitting water intrusion into the walls of the units. The below timeline is a typical, if not accelerated demonstration of how the Chapter 558 process would apply.

- Day 0: Claimant discovers/is informed by unit owners of alleged defects in window installation, which is assumed to be a defect.⁵ Claimant association notifies its counsel who seeks and retains outside counsel for this issue.
- Day 15: Claimant serves its Notice of Claim on Contractor.⁶
- Day 25: Contractor serves copies of the Notice of Claim to its drywall and window subcontractors, and window materials supplier.
- Day 45: Contractor contacts Claimant and makes a demand for an inspection of all 15 units which feature the alleged construction defect. At this point, claimant is obligated by the statute to allow an inspection of each instance of the defect in each unit where the defect is claimed. From a practical standpoint, the association must get the consent of each unit owner to permit entry and observation of the defect, which, for the purposes of the hypothetical, takes until and through Day 70.
- Day 55: Subcontractors and material supplier contact claimant to demand inspection of all 15 units which feature the alleged construction defect.⁷ To the extent that the Contractor has already inspected any of the claimants’ units, the subcontractors and material supplier are entitled to re-inspect the units, extending the process through Day 90.
- Day 90: Inspections are complete by all noticed parties.
- Day 91: Subcontractors demand destructive testing of the claimed defect which was not conducted in the initial

inspections, and serve claimant with conforming notice pursuant to §558.004(2).

- Day 93: Claimant objects to individual designated by Subcontractor to perform destructive testing.
- Day 95: Claimant and Subcontractor agree to destructive testing and agree to appropriate individuals to attend on behalf of claimant and Subcontractor.
- Day 105: Destructive testing is completed.
- Day 108: Contractor is submits written statement that the Contractor disputing the claim.⁸ Pursuant to §558.004(6) the claimant may now file its action against the contractor.
- Day 109: All contractors dispute the claim.

Statutory Timeline for Association with 20 or more Parcels as Claimant

A claimant must serve its Notice of Claim to the Contractor Recipient at least 120 days before filing suit. Within 50 days of receipt of the Notice of Claim, the Contractor Recipient is entitled to perform a “reasonable inspection” of the “property or each unit” subject to the claim. Within 30 days of the receipt of the Notice of Claim, the Contractor Recipient may forward a copy of the notice of claim to each Secondary Recipient who the Contractor Recipient believes is responsible for each claimed defect, and those Secondary Recipients may inspect the defect, and have 30 days from their receipt of the Notice of Claim to issue a response to the Contractor Recipient who forwarded the Notice of Claim. Within 75 days after receiving a copy of the Notice of Claim, the Contractor Recipient must serve a written response to the claimant indicating its response. If the Contractor Recipient disputes the claim or does not respond timely, the claimant may file its action after the expiration of the initial 120 days; however, if the claimant receives a settlement offer in response, the claimant must provide written notice either accepting or rejecting the settlement offer to the entity making the settlement offer within 45 days of receipt.

The above scheme creates even greater potential for extreme abuse by the Contractor Recipient of the notice of claim. Consider a similar hypothetical situation where a condominium association governing a 200-unit condominium, as a claimant seeks to assert a claim against the general contractor for defective window installations found in each unit of the condominium to be causing water intrusion into the walls of the units:

- Day 0: Claimant discovers/is informed by unit owners of alleged defects in window installation, which is assumed to

Caveat Emptor—Florida’s Pre-Litigation Defect Notice Scheme

be a defect. Claimant association notifies its counsel who seeks and retains outside counsel for this issue.

- Day 15: Claimant serves its Notice of Claim on Contractor.
- Day 45: Contractor serves copies of the Notice of Claim to its drywall and window subcontractors, and window materials supplier.
- Day 65: Contractor contacts claimant and makes a demand for an inspection of all 200 units which feature the alleged construction defect. Note that the statute itself allows for inspection of “each alleged defect” which can be read to include each defect alleged, or each instance of each defect alleged.
- Day 85: Subcontractors and material supplier contact claimant to demand inspection of all 200 units which feature the alleged construction defect. To the extent that the Contractor has already inspected any of the claimants’ units, the subcontractors and material supplier are entitled to re-inspect the units, extending the process through day 120.
- Day 120: Initial inspections are complete.
- Day 121: Subcontractors demand destructive testing of the claimed defect which was not conducted in first round of inspections, and serve claimant with conforming notice pursuant to 558.004(2).
- Day 124: Claimant objects to individual designated by Subcontractor to perform destructive testing.
- Day 130: Claimant and Subcontractor agree to destructive testing.
- Day 165: Destructive testing and repairs to premises are all completed.
- Day 170: Contractor submits written statement that the Contractor disputes the claim. Pursuant to §558.004(6) the Claimant may now file its action.
- Day 173: All contractors dispute the claim.

The Recipient’s Right to Inspections Can Create Open-ended Delay

The timelines established above are approximate (and perhaps optimistic), but illustrate how the obvious inconsistencies within the language of the statute regarding the amounts of time provided for inspection and response from the Contractor Recipients can impact the execution of Chapter 558 prerequisites, and shows how the need for significant inspection of the alleged defect can lengthen the process. Additionally, for larger projects, such as high-rise condominiums, the right of the Contractor Recipient after the Notice of Claim to inspect

the defects can result in significant delay while the claimant obtains permission for entry and schedules the inspection with the recipient of the claim. In an instance where water penetration through windows of a high rise is the alleged defect, the inspection time itself can be drawn out by the need for inspectors to “swing the building” to obtain an inspection of the outside surface. Historically, South and Central Florida have been prime locations for non-residents to maintain vacation residences; securing the consent of individual unit owners who are not local, or out of the country can also significantly delay the inspection process.

Frequently claimants will resist attempts by contractors to inspect each instance of the defect, citing overburden and disruption or unavailability of the residents who own the units; the scope of inspection authorized by Chapter 558 in such instances remains a contentious and undecided issue. Where a filed action already exists between the claimant and the Contractor Recipient (perhaps for breach of contract), the parties may submit the issue of the scope of inspection under Chapter 558 to the court, otherwise, stalemates in inspection conduct can serve to indefinitely delay the progress of the procedures imposed by Chapter 558.

Savvy Recipients can Delay at the Notice of Claim Stage

The Chapter 558 procedure is simply a predicate to filing suit. Unless a pre-existing action already exists, there is no provision in the statute to indicate or resolve conflicts that arise in the conduct of the procedure itself, absent cooperation of parties, to defer to judicial determination of any conflicts during the Chapter 558 process. Thus, Contractor Recipients may evade their obligations under the statute (and indefinitely delay the progress of the resolution of the defects) by claiming that the notice itself was defective or lacking suitable detail for the Contractor Recipient to respond.

Section 558.004(1) obligates a claimant to serve the Notice of Claim describing the claim in “reasonable detail sufficient to determine the general nature of each alleged construction defect and a description of the damage or loss resulting from the defect, if known.” There has been no judicial interpretation of “reasonable detail sufficient to determine the general nature,” but builders often respond to Notices of Claim with correspondence claiming the Notice itself is too “insufficient to determine the nature of the defect” and thus, they are able to delay the process further. Claimants should ensure that, at minimum, a Notice of Claim describes the location of the defect, the system impacted (i.e. windows,

walls) the exact locations of the defect, and if possible, the anticipated harm to be resulting from the defect (i.e. the water intrusion caused by hypothetical defects in window installations). Engineers who conduct forensic examinations of properties typically prepare reports including photographs, descriptions, and citation to Code sections which each identified defect violates. Although those inspections can be expensive, attaching a forensic engineer’s report is the safest way to avoid delay caused by claimed ambiguity in the Notice of Claim.

CHAPTER 558 AND CONTRACTS

Section 558.005, Florida Statutes, dictates that statutory mandatory warning language should be included in “every contract for the design, construction or remodeling of real property...”⁹ in order for the procedures found in Chapter 558 to govern the contract. However, the specific statutory warning language itself creates ambiguities.

Those drafting contracts for contractors, developers, subcontractors, suppliers, and design professionals should note that, for the provisions of Chapter 558 to apply to the project in question, any direct contract with an owner must include the following statutory language (in substantially the same form):

CHAPTER 558 NOTICE OF CLAIM
CHAPTER 558, FLORIDA STATUTES,
CONTAINS IMPORTANT REQUIREMENTS
YOU MUST FOLLOW BEFORE YOU MAY
BRING ANY LEGAL ACTION FOR AN ALLEGED
CONSTRUCTION DEFECT. SIXTY DAYS
BEFORE YOU BRING ANY LEGAL ACTION,
YOU MUST DELIVER TO THE OTHER PARTY
TO THIS CONTRACT A WRITTEN NOTICE,
REFERRING TO CHAPTER 558, OF ANY CON-
STRUCTION CONDITIONS YOU ALLEGE
ARE DEFECTIVE AND PROVIDE SUCH PER-
SON THE OPPORTUNITY TO INSPECT THE
ALLEGED CONSTRUCTION DEFECTS AND
TO CONSIDER MAKING AN OFFER TO
REPAIR OR PAY FOR THE ALLEGED CON-
STRUCTION DEFECTS. YOU ARE NOT OBLI-
GATED TO ACCEPT ANY OFFER WHICH MAY
BE MADE. THERE ARE STRICT DEADLINES
AND PROCEDURES UNDER THIS FLORIDA
LAW WHICH MUST BE MET AND FOLLOWED
TO PROTECT YOUR INTERESTS.

The warning itself creates problems. Aside from the obvious omission of the 120-day requirement for certain association claimants, the Notice of Claim provision expressly applies to “any legal action for an alleged construction defect” but “action” is otherwise defined¹⁰ as “any civil action or arbitration proceeding for damages or indemnity asserting a claim for damage to or loss of real or personal property caused by an alleged construction defect, but does not include any ... claim for personal injuries...” Also, it is unclear as to whether a garden-variety negligence claim against a contractor is subject to a Notice of Claim.

ADVICE FOR INVESTORS

When prices are sagging and market inventory is accumulating, there are great deals available. For fledgling developers, mid-stream or just completed projects present an attractive target. When purchasing a project, an investor should review all direct design and construction projects for Chapter 558 provisions; if new contracts are being drawn, it strongly benefits the purchaser to exempt themselves from Chapter 558. Likewise, investors who are also contractors or developers or design professionals, and who hold appropriate licensure, should consider taking on a role as a “design/builder” or “owner/developer” on the project to avoid Chapter 558. Judges have reasoned that the statute omits contractors and design professionals from being claimants, and therefore direct contracts with an owner/developer or design/builder are not subject to Chapter 558.¹¹

Owners, however, may have inadvertently been given a defensive loophole. Under Section 558.003, Fla. Stat., a claimant may not file an action in court without first complying with the requirements of Chapter 558, if applicable. In case such an action is filed, the Contractor Recipient may file a motion to abate the action, and “on timely motion the court shall abate the action, without prejudice.” Although §558.003 has been criticized as unconstitutional¹² it enables an owner who is defending a contractor’s lawsuit (typically for construction lien foreclosure or breach of contract) to file a counterclaim or third-party claim for construction defects. In that situation, the party served with the defects claim would likely file a motion to abate the action pending compliance, and the entire action shudders to a halt.¹³

Investors should be cognizant of the challenges of instituting an action on a project mid-stream, thereby delaying completion of the project and taking it to market. In the event of defects, the investors may be subject to Chapter 558, which, despite its stated purpose, detrimentally impacts a claimants’ ability to bring suit against contractors, creates lengthy delay, and can ruin what looked like a smart investment. Caveat Emptor.

Caveat Emptor—Florida's Pre-Litigation Defect Notice Scheme

NOTES

1. Claimant is defined in §558.002(3) as "property owner, including a subsequent purchaser or association who asserts a claim for damages against a contractor, supplier, or design professional concerning a construction defect or subsequent owner who asserts a claim for indemnification for such damages." The term does not include a contractor, subcontractor, supplier, or design professional.
2. Construction defect is defined in §558.002(4) as "a deficiency in, or a deficiency arising out of, the design, specifications, surveying, planning, supervision, observation of construction, or construction repair, alteration, or remodeling of real property resulting from:
 - a. Defective material, products or components used in the construction or remodeling;
 - b. a violation of the applicable codes in effect at the time of construction or remodeling which gives rise to a cause of action pursuant to s. 553.84;
 - c. a failure of the design of real property to meet the applicable professional standards of care at the time of governmental approval;
 - d. a failure to construct or remodel real property in accordance with trade standards for good workmanlike construction at the time of construction."
3. See §489.128, Fla. Stat. for a discussion of unlicensed contracting.
4. To "put clothes on the emperor," §558.005(3) allows parties to modify the timing found in the statute by agreement.
5. Pursuant to §558.004(9), a claimant may make "emergency repairs to the property as are required to protect the health, safety and welfare of the claimant. The statute is silent as to what claims procedure may apply to a defect repaired on an emergency basis.
6. Section 558.004(1) encourages, but does not mandate that a claimant serve the notice of claim within 15 days of discovery of the defects.
7. Technically, the statute is internally contradictory on this point- §558.004(3) indicates that "within 10 days after the receipt of the notice of claim....the person receiving the notice under subsection (1) may forward a copy of the notice of claim to each contractor...whom it reasonably believes is responsible for each defect specified in the notice of claim.... Each such contractor... may inspect the property as provided in subsection (2). §558.004(2) allows the contractor to "within 30 days after receipt of the notice of claim...perform a reasonable inspection." However, 558.004(4) requires that contractor who received the notice of claim from the initial recipient to "within 15 days after receiving a copy of the notice of claim pursuant to subsection (3)...[to] serve a written response to the person who forwarded a copy of the notice of claim" including in that response "a report, if any of the scope of any inspection of the property, the findings and results of the inspection." Under §558.004(3), the secondary recipient has 30 days to notify the claimant of their demand to conduct an investigation, but under 558.004(4) must report the findings of the investigation within 15 days of the receipt of the notice of claim.
8. Although §558.004(5) requires that the person who received notice under §558.004(1) respond in writing to the claimant "within 45 days" in the above hypothetical, the obligation for the claimant to cooperate with the contractor and subcontractors, as imposed by §558.004(2) to allow inspection extends the date for that response. Whether the 45 day deadline imposed by §558.004(5) is intended to give way to the realities imposed by the inspection requirement is an open question.
9. See 558.005(1), Fla. Stat.
10. See 558.002(2), Fla. Stat.
11. See *Centex Homes v. Mr. Stucco, Inc.*, 2007 WL 2264622 (M.D. Fla. 2007); *Centex Homes v. Turlington Custom Stucco Plastering*, 2007 WL 2010803 (M.D. Fla. 2007); *Specialty Engineering Consultant, Inc. v. Hovstone Properties, Florida, LLC*, 968 So.2d 680(Fla.4 DCA 2007).
12. See 77-OCT Fla. B.J. 18.
13. See *id.*

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