ARIZONA LEGISLATURE MAKES SIGNIFICANT REVISIONS TO SHAPE OF CONSTRUCTION DEFECT CLAIMS

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On April 10, 2019, Governor Doug Ducey signed SB 1271 into law. The product of over two years of lobbying and interest group meetings, this bill makes significant and myriad changes to existing laws relating to residential construction.

REVERSING *AMBERWOOD* – PROPORTIONAL LIABILITY ONLY

One of the main ways this bill immediately impacts the contractor-subcontractor relationship is by limiting an indemnitor's potential obligations only to the extent of its own negligence. The 2017 Arizona Court of Appeals case *Amberwood Development, Inc. v. Swann's Grading, Inc.*, No. 1 CA–CV 15–0786, 2017 WL 712269 found that a subcontractor could be held responsible for indemnity broader than its own scope of work (and without a finding of fault) if the contract did not expressly limit its risk that narrowly. SB1271 creates a new statute, A.R.S. § 32-1159.01, to reverse that (non-binding) decision.

Section A of the new statute voids such broad indemnification agreements in construction or architect-engineer contracts as against public policy. It voids any such provision "to the extent that it purports to insure, to indemnify or to hold harmless the promisee from or against liability for loss or damage resulting from the negligence of the promisee or the promisee's indemnitees, employees, subcontractors, consultants or agents other than the promisor." Thus, a subcontractor's indemnity is now limited only to the extent of its own negligent workmanship.

Section D of the new statute notes that the duty to defend can still apply to claims "arising out of or relating to" the contracting party's work. Because this does not require a finding of fault to limit the duty to defend, it appears unchanged by the new statute.

Of note to insurers is Section C, which states that an insurer is not required to indemnify an additional insured for the proportion of fault allocated to it. This does not limit the duty to defend, however, so the policy should still be the first place to look when determining any defense obligation owed to an additional insured.

The statute's scope is limited to construction and architect-engineer contracts between private parties for residential dwellings. A.R.S. § 32-1159.01(E). These terms are given specific definitions that are broad enough to cover the work of virtually all engineers, architects, design professionals, contractors and subcontractors. *See* A.R.S. § 32-1159.01(G). The new statute does not apply to contracts with the state or a municipality (A.R.S. § 32-1159.01(F)(1)); agricultural improvement districts (§ 32-1159.01(F)(2)); surety or performance bonds by its principal or indemnitors (§ 32-1159.01 (F)(3)); an insurance agreement between the insurer and named insureds (§ 32-1159.01(F)(4)); and public service corporation's rules, regulations or tariffs that are approved by the Corporation Commission (§ 32-1159.01(F)(7)). It is likewise not intended to affect insurance policies as between a carrier and its additional insureds (§ 32-1159.01 (F)(5)) or the multiple insureds of a single policy other than the proportionality limits any insured may have to the other insureds imposed by the newly instituted Sections A, B, and C. (§ 32-1159.01 (F)(6)).

REVISIONS TO THE PURCHASER DWELLING ACT

Attorneys' Fees Reinstituted

The Legislature reinstated A.R.S. § 12-1364 to allow for recovery of attorneys' fees. A Court now may award reasonable attorneys' fees to the prevailing party. (§ 12-1364(A)). The homeowner is deemed the prevailing party "if the relief obtained by the purchaser for that contested issue, exclusive of any fees

and taxable costs, is more favorable than the repairs or replacements and offers made by the seller…." *Id*. If it is not, the seller is considered the prevailing party.

The new statute sets guidelines to consider when calculating whether attorneys' fees are reasonable. The Court should weigh:

1. The repairs, replacements or offers made by the seller, if any, before the purchaser filed the dwelling action pursuant to section 12-1363.
2. The purchaser's response to the seller's repairs, replacements or offers made or proposed, if any, before the purchaser filed the dwelling action pursuant to section 12-1363.
3. The relation between the fees incurred over the duration of the dwelling action and the value of the relief obtained with respect to the contested issue.
4. The amount of fees incurred in responding to any unsuccessful motions, claims and defenses during the duration of the dwelling action.

Id. A "contested issue" is "an issue that relates to an alleged construction defect and that is contested by a purchaser following the conclusion of the repair and replacement procedures prescribed in section 12-1363." The new statute does not replace contractual fee provisions (§ 12-1364(C)).

Subcontractor Participation in the PDA

The changes now require the general contractor to promptly forward any PDA notice to the subcontractors that worked on the house, and specifically allows electronic service. (§ 12-1363 (A)). The subcontractor is now provided the right to inspect, test, and repair the property that was previously provided to the general contractor in the 2015 revisions (§ 12-1363 (B)-(C)).

Homeowner Affidavits

A homeowner who brings a dwelling action must now submit an affidavit along with their complaint, affirming they have "read the entire complaint, agree[] with all of the allegations and facts contained in the complaint and, unless authorized by statute or rule, is not receiving and has not been promised anything of value in exchange for filing the dwelling action." (§ 12-1363(N)).

IMPACT ON THIRD-PARTY PROCEDURE

Changes are also made to the procedure of bringing third-party claims. The statutes of limitation and repose (*e.g.* A.R.S. 12-552) are now tolled from the date the general contractor receives the PDA notice until nine months after a civil suit or arbitration demand is served on it. (§ 12-1363 (G)). Once suit is commenced, subcontractors must be joined as third-party defendants if feasible and subject to the Arizona Rules of Civil Procedure (§ 12-1362(D)). The finder of fact must determine:

1. If a construction defect exists AND
2. The amount of damages caused by the defect AND
3. Each subcontractor whose conduct "whether by action or omission, may have caused, in whole or in part, any construction defect." (§ 12-1362(D)).

The homeowner specifically has the burden of proof as to steps 1.a. and 1.b., but the statute is silent as to who is tasked to proving item 1.c.. The finder of fact must then allocate pro rata shares of fault to the subcontractors whose work is implicated. *Id*. The general contractor has the burden of proving each subcontractor's fault in step 2. Subject to the Arizona Rules of Civil Procedure, the new bill requires Steps 1 and 2 to be bifurcated. (§ 12-1362(E)).

RETROACTIVITY

The statute expressly applies retroactively "to from and after June 30, 2019." It therefore stands to reason that these statutes apply to all construction defect claims made from June 30, 2019 onward.

NEXT STEPS

As with any new law, the contours have not been fleshed out. Parties have yet to explore the outer confines of what is and is not enforceable about this bill and its changes to the construction statutes. Our firm will continue to monitor the litigation trends and any subsequent action by the Legislature to further revise the way defect cases are handled.

This alert is only a broad summary of the changes made by this new bill. Please look for more detailed analysis from us in the weeks and months ahead.

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