THE COMMITTEE ON
COMMERCIAL & BUSINESS
LITIGATION
AMERICAN BAR ASSOCIATION ▪ SECTION OF LITIGATION ▪ VOL. 12 NO. 2 WINTER 2011

Legislative and Judicial Intervention in Construction Litigation in Texas

BY MITZI T. SHANNON AND SHELLY W. RIVAS

When the Texas Supreme Court issued its opinion in *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968), it likely had no inclination that over the span of almost 42 years, the protections for homeowners that were defined by its decision would first be severely limited and then almost fully restored by the actions of the Texas legislature. The issue before the court was whether, even without any express representations regarding construction, a homebuilder was impliedly warranting that the construction had been completed in a good and workmanlike manner and that the home was suitable for human habitation.

Shannon

Rivas

Rejecting the long-applied principle of caveat emptor and providing protection for homeowners, the court noted that "[t]he *caveat emptor* rule as applied to new houses is an anachronism patently out of harmony with modern home buying practices. It does a disservice not only to the ordinary prudent purchaser but to the industry itself by lending encouragement to the unscrupulous, fly-by-night operator and purveyor of shoddy work." *Id.* at 562. Thus began an era of protection for homeowners with implied warranties regarding their new homes.

Because *Humber* offered no specific explanation of what "good and workmanlike manner" really meant, however, it was

(Continued on page 12)

A Road Map to Preparing Claims on Behalf of Contractors and Subcontractors

BY STEPHANIE L. JONAITIS

Representing contractors or subcontractors in construction disputes requires a careful analysis at the outset of the matter to determine deadlines, potential remedies, and all possible avenues of recovery. In many situations, there are alternate routes a contractor or subcontractor can take to pursue recovery from various project participants. The following is a series of questions practitioners should ask themselves when conducting a preliminary analysis of a contractor's potential claims.

Jonaitis

What Are the Contractual Dispute Resolution Requirements?

One of the first things to request of the contractor is a copy of all the agreements with the owner, or in the case of a subcontractor, its subcontract and the prime contract, if available. The contract is likely to contain important terms regarding dispute resolution and applicable conditions precedent to filing a lawsuit. These may include time limitations and specific procedures for the submission of claims to the general contractor and/or owner before legal action may be commenced. Because parties may incorporate by reference certain portions of a prime contract in a subcontract, review of the prime contract is also essential to locate any mediation provisions or

(Continued on page 16)

1 - Published in *Commercial & Business Litigation*, Volume 12, Number 2, Winter 2011. © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

Letter from the Chairs

Greenwald

Timkovich

Stio

As we head toward into the halfway mark of the bar year, we are pleased with the great progress the Committee continues to make in providing members with timely information on legal issues and a platform for networking with attorneys from throughout the country.

An example of the Committee's work is found in this issue of *Commercial & Business Litigation*, which focuses on construction litigation. The six new articles in this issue explore how to analyze contractor and subcontractor claims, defenses that banks and title insurers can assert in response to mechanic's liens, recent developments in state construction lien statutes, statutory and common-law warranty claims, the insurability of mechanic's liens, and the applicability of copyright to architects, contractors, and developers. We'd like to thank the Commercial & Business Litigation Construction Litigation Subcommittee and each of the authors for contributing content for this issue. Special thanks also goes out to newsletter editors Giugi Carminati and Celeste Coco-Ewing for the time and significant effort they put into publishing a fantastic newsletter.

We'd also like to remind all the members of our Committee about upcoming newsletter issues and the publication opportunities that are available. Our Spring 2011 issue will focus on banking litigation, and our Summer 2011 issue will focus on alternate dispute resolution (ADR). If you are interested in writing an article on either of these topics, please reach out to the Committee's newsletter editor, Kelly Kszywienski (kkszywienski@swlaw.com), who will be coordinating the next issue. For those of you who do not have time to write an article, the Committee also publishes new developments and case summaries on our Committee webpage, www.abanet.org/litigation/committees/commercial. If you are interested in submitting a case summary or news story, please drop a note to either of our web editors, John R. Bielema (john.bielema@bryancave.com) or Brad Babbitt (bbabbitt@rc.com). This webpage is constantly updated, and it provides timely information to the more than 4,000 members of the Commercial & Business Litigation Committee.

We would also like to remind you that the 2011 Section of Litigation's Annual Conference will take place at the Fontainebleau Resort in Miami, Florida, April 13–15, 2011. Our Committee will once again coordinate a Committee

Commercial & Business Litigation on the Web

Letter from the Editors

This issue of *Commercial & Business Litigation* focuses on construction law. We hope that it provides you with useful, practical advice about problems and solutions for practitioners dealing with cases involving the construction industry.

Among the articles included in this issue is a piece by Mitzi T. Shannon and Shelly W. Rivas entitled "Legislative and Judicial Intervention in Construction Litigation in Texas." This article discusses the differences between statutory and common-law warranties in Texas and the problems with legislating warranties to protect homeowners from residential construction defects. In an article entitled "A Road Map to Preparing Claims on Behalf of Contractors and Subcontractors," Stephanie L. Jonaitis provides a useful roadmap to the issues that an attorney should investigate when first retained by a contractor to prosecute affirmative claims on a construction project. Andrew Crain and Melissa Rhoden add to this newsletter by exploring the copyright issues affecting architects, contractors, and developers. A piece by Edward B. Gentilcore chronicles the developments in lien laws that affect the amount of security and leverage contractors and subcontractors have in Utah, North Carolina, Oregon, and Pennsylvania. Michael S. LeBoff provides a timely piece entitled "*Bankers Trust*, *Brown*, and Exclusion 3(a): The Insurability of Mechanic's Liens" that discusses the insurability of mechanics' liens, while Mark E. Wilson and Jeremy D. Kerman's article explains the fine line between real estate and fixtures and the effect this has on a bank's priority rights over mechanic-lien claims. We hope you enjoy, and learn from, this issue of *Commercial & Business Litigation*.

Carminati

Coco-Ewing

We invite you to send comments on this issue, or contribute articles to future issues of *Commercial & Business Litigation*, by contacting Kelly Kszywienski (kkszywienski@swlaw.com).

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

dinner and hold a general membership meeting for our members who attend. We will also sponsor the following CLE programs:

- Minority Hiring and Retention: Is It a Black-and-White Issue?
- Marketing Strategies for Women and Minority Litigators
- Lender Liability: Best Practices and Strategies for Defending and Avoiding Today's Lender Liability Claims

Please keep an eye out for our email updates outlining the details for our Committee dinner, general membership meeting, and CLE programs at the Section Annual Conference. We hope that you can attend and take part in the festivities. The Annual Conference is a great opportunity to catch up on recent developments in the law, network with other members of the Committee, and earn CLE credits. And, if this is not enticing enough, there also is South Beach.

Finally, if you have any friends or colleagues interested in the ABA, please encourage them to join our Committee. They can easily do so by emailing any of the Committee chairs or going to the ABA website at www.abanet.org/committee_join/ocj_join.cfm. ■

Bart Greenwald
Angelo A. Stio III
Elizabeth T. Timkovich

www.abanet.org/litigation/committees/commercial

Kszywienski

Upcoming newsletter themes and submission dates for articles are as follows:

Spring 2011: Banking Litigation
Deadline: March 1, 2011

Summer 2011: ADR
Deadline: June 1, 2011

If you are interested in submitting an article, a standard piece is roughly 1,500 words in length, with all citations in the form of in-text notes. The articles should be submitted via email as a Microsoft Word document. You will be notified shortly after submission if your article was selected for publication.

Thank you for your interest in the ABA and the Commercial & Business Litigation Committee. ■

Maria-Vittoria "Giugi" Carminati
Celeste Coco-Ewing

3 - Published in *Commercial & Business Litigation*, Volume 12, Number 2, Winter 2011. © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

COMMERCIAL & BUSINESS LITIGATION

Committee on Commercial and Business Litigation

COMMITTEE CHAIRS

Angelo A. Stio III
Pepper Hamilton, LLP
301 Carnegie Center
Suite 400
Princeton, NJ 08543
(609) 452-0808
stioa@pepperlaw.com

Bart Greenwald
Frost Brown Todd LLC
400 W. Market Street
32nd Floor
Louisville, KY 40202-3363
(502) 568-0318
bgreenwald@fbtlaw.com

Elizabeth T. Timkovich
Winston & Strawn LLP
214 N. Tryon Street
Charlotte, NC 28202-1078
(704) 350-7780
ETimkovich@winston.com

NEWSLETTER EDITOR

Kelly A. Kszywienski
Snell & Wilmer, LLP
One Arizona Center
400 East Van Buren
Phoenix, AZ 85004
(602) 382-6384
kkszywienski@swlaw.com

NEWSLETTER EDITORIAL BOARD

M. Vittoria "Giugi" Carminati
Weil, Gotshal & Manges
700 Louisiana Street
Suite 1600
Houston, TX 77002
(713) 546-5315
Giugi.Carminati@weil.com

Celeste R. Coco-Ewing
Barrasso Usdin Kupperman
Freeman & Sarver, LLC
LL&E Tower, Suite 2400
909 Poydras Street
New Orleans, LA 70112
(504) 589-9725
ccoco-ewing@barrassousdin.com

Michael S. LeBoff
Hodel Briggs Winter, LLP
8105 Irvine Center Drive
Suite 1400
Irvine, CA 92618
(949) 450-4435
mleboff@hbwllp.com

ABA PUBLISHING

Jason Hicks
Associate Editor

Monica Alejo
Graphic Designer

Commercial & Business Litigation Journal (ISSN 1936-7597) is published quarterly by the Commercial & Business Litigation Committee, Section of Litigation, American Bar Association, 321 N. Clark Street, Chicago, IL 60654-7598; www.abanet.org/litigation. The views expressed within do not necessarily reflect the views or policies of the American Bar Association, the Section of Litigation, or the Commercial & Business Litigation Committee.

Copyright © 2011 American Bar Association. All rights reserved. For permission to reprint, contact ABA Copyrights & Contracts, 321 N. Clark Street, Chicago, IL 60654-7598; fax: (312) 988-6030; email: copyright@abanet.org.

Address corrections should be sent to the American Bar Association, c/o ABA Service Center, 321 N. Clark Street, Chicago, IL 60654-7598.

www.abanet.org/litigation/committees/commercial

Section of Litigation

Copyright Issues for Architects, Contractors, and Developers in the Digital Age

BY ANDREW CRAIN AND MELISSA RHODEN

Crain

Electronic architectural drawing files, like any digital documents, can be transferred virtually anywhere almost immediately. For any number of reasons, the architectural drawing files of one architect or firm may conceivably end up on the desk, or worse, computer screen, of another architect or firm. While there certainly may be legitimate reasons for this to occur, problems can arise when drawing content from those files is copied into the drawing files of another architect on a different project. When this happens, significant copyright infringement liability can result, not only for the individual architect who made the unauthorized copy, but also for the architectural firm whose drawings contain the copied material, and the developer of the project, contractors, and potentially even the users (i.e., tenants) of the completed building.

How Does Copyright Law Apply to Architecture?

Before the enactment of the Architectural Works Copyright Protection Act (AWCPA) in 1990, works of architecture were afforded only limited copyright protection. Architectural plans could be registered for copyright as a "pictorial, graphic, and sculptural work" under 17 U.S.C. § 102(a)(5), but actual architectural structures were allowed almost no protection. *See Richmond Homes Mgmt., Inc. v. Raintree, Inc.*, 862 F. Supp. 1517, 1524 (W.D. Va. 1994). As the legislative history of the AWCPA indicates, prior to its enactment, it was possible to construct an identical building from architectural plans or drawings and escape copyright liability if the plans or drawings themselves were not actually copied. *See* H.R. Rep No. 101–735. Congress enacted the AWCPA to extend protection to "architectural works" as a new category of authorship.

The AWCPA extends protection to "architectural works."

Thus, an architectural work is the "design of a building as embodied in any tangible medium of expression," which may include "a building, architectural plans, or drawings." 17 U.S.C. § 101 (2010). Moreover, an architectural work includes the overall form of a building as well as the "arrangement and composition of spaces and elements in the design." *Id.* However, an architectural works copyright explicitly excludes individual standard features, such as doors and windows, which makes sense because of the functionality exclusion of copyright (i.e., copyright protects expression and not function or utility). *See id.*

However, that does not mean that the composition or arrangement of those features is not copyrightable. Indeed, the AWCPA's legislative history recognizes that creativity in architecture frequently takes the form of the selection, coordination, or arrangement of unprotectable elements into an original, protectable whole. *See* H.R. Rep. No. 101–735.

The primary effect of the AWCPA is to provide copyright protection to *physical* architectural works. The AWCPA does not, however, apply to copyrights in technical drawings. Before 1990, only architectural plans were protected by copyright, and only against copying as technical drawings, not as embodied in a structure based on the drawings. The 1990 act did not change this law. Rather, the 1990 act added protection in § 102(a)(8) of the copyright statute for the built structure, which was a new form of protection with its own registration requirements and infringement analysis.

Now, a work can obtain protection as both an architectural work (under § 102(a)(8)) and a technical drawing (under § 102(a)(5)), but only if the work is registered under both categories. This results in two separate copyright registration certificates.

Proving Copyright Infringement

To establish a prima facie case of copyright infringement for any copyrighted work, including architectural technical drawings and works, a copyright owner must prove that he or she owns a valid copyright and that the defendant copied constituent elements of the work that are original. *See Feist Publications, Inc. v. Rural Tel. Srv. Co., Inc.*, 499 U.S. 340, 361 (1991). A certificate of copyright registration made before or within five years of the first publication of the work constitutes prima facie proof of ownership of a valid copyright, including the element of originality, which is yet another reason to register an original work sooner rather than later. *See Arthur Rutenberg Corp. v. Dawney*, 647 F. Supp. 1214, 1216 (M.D. Fla. 1986).

In addition to proving ownership, a plaintiff must also prove that protectable elements of the work were copied. Direct evidence of copying is rare, so indirect evidence is more typically shown. Indirect, or circumstantial, evidence of copying involves proof that the infringer had access to the copyrighted work during or prior to creation of the infringing work, and that the infringing work is substantially similar to the copyrighted work. *See Donald Frederick Evans & Assoc. v. Cont'l Homes, Inc.*, 785 F.2d 897, 904 (11th Cir. 1986).

With architecturally related copyrights, access may arise in several different ways. For instance, an architect may

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

depart one firm for another and take physical or electronic architectural drawing files to the new firm. Or, multiple architectural firms may be involved on different aspects of the same project, especially larger projects, thereby necessitating the exchange of architectural CAD files among firms. Developers or contractors may also (with or without authorization) share architectural drawings among different architectural firms for the implementation of features used in a prior project to continue a design brand or so that previously priced building components are again utilized.

Although a copyright owner may prove that an infringer had access to and copied the protected work, infringement does not arise unless there is substantial similarity between the original and allegedly infringing work. *See Original Appalachian Artworks, Inc. v. Toy Loft, Inc.*, 684 F.2d 821, 824 (11th Cir. 1982). Substantial similarity exists "where an average lay observer would recognize the alleged copy as having been appropriated." *Milliken & Co. v. Shaw Indust., Inc.*, 978 F. Supp. 1155, 1159 (N.D. Ga. 1997). Not surprisingly, where electronic architectural drawings are dragged and dropped from a drawing file of a copyrighted work to a subsequent drawing file by someone lacking authority to do so, the work is not only substantially similar, but often identical.

Recoveries for Infringement

If a copyright owner establishes infringement liability, then a number of damages and remedy options are available. A first remedy is an injunction to prevent or restrain the infringement. *See* 17 U.S.C. § 502 (2010). An architect copyright owner could potentially seek to enjoin an infringing architect, developer, or contractor from using infringing architectural plans. Such an injunction could potentially prohibit the continued construction of a building, the continued use of infringing plans in the construction of a building, the actual construction of an infringing building itself, or the occupancy or use of an infringing building.

Regarding monetary damages, copyright owners may choose to pursue actual damages, as allowed by 17 U.S.C. § 504(a). However, actual damages may be negligible or even nonexistent in regard to architecturally related copyrights, unless, for example, the copyrighted design is one intended for use more than once, such as a tract house design.

Another remedy allowed by § 504(b) of the copyright statute is lost profits, or infringer's profits. Interestingly, § 504(b) actually permits the copyright owner to recover both lost profits and actual damages to the extent that any lost profits recovery is not already taken into account in the actual damages award. *See* 17 U.S.C. § 504(b) (2010).

In proving the infringer's profits, the copyright owner must only prove the infringer's gross revenues. *See id.* Thereafter, the infringer then bears the burden of proving those deductible expenses and profits not attributable to the copyright infringement. "[A]ny doubt as to the computation of costs or profits is to be resolved in favor of the plaintiff." *Id.* This burden-shifting rule contemplates that the infringer is always going to be in a better position than a plaintiff copyright owner regarding its financial data. If an infringer commingles profits attributable to the infringement with costs and noninfringement-related profits, then the infringer may pay a hefty price for doing so.

Another unique remedy provided by the copyright statute is statutory damages. Section 504(c) provides that a copyright owner may recover a statutory damage remedy instead of actual damages and infringer's profits. *See id.* at (c). The statute allows the copyright owner to make this election at any time prior to the rendering of the final judgment, and, if elected, the remedy ranges from a minimum of $750 up to $30,000, as the court deems just, for all infringements of one work. *See id.* at (c)(1). If a copyright owner can establish that the infringement was intentional or willful, then the statutory damages award may be enhanced up to $150,000. *See id.* at (c)(2).

A statutory damages recovery is only available if the copyright owner registered the copyright of an unpublished work before the infringer commenced the infringement. *See* 17 U.S.C § 412 (2010). If the infringed work has been published, then statutory damages are available to the copyright owner if the work was registered before the infringement commenced or within three months of the first publication of the infringed work. *See id.* Thus, this is yet another reason to register the copyright of work sooner rather than later.

The copyright statute also allows for the recovery of attorney fees to the prevailing party. *See* 17 U.S.C § 505 (2010). However, just as with statutory damages, the copyright plaintiff must have registered the copyrighted work prior to the commencement of the infringement for attorney fees to be recoverable. *See* 17 U.S.C. § 412 (2010).

Potential Copyright Snares

Despite the real and significant potential damage recoveries and remedies available for copyright infringement, common misconceptions persist in architecture, construction, and project development that may create substantial copyright infringement exposure. As an example, while architects might generally agree that copying the electronic files of another architect's architectural plans is impermissible, some may find no problem using the architectural plans of another as a reference or inspiration for the creation of another work. Whether such practice is permissible depends on the content taken and whether the resulting work is substantially similar to the copyrighted work used as a reference. Architects, developers, and contractors alike should review their standard practices to ensure that the copyrighted work of another is not being used without authorization.

Authorization to use another's work may often result from an incorrect understanding as to the ownership of the

(Continued on page 19)

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

It's a Technologicality: The Law Is Challenged with Accommodating New Developments

BY EDWARD B. GENTILCORE

Gentilcore

These days, new words are being created intentionally or by sheer accident as a result of either a need to more accurately explain a given situation or from combining two seemingly related thoughts into a single concept. In certain circumstances, the development of the newly uttered word is the result of a need to accurately capture the person's views and emotions at that particular point in time.

As many view the law, they consider legal nuances and details to be matters of technicality. Some phrases that come to mind are "they beat us on a technicality" or "he was released on a technicality." These phrases can be used to convey what is, in actuality, a much more detailed factual and legal reasoning behind the outcome in those legal proceedings.

The made-up term in this article's headline combines the term "technicality" with the concept of technology, as recent technological innovations have provided a significant challenge to the law. These technological advancements appear to have multiplied exponentially, leaving us all amazed by what is now capable, compared to a short time ago when some of these innovations seemed well beyond reasonable comprehension.

The law is challenged with catching up to new technological developments.

A recent article discussing developments in the green construction arena, "Growing Demand for Green Construction Requires Legal Evolution," *The Construction Lawyer*, Vol. 30, No. 3, Summer 2010, noted that law tends to follow technology. Stated another way, with rampant technological advancements occurring, the law is challenged with catching up to, reacting to, and accommodating these new technological developments and addressing the issues arising in the technological realm and reality.

Consider the issues to be confronted regarding e-discovery and the vast generation and accumulation of electronic communications in this day and age. Volumes of commentary and analysis, as well as case decisions, have focused on how to best address the requirements of "document" (as that term is now loosely understood) preservation and production. A recent matter resulted in a voluminous magistrate's memorandum, order, and recommendation, comprehensively discussing the requirements for securing this evidence for disclosure and the consequences of ignoring or deliberately disregarding those preservation obligations. *See Victor Stanley, Inc. v. Creative Pipe, Inc.*, U.S. Dist. Ct. D. Md. (Sept. 9, 2010) at Case No. MJG-06-2662. Even more recently, the district court in the same case, reviewing Magistrate Judge Grimm's decision, ordered severe monetary sanctions for what the court concluded were clear and intentional efforts to eliminate the electronic trail of communications on a matter, but stopped short of ordering a magistrate-recommended incarceration.

Also consider another article that recently appeared on the *ABA Journal* website, www.abajournal.com, discussing a firm's utilizing "predictive coding software" to assist in the review of millions of pages of electronic documents in a period of less than one month's time. Some of the reactions and comments following that article included whether or not the utilization of that software program actually constituted an "attorney review" of the information. In fact, such an issue may very well become the subject of further articles, and even cases, when claims arise regarding possible inadvertent disclosure of privileged information or other relevancy disputes over non-production of this "reviewed" data and information.

Keep in mind the changing landscape of rules involving the disclosure of draft expert reports in the federal court system. The very recent amendments to Federal Rule of Civil Procedure 26 can be traced in some respects to the reality that reviewing expert reports in an electronic form allows them to be more readily reviewed, revised, and edited without necessarily creating distinctive "drafts." Therefore, an anomaly was created whereby more technologically savvy or experienced practitioners and experts could have an advantage over those utilizing traditional (or, by some estimates, outdated) modes of communication for discussing and addressing finer points in the creation of the expert's written deliverable.

These technological developments are not limited to issues of electronic discovery or expert-report preparation. For example, in the recent decision from the U.S. Court of Appeals for the Seventh Circuit in *Illinois v. Hemi Group, LLC*, No. 09-1407 (Sept. 14, 2010), the appellate court concluded a parties' "presence" within a state could be established by an interactive website that allowed one of that state's residents to purchase products from the out-of-state Internet seller. Clearly, the potential impact of such a decision could leave those more accustomed to the analyses of the *Pennoyer v. Neff*, *International Shoe v. State of Washington*, *World-Wide Volkswagen Corp. v. Woodson*, and *Asahi Metal Industry Co. v. Superior Court* cases with their heads spinning. Nevertheless,

 Published in *Commercial & Business Litigation*, Volume 12, Number 2, Winter 2011. © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

questions like these are going to be more common when there is a large-scale proliferation of interstate (not to mention international) commerce through means such as a computer terminal, iPad, or even one's own phone. Some of these cases have already arisen, with mixed results. *See, e.g.*, *CompuServe, Inc. v. Patterson*, 89 F.3d 1257 (6th Cir. 1996); *Zippo Mfg. Co. v. Zippo Dot Com, Inc.*, 952 F. Supp. 1119 (W.D. Pa. 1997).

Despite the intriguing nature of these issues, it is rare that they would always advance themselves rapidly enough to command immediate attention by the courts, including the nation's highest court. A rare example comes from a recent dissenting opinion of U.S. Supreme Court Justice Samuel Alito in *Whitney Harper v. Maverick Recording Company*, 562 U.S. ___ (Nov. 29, 2010) on a petition for writ of certiorari to the U.S. Court of Appeals for the Fifth Circuit (the petition was denied). In his opinion, Justice Alito dissented from the denial of the writ of certiorari with a brief, but still intellectually challenging, analysis. In this case, a 16-year-old girl was charged with infringing the respondent's copyrights by downloading digital music files. While the district court had determined there were genuine issues of fact on whether she could be characterized as an innocent infringer under the U.S. Copyright Act, 17 U.S.C. § 402(d), the appellate court reversed, saying that the language of § 402(d) precluded the application of that defense by definition. Interestingly, the case turned on language in the Copyright Act referring to "phonorecord" or "phonorecords." For those unfamiliar with the vinyl predecessors of today's modern CDs and music data files, the phonorecord was, at its time, the audiophile's best method of capturing and delivering the desired music of his or her favorite artist. It is unfortunate that this law, adopted in 1988, was hardly visionary in nature. The Copyright Act simply did not accommodate what we understand today as the best means of presently capturing and delivering one's favorite music selections. Nevertheless, with that provision being the only avenue to protect the innocent infringer, the courts have been forced to address and evaluate that language with much more modern terminology and sensibility. In his dissent, Justice Alito concluded that the Fifth Circuit's decision "may or may not set out a sensible rule for the post-'phonorecord' age, but it is at least questionable whether the decision correctly interprets § 402(d)." For that reason, he concluded the writ should have been granted.

What do these various technology-based developments mean for today's lawyers, litigators, and in-house counsel charged with navigating their clients' and companies' interests in a fashion that will minimize risk and liability? Perhaps all of the foregoing are calls to action to, where possible, more proactively evaluate and craft contractual documentation in a way that preserves the parties' objectives in agreements, disputes, or transactions, and utilizes those opportunities to more directly embrace the specific technology being employed.

Reconsider the example of green building, mentioned previously. There is presently a great deal of interest in initiatives designed to increase the efficient construction and operation of structures throughout the United States and beyond. However, as has already been observed, some parties have taken issue with whether the technical elements of green building are adequately addressed in the current contractual lexicon. As a result, new contract forms, including the ConsensusDOCS Green Building Addendum, were developed to embrace and encourage these green-building initiatives. In other instances, litigation has ensued where representations regarding a building's "green" characteristics have not met reality. These cases are presently navigating their way through the courts.

New contract forms were developed to encourage green-building initiatives.

While there is unlikely to be a shortage of disputes over emerging technologies and the difficult issues they will undoubtedly continue to present, more proactive evaluation of these technological developments in the contractual and transactional model may help to resolve many of those issues before they reach the court docket. Such is the challenge of developing the next technologicality in the law. ■

Edward B. Gentilcore is vice chair of Duane Morris' Construction Group.

now available for free on iTunes™.
www.abanet.org/litigation/soundadvice

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

Bankers Trust, Brown, and Exclusion 3(a): The Insurability of Mechanic's Liens

BY MICHAEL S. LEBOFF

LeBoff

Take the following not-too-uncommon scenario: A lender and a developer enter into a commercial loan agreement for the construction of a new real estate development. During the course of construction, prior to the disbursement of the full loan amount, the developer defaults. The lender, per the terms of the loan agreement, refuses to disburse the remaining loan funds.

Not surprisingly, because the developer defaulted before the project was completed, the developer did not pay the contractors, subcontractors, or material suppliers. As a result, the lender finds itself with a host of subcontractors with perfected mechanic's liens claiming priority over the lender's secured deed of trust.

The lender then tenders the mechanic's lien claims to a title insurer. The title insurer denies the claim pursuant to Exclusion 3(a) of the policy, claiming that the lender "created, suffered, assumed, or agreed" to the priority of the mechanic's liens by failing to continue to fund the loan after the developer's default.

Was the title insurer correct in denying the claim? (Whether the mechanic's liens would, in fact, have priority over the lender's deed of trust will vary from state to state and is outside the scope of this article.)

Find Us on Twitter and Facebook.

"Like" The ABA Section of Litigation on Facebook

Follow @ABALitigation on Twitter

Find timely articles and news updates, CLE program information, and recent podcasts for litigators.

Section of Litigation

Exclusion 3(a)

Exclusion 3(a) of the typical ALTA lenders title insurance policy excludes coverage for "[d]efects, liens, encumbrances, adverse claims or other matters . . . created, suffered, assumed or agreed to by the insured claimant." The intent behind this exclusion is obvious. If a person takes property with knowledge of a lien, he or she should not be able to force the title insurer to pay off the lien he or she knowingly assumed. Likewise, if a property owner conveys an interest to another party, he or she cannot complain that the interest he or she conveyed impacts his or her title. However, the application of this exclusion is not so simple.

Bankers Trust* and *Brown

The two primary cases on which title insurers rely in support of the argument that the refusal to continue to fund a construction loan post-default falls under Exclusion 3(a) are *Bankers Trust Co. v. Transamerica Title Ins. Co.*, 594 F.2d 231 (10th Cir. 1979) and *Brown v. St. Paul Title Ins. Co.*, 634 F.2d 1103 (8th Cir. 1980).

In *Bankers Trust*, the Tenth Circuit affirmed summary judgment where the district court held that where "work was performed and payment was not made up to the amount of the lender's loan commitment, the resulting mechanic's liens must be considered to have been created or suffered by the insured claimant and such liens are expressly excluded from coverage by the language of the title policy." 594 F.2d at 234. The Tenth Circuit's opinion, however, did not rely or even discuss the title insurance policy or Exclusion 3(a). Instead, it focused entirely on a separate distribution agreement between the lender and title company under which the title company disbursed the loan funds advanced by the lender.

The following year, in *Brown,* the Eighth Circuit applied *Bankers Trust* in another case where the lender stopped funding a construction loan after the developer's default. In ruling that the resulting mechanic's liens were excluded under the title policy, the Eighth Circuit stated that: "While [the lender] admittedly was under no obligation to continue funding the project after the default, it seems clear that the parties contemplated that [the lender] would provide adequate funds to pay for the work completed prior to the default. To hold otherwise would give the insured an unwarranted windfall and would place the title insurer in the untenable position of guaranteeing payment of work for which loan funds were never advanced." 634 F.2d at 1110.

Thus, armed with *Bankers Trust* and *Brown*, title carriers have denied coverage of mechanic's lien claims where there were any undisbursed loan funds.

 Published in *Commercial & Business Litigation*, Volume 12, Number 2, Winter 2011. © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

Bankers Trust and *Brown* Fail to Take Hold

Although the issue has not (yet) been the subject of many recent appellate court opinions, the cases that have come out since *Bankers Trust* and *Brown* do not necessarily support the carriers' denial of coverage. In fact, in the 30 years since these two cases, very few courts have fully embraced those rulings. To the contrary, subsequent cases have substantially limited the reach of *Bankers Trust* and *Brown*.

For example, in *Mid-South Title Insurance Corp. v. Resolution Trust Corp.*, 840 F. Supp. 522 (W.D. Tenn. 1993), when presented with similar facts, the court refused to find that a lender "created, suffered or assumed" mechanic's liens where it refused to disburse loan funds after the borrower's default. Among other things, the *Mid-South Title* court found that *Bankers Trust* and *Brown* were "factually inapposite" because both of those cases involved situations where the lender and title insurer also entered into a concurrent distribution agreement that created an "implied duty to provide adequate loan funds to satisfy any charges incurred prior to default." *Id.* at 527.

The court also noted that there was no language in the title policy expressly excluding lien coverage until all loan funds were disbursed, and "[h]ad the insurance company intended to exclude any project liens so long as the loan commitment was not fully funded, it could certainly have provided for it in the title policy. It did not do so and this court should not imply such an exclusion in the contract simply because it would now appear to make good business sense to have it."

Similarly, in *Resolution Trust Corp. v. Ford Mall Association, LP*, 819 F. Supp. 826, 840 n.16 (D. Minn. 1991), the district court rejected the title insurer's argument that mechanic's liens are excluded under the title insurance policy where the lender failed to disburse all of the committed loan proceeds.

More generally, other cases have cast doubt on Exclusion 3(a), holding that the exclusion, on its face, is ambiguous, and therefore must be interpreted against the insured. *See Chicago Title Ins. Co. v. Resolution Trust Corp.*, 53 F.3d 899, 907 (8th Cir. 1995); *Safeco Title Ins. Co. v. Moskopoulos*, 116 Cal.App. 3d 568, 667 (1981). *But see First Am. Title Ins. Co. v. Action Acquisitions, LLC*, 187 P.3d 1107, 1113 (Ariz. 2008) (finding that Exclusion 3(a) is not ambiguous). As a result, those courts have applied Exclusion 3(a) only where there is "conscious, deliberate causation" on the part of the insured. *Stevens v. United General Title Ins. Co.*, 801 A.2d 61, 69 (*See* D.C. 2002); *Moskopoulos*, 116 Cal. App. 3d at 667. *But see Action Acquisitions*, 187 P.2d at 1113 (holding Exclusion 3(a) applies whenever the insured intended the act that resulted in the defect even if the insured did not intend the defect itself.)

General Rules of Interpretation Complicate Matters Further

It is also difficult to reconcile an insurance carrier's reliance on a general exclusion like 3(a) when other more specific provisions of the typical American Land Title Association (ALTA) lender's policy would seem to cover mechanic's liens, so long as the work was commenced or contracted prior to the date of the insurance policy.

Coverage No. 7, for example, provides coverage, without limitation, for losses arising out of the "[l]ack of priority of the lien of the insured mortgage over any statutory lien for services, labor or material . . . arising from an improvement or work related to the land which is contracted for or commenced prior to Date of Policy." Nothing in Coverage No. 7 requires the lender to fully exhaust its funding commitment where the developer has materially defaulted on the note. Accordingly, under the policy provisions specifically addressing mechanic's liens, it would seem when the construction was contracted or commenced is more important than whether the loan was fully funded at the time of default. Additional endorsements in the policy can muddy the waters even further.

Additionally, Exclusion 6, which is essentially the converse of Coverage No. 7 above, is the only exclusion that specifically applies to mechanic's liens. That provision excludes coverage for "[a]ny statutory lien for services, labor or materials (or the claim of priority of any statutory lien for services, labor or materials over the lien of the insured mortgage) arising from an improvement or work related to the land which is contracted for and commenced subsequent to Date of Policy and is not financed in whole or in part by proceeds of the indebtedness secured by the insured mortgage which at Date of Policy the insured has advanced or is obligated to advance." Thus, if a mechanic's lien is based on construction that was contracted for and commenced prior to the date of policy, those liens are outside Exclusion 6, and thus presumably covered by the policy.

Subsequent cases have limited the reach of *Bankers Trust* and *Brown*.

Conclusion

Given the present state of the economy, disputes concerning the coverage of mechanic's liens where the loan funds have not been fully disbursed are and will continue to proliferate. While the insurance companies are wielding *Bankers Trust*, *Brown*, and Exclusion 3(a) as a defense to coverage, there are a number of considerations showing their position may not be on solid ground. Only time, and a more developed body of case law, will tell. ■

Michael S. LeBoff is an attorney at Hodel Briggs Winter, LLP, in Irvine, California, and a chair of the Subcommittee on Banking and Lender Liability. He can be reached at mleboff@hbwllp.com.

9 - Published in *Commercial & Business Litigation*, Volume 12, Number 2, Winter 2011. © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

Banks' Priority Rights over Mechanic Lien Claims for Unlienable Work

BY MARK E. WILSON AND JEREMY D. KERMAN

Wilson

Kerman

Banks expect a priority position on real property collateral when they record a mortgage. The principle of "first in time, first in right" adds an important level of certainty and reliability to the business of secured lending.

Occasionally, however (it's actually regrettably often in our current economic climate), banks find that their borrowers have contracted for work related to the real property collateral but have not paid the bill. The contractor's remedy against the property is a mechanic's lien, which typically gives the contractor a super-priority position back to the date of the unfulfilled contract, even if the failure to pay occurred after the date of the mortgage.

Mechanic's liens frustrate the settled expectations of secured lenders. The mortgage is no longer first in line in the foreclosure proceeding. The theory is that the contract improves the value of the collateral, so the contractor should be paid off the top, then the secured party collects the remaining value without the improvement, which is all the secured party reasonably anticipated in the mortgage transaction in the first place. This can be a hardship to the lender, which is why standard-form title policies cover mechanic's liens that pre-date the mortgage. Title insurers must still defend lien claims on behalf of the insured lender, however.

Moreover, a bank is not out of the woods just because a contract post-dates the mortgage. In many states, the contractor still has priority over the mortgagee to the extent that the work enhances the value of the property, and title insurers often will not defend such post-mortgage claims.

What arguments are available to banks and title insurers faced with lien claims like these? An important arrow in the lender's quiver comes from the ancient real property law of fixtures. In most states, the work at issue had to improve the real estate rather than serve some other purpose, such as simply improving the value of the business operating on the real estate. In other words, the work must be for a permanent improvement, or a "fixture," on the property.

But what exactly is a fixture? Courts have long struggled with the question, but most have adopted a test to determine whether certain work constitutes a lienable fixture. The test dates back to 1853. *See Teaff v. Hewitt,* 1 Ohio St. 511 (1853) (*rev'd* on other grounds). In this case, the lender recorded a mortgage on the owner's wool factory. Another creditor levied certain equipment at the factory. The court addressed whether the equipment, including a steam engine, boilers, and wool-carding machines, added value to the realty, which depended on whether the items were fixtures. If they were fixtures, they were subject to the lender's mortgage and not the other creditor's levy.

Synthesizing several approaches to this issue, the court arrived at a united application of disparate tests as the "safest criterion of a fixture." These criteria include:

- Actual annexation to the realty, or something appurtenant to it.
- Appropriation to the use or purpose of the part of the realty to which it is connected.
- The intention of the party making the annexation to make it a permanent accession to free-hold. Intention can be inferred from the nature of the item, the relation and situation of the party making the annexation, the structure and mode of annexation, and the purpose or use of the annexation. *Id.* at 529–30.

Applying this new test, the court first noted that the actual connection with the realty in this case was slight: "The bands and straps by which the machinery was attached to the motive power of the steam engine and boilers could easily be thrown off, and the cleats or means used to keep the machinery steady and in its proper place for use, were such as to admit of its removal without injury to any property, or even inconvenience." *Id.* at 534. As to the second factor, the court determined that the "use or purpose to which the machinery was applied was that of a trade or the business of manufacturing" occurring on the property, which suggested that the machinery may have improved the value of the business operating the factory but not the property itself. *Id.* at 534–35. Finally, the court noted, "Neither the mode of the annexation nor the use to which it was applied, indicated any design to change the character of the property." *Id.* at 535. The court further commented on the very nature of the machinery itself, suggesting that, "the customary removal of it from place to place, its liability to be taken away or disposed of, and other articles of the same kind supplied to take its place, show that it was not intended to be a permanent accession to the freehold, and therefore was not covered by the mortgage." *Id.* at 536.

Most courts apply a form of this test in the mechanic's lien context. In Illinois, for example, the test to determine whether work is lienable is threefold:

- the means by which the fixture is annexed to the building;

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

- whether the item is adapted to and necessary for a particular purpose for which the property is devoted; and
- whether the party having an interest in the premises intended the item to become a permanent part of the property. *See Safari Circuits, Inc. v. Chicago Sch. Reform Bd. of Trs.*, 474 F. Supp. 2d 993, 998 (N.D. Ill. 2007).

In *Safari*, the contractor installed several computer servers and various other audio and video devices at a school, which were networked with cables, attached to a metal rack running along the ceiling, and mounted on large racks by screws (with the racks then bolted to the floor). In holding that the work did not enhance the value of the property, the court noted that all of the equipment could be removed by trained technicians without materially damaging the real property; the equipment was not an essential improvement to the building and its educational purpose, even though the equipment was custom-designed for the school's educational purposes; and there was no evidence that the intention behind the installation was to enhance the value of the real property because moving locations would require the school to unscrew and move all of the equipment.

This view represents a trend where courts focus on the "intent" factor, whereas earlier courts often focused on the "annexation" factor and the method by which the item or work in question was affixed to the realty. For example, in determining whether sink units were fixtures, the California District Court of Appeal analogized the sinks to refrigerators and stoves, which "are movable and can be disconnected by merely pulling a plug or unscrewing a gas connection." *Daniger v. Hunter*, 114 Cal. App. 2d 796, 798 (Cal. Dist. Ct. App. 1952). Ultimately, the court concluded that the sinks were nonlienable after focusing on the fact that these specific sinks were not "built in" to the realty, but were movable units that could be disconnected and removed without damage to the realty itself.

Other courts have shown a similar trend in applying the *Teaff* test, although these courts have long emphasized the "intent" factor over the "annexation" factor, or at least looked to the method of annexation as an indication of intent. As far back as 1912, the Supreme Court of Arizona applied the *Teaff* test in determining whether a double cylinder ammonia compressor and appurtenances in a slaughterhouse constituted fixtures for the purpose of a mechanic's lien. The court noted that "[w]hether a thing is a fixture depends largely upon the intention with which it is affixed to the realty; whether it is attached as a permanent fixture to the realty or not." *Independent Meat Co. of Jerome v. Crane Co.*, 184 P. 992, 994 (Ariz. 1912). In other words, the court gave more weight to whether the machinery was intended to become a permanent part of the slaughterhouse building than to how the machinery was actually attached to the building. Ultimately, the court determined that the ammonia compressor was a fixture because the contract under which it was furnished contained a stipulation to remove the machinery that was never enforced, indicating an intention for the machinery to become part of the realty.

Modern courts have applied similar logic. In *Price v. Sunmaster*, the defendant filed a motion to vacate a default judgment in an action to foreclose a mechanic's lien based on improvements made to a mobile home on the land. 558 P.2d 966, 970 (Ariz. Ct. App. 1976). While noting that the defendant's complaint did not allege that the improvements were annexed to the realty, or that the improvements were adaptable to facilitate the purpose of the realty, the court focused on the fact that the complaint made no allegations that the plaintiffs intended for the work done to be a permanent improvement to the land itself. In fact, the court took note that the complaint even indicated that the improvements were moved, "thus casting doubt on such intention [that the improvements were permanent]." *Id.*

Of course, not all applications of the *Teaff* test are cut and dry, and courts often struggle with the facts of each individual case. For instance, in holding that carpeting was a permanent, lienable improvement to the realty, the Supreme Court of New York cited two previous cases holding that carpeting did not come within the "ambit of a 'permanent' improvement": *Application of the Campagna Development Corp.*, 347 N.Y.S.2d 253, 254 (N.Y. Sup. Ct. 1973) (citing *Hayes v. Carpeting Sales & Service Corp.*, 260 N.Y.S.2d 62 (N.Y. Sup. Ct. 1965) and *Pike v. Naylon Securities Co., Inc.*, 251 N.Y.S. 659 (N.Y. Sup. Ct. 1931)). The court distinguished the present case by noting that the carpeting was "not merely a decorative floor covering but constituted an integral part of the condominium construction." *Id.* The court also focused on the "annexation" factor of the *Teaff* test, stating that the 1965 and 1931 cases dealt with carpeting that covered the permanent floor, whereas the present case dealt with carpeting fixed to the subfloor with nails, staples, and cement that was a "virtual necessity" because there was no wood flooring covering the rough subflooring. *Id.*

Ultimately, while the *Teaff* test remains the law today in most jurisdictions, it can be maddeningly difficult to apply in practice. Even so, for the secured lender faced with a mechanic's lien claim, the rule may provide relief. Did the contractor build an integral part of the structure on the building, or did the contractor merely install some equipment and related infrastructure for the operator of the space? If it was the latter, the bank may have priority after all. ■

Mark E. Wilson is a partner and head of the Commercial Law Group at Kerns, Frost & Pearlman, LLC, with offices in Chicago and Lake County, Illinois. Jeremy D. Kerman is an associate in the firm's Chicago office.

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

Legislative and Judicial Intervention

(Continued from page 1)

difficult for both homeowners and homebuilders to know whether construction was defective. Courts attempted to provide guidance. For example, in *Kamarath v. Bennett,* 568 S.W.2d 658, 661 (Tex. 1978), the Texas Supreme Court defined breach of the implied warranty to include construction defects that "render the premises unsafe, or unsanitary, or otherwise unfit for living therein."

Homebuilders reacted to the "creation" of these implied warranties and the court's expanding scope of these implied warranties by including language in construction contracts by which homeowners expressly waived the implied warranties in favor of defined warranties, typically less encompassing than the implied warranties. For a period of time, the Texas Supreme Court allowed such provisions in construction contracts as long as the waiver language was "clear and free from doubt," and protections for homeowners appeared to be on the decline. *G-W-L v. Robichaux,* 643 S.W.2d 392, 393 (Tex. 1982) (a provision stating that "there being no oral agreements, representations, conditions, warranties, express or implied" was held to be clear and free from doubt). Five years later, however, the Texas Supreme Court reconsidered the wisdom of these express waivers.

In *Melody Home Manufacturing Co. v. Barnes*, 741 S.W.2d 349, 355 (Tex. 1987), the court concluded that the implied warranties could not be waived. "It would be incongruous if public policy required the creation of an implied warranty, yet allowed the warranty to be disclaimed and its protection eliminated merely by a pre-printed standard form disclaimer or an unintelligible merger clause." To the extent that the court's prior opinion in *Robichaux* was inconsistent with this finding, it was overruled. *See id.* The opinion also extended the scope of implied warranties to cover renovation and remodeling of existing homes.

The Passing of Consumer Protection Laws

Against this backdrop of court opinions regarding implied warranties, statutory protections for consumers came into existence with the 1973 enactment of the Texas Deceptive Trade Practices: Consumer Protection Act (DTPA). *See* Tex. Bus. & Comm. Code Ann. § 17.42 (West 2002) *et seq.* In particular, homeowners now had a new weapon in their arsenal to address defects in the construction of their homes. Homeowners could assert a claim against a builder or a remodeler based on misrepresentations regarding the quality, characteristics, uses, and benefits of their home or improvements to their home. In addition, claims could be asserted for breach of both express and implied warranties. The DTPA declared that the waiver of warranties was contrary to public policy and set out very specific requirements before warranties could be waived: The waiver must be in writing and signed by the homeowner, the homeowner must not be in a significantly disparate bargaining position, and the consumer must have been represented by an attorney when obtaining the goods or services that are the subject of the claim against the homeowner. *See* Tex. Bus. & Comm. Code Ann. § 17.42 (West 2002).

The Residential Construction Liability Act

By 1987, homeowners were well protected, but homebuilders were feeling the pressure of increasing litigation and focused their efforts on legislative relief to limit their liability to homeowners. That relief came in the form of the Residential Construction Liability Act (RCLA), Tex. Prop. Code Ann. § 27, *et seq.* (West 2000 and Supp. 2009), which was enacted in 1989 and described by Senator Monford as being enacted to "provide a fair and appropriate balance with respect to the resolution of construction disputes between a residential contractor and an owner." Tape of Hearings on Texas Senate Bill 1012, Before the Senate Committee on Jurisprudence, 71st Leg., R.S., Tape 2, Side 1 (April 4, 1989) (statement of Senator Monford). When enacted, the RCLA delineated prerequisites with which homeowners must comply before they could file suit against a homebuilder. Notice of proposed construction defects had to be given first, and homebuilders had the right to inspect and make an offer to repair construction defects; a homeowner's recovery of damages was limited if the homeowner unreasonably rejected an offer to repair or a cash settlement or if the homeowner did not give the homebuilder a reasonable opportunity to make the repairs. Although the implications were not clear at the time, the RCLA also provided that, in the event of a conflict between the RCLA and the DTPA, the RCLA would prevail.

Homebuilders were not content with the limited scope of the RCLA when it was first enacted, but a series of amendments from 1993 to 2003 increased the protections for homebuilders. The 1993 amendments gave homebuilders more defenses and limited the types of damages that could be recovered by homeowners. Specifically, homebuilders were not liable for the portion of the homeowner's damages that were caused by persons other than the homebuilder, the failure of the homeowner to mitigate damages or reasonably maintain the home, normal wear and tear, normal shrinkage due to drying or settlement of construction components, and the homebuilder's reliance on false or inaccurate written information from official government records, so long as the builder could not reasonably have known of the falsity or inaccuracy. While the original version of the RCLA only limited damages if the homeowner unreasonably rejected an offer to repair or a cash settlement, in 1993, damages arising from the following were specifically excluded (except in a claim for fraud): physical pain, mental anguish, loss of consortium, disfigurement,

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

physical impairment, and loss of companionship and society. In addition, beginning with the 1993 amendment, homeowners could no longer recover punitive damages. Subsequent amendments added additional layers of complexity to the ability of a homeowner to pursue a claim for construction defects. With the 1995 amendment, homebuilders could abate any lawsuit that had been filed if a homeowner had not provided the required opportunity to inspect and cure. A requirement for mediation was added by the 1999 amendment.

Even with these amendments to the RCLA, homebuilders constantly found themselves on the losing end of a jury verdict when the issue was whether or not the homebuilder had made a reasonable offer to repair a construction defect. On the heals of decisions in *O'Donnell v. Roger Bullivant of Texas, Inc.*, 940 S.W.2d 411 (Tex. App. Ft. Worth 1997) and *Bruce v. Jim Walters Homes, Inc.*, 943 S.W.2d 121 (Tex. App. San Antonio 1997), the decision in *Perry Homes v. Alwattari*, 33 S.W.3d 376 (Tex. App. Ft. Worth 2000), signaled that any litigation involving legislation that was capable of being interpreted, either by court or jury, in favor of a homeowner and against a homebuilder, would be resolved in favor of the homeowner.

In *Alwattari*, after an initial settlement proposal from the homebuilder was rejected, the parties continued to negotiate for repairs even though a lawsuit was on file. By the time the case was tried, the homebuilder had made all of the repairs identified by the homeowner's expert and had only cosmetic repairs to complete. Despite these efforts, a jury found that because the original settlement offer made by the homebuilder was not reasonable, the homebuilder was not entitled to any limitation on damages or defenses to liability provided for in the RCLA. *See id.* at 384.

Finally, citing to *Bruce* for the proposition that a homeowner could bring other claims that did not conflict with the remedial purpose of the RCLA, the court further sustained the findings of violations of the DTPA because the RCLA provision relating to preemption did not apply due to the unreasonable settlement offer made by the homebuilder. *See id.* at 382.

Besides the court opinions cited above, which took away what the legislature had tried to give with the amendments to the RCLA, in 2002, the Texas Supreme Court, in *Centex Homes v. Buecher*, 95 S.W.3d 266 (Tex. 2002), once again had the opportunity to discuss implied warranties and the possibility of waiver of those warranties. The court distinguished between the implied warranty of good and workmanlike manner and the warranty of habitability, noting that good workmanship focused on the conduct of the homebuilder and served as a gap filler or default warranty in those situations in which the parties had not contracted otherwise. *See id.* at 273. Conversely, the implied warranty of habitability focused on the completed home and was a form of strict liability, because "the adequacy of the completed structure and not the manner of performance by the builder governs liability." *Id.* at 273. The court concluded that an implied warranty of good workmanship could be waived by the parties if their agreement provided for the "manner, performance or quality of the desired construction." *Id.* at 275. However, because it was a form of strict liability, the implied warranty of habitability could not generally be waived.

The Texas Residential Construction Commission Act

As had been the history in Texas since 1968 in construction defect issues, now that the courts had spoken again, it was time for the legislature to once again respond to concerns of Texas homebuilders as represented by the Texas Association of Builders. It did so and changed the playing field for homeowners dramatically when it enacted the Texas Residential Construction Commission Act (TRCCA), Tex. Prop. Code Ann. § 401, *et seq.* (West 2007, Supp. 2009), which established the Texas Residential Construction Commission (TRCC).

The TRCCA implemented a more detailed process than that set out under RCLA.

Generally, the TRCCA implemented a more detailed administrative process than that set out under RCLA designed to facilitate the resolution of disputes relating to alleged residential construction defects as a mandatory prerequisite to litigation. The TRCCA also required builders to become registered with the commission to perform residential construction and remodeling in Texas. Along with the registration requirements for homebuilders, the most controversial aspect of TRCCA was its preemption of common-law warranties. The implied warranties of habitability and workmanship created by case law and still viable with the passage of the DTPA and RCLA faded into the mist with the statutory warranties created by TRCCA. The only warranties afforded homeowners following the TRCCA's passage were those created by the TRCCA. Homebuilders rejoiced, believing that the presumptions they faced under the DTPA and RCLA would be obviated. However, the creation of a regulatory scheme brought homebuilders and homeowners a completely different scope of problems while leaving unanswered the true goal of the legislation: taking residential construction issues out of the hands of a jury and placing them in the hands of those knowledgeable in the industry.

The TRCCA authorized the commission to enact and define what warranties were to be owed to homeowners and binding upon homebuilders. The commission adopted building and performance standards, repair obligations, and limited warranties. This was the framework by which homebuilders were required to perform, and it outlined what duties were owed to homeowners. The commission's administrative rules

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

likewise made clear that they were exclusive, and no others were available to homeowners:

1. The warranties established by the commission in this chapter supersede all implied warranties for new residential construction or residential improvements that commence on or after the effective date of this chapter.
2. The warranties established by the commission in this chapter are the only warranties applicable to new residential construction unless a particular warranty is created by a statute that expressly refers to residential construction or residential improvements or is created by any express warranty set forth in writing by the builder. 10 Tex. Admin. Code § 304.3(h)(1)-(2) (2010).

Although the waiver of warranties was difficult enough under the DTPA, the TRCCA now made it impossible.

The statutory warranty of habitability, a long survivor in case law, was rewritten under the TRCCA to make it consistent with the building and performance standards adopted by the commission, so long as the home was "safe, sanitary, and fit for humans to habitate." Likewise, the implied warranty of workmanship was replaced with the specific requirements of homebuilders to comply with the TRCCA's building and performance standards.

The implied warranties of 1968 once again apply for the protection of homeowners.

The commission went as far as to require homeowners to maintain the property and residence so as not to increase any damage or increase the severity of the alleged defect. By statute, homeowners were required to periodically repaint and reseal, caulk, replace manufactured systems such as HVAC filters, and preserve landscaped areas and exterior grading that could impact the stability and structure of the residence. Likewise, the homebuilder was given explicit instructions on repair and replacement, including taking on the responsibility to finish a repaired area to its original design at the homebuilder's cost. As far as manufactured products, the homebuilder's duty was limited to the scope of the manufacturer's warranty and nothing ancillary to it. With these firm directives, the homebuilder's industry was confident that the loopholes still present after the passage of RCLA were closed.

However, because of the inherent contradiction within the TRCCA, being both a licensing and patrolling regulatory body with no ability to screen competent homebuilders from the incompetent at the registration and licensing stage, the administrative scheme struggled in its implementation from the outset. With the public trust in the commission diminishing due to the cumbersome and time-consuming inspection process, a homebuilder's ability to seek dismissal for a violation of the administrative scheme was too strong an impediment to effective implementation. The tide began to shift from a strong homebuilder's lobby to a growing concern for the rights and remedies available to homeowners who had historically been protected by the courts and the legislature.

Where Are Homeowners Now?

By the terms of Section 401.006 of the Texas Property Code (the Sunset Provision), the TRCC was subject to the Texas Sunset Act (Tex. Govt. Code Ann. § 325, *et seq.* (West 2005)) and was set to be abolished on September 1, 2009, unless new legislation was passed continuing its existence. The Sunset Advisory Commission Staff recommended that the TRCC be abolished and the TRCCA repealed. As expected, the TRCC, in its management response, objected to that recommendation and proposed several changes to make the TRCC more effective. Ultimately, the Sunset Advisory Commission recommended to the legislature that the TRCCA be amended but not abolished. House Bill 2295 was introduced as a mechanism to make changes to the TRCCA as recommended by the Sunset Advisory Commission. House Bill 2295 made its way through the House, where it passed on a 137-7 vote, but it was changed dramatically in the process: "[W]hat was meant to still be a low-cost, low-level way to deal with smaller problems between home builders and their customers, grew into a larger agency with more employees and more powers, including licensure." Walt Nett, *Group's End Puts Burden Onto Courts*, Lubbock Avalanche Journal (July 12, 2009). The bill ultimately died in a Senate committee without a hearing at the request of the bill's sponsors as a result of the House amendments.

The abolishment of the TRCC and repeal of the TRCCA mean that residential construction disputes in Texas have come full circle. The implied warranties that were first recognized in 1968 once again apply for the protection of homeowners, and the RCLA still exists so that a homebuilder can present a settlement proposal in response to construction complaints. The DTPA is still alive and well for those situations in which no reasonable settlement proposal has been made. It is anticipated that, consistent with prior decisions, Texas juries will still be persuaded that settlement proposals are not reasonable, at which point any remaining RCLA limitations on types and amounts of available damages will not apply. It is a new day in residential construction litigation, but one that has a long history of both legislative and judicial intervention. ■

Mitzi T. Shannon and Shelly W. Rivas are partners in the law firm of Kemp Smith, LLP.

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

THE BENEFITS OF MEMBERSHIP

Build Your Practice with Cutting-Edge Information

Find it at **LitigationNews.org**

- Nationwide Coverage of Trends and Developments
- Analysis by Practicing Litigators
- Practice-specific Tips and How-to's

Plus one-click access to

- Litigation Podcast
- Entire archive of practice area publications
- *Litigation Journal*'s current issue and archive
- ABA Bookstore

15 - Published in *Commercial & Business Litigation*, Volume 12, Number 2, Winter 2011. © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

Road Map to Preparing Claims

(Continued from page 1)

other conditions precedent to litigation or arbitration, which may apply to a subcontractor. Moreover, one should pay attention to the applicable timeframes for claims and observe them. Contractual provisions may also provide guidance as to the choice of law provisions or venue for disputes.

Some jurisdictions, however, will deem void any choice of law and/or forum selection clauses that require the application of another jurisdiction's law or litigation in a jurisdiction other than the location of the project. *See, e.g.*, N.Y. Gen. Bus. Law § 757(1) (Consol. 2010) (dictating that for New York construction projects, contractual provisions that provide for the application of a different state's law and/or require arbitration or litigation to take place outside New York are void); R.I. Gen. Laws § 6-34.1-1 (2010) (allowing a party to void a provision in a construction agreement that requires the application of different law or arbitration or litigation in a forum other than Rhode Island when the project is located in Rhode Island). Identifying the location of the dispute, the dispute resolution mechanism, and the applicable law early in the engagement is invaluable and will help focus the litigation plan moving forward.

Is the Project Bonded?

On construction projects, there may be payment bonds and/or performance bonds in place that inure to the benefit of contractors and subcontractors and provide an avenue of recovery. A payment bond generally runs in favor of subcontractors and suppliers and obligates the surety to pay outstanding amounts owed to the subcontractor if the general contractor fails to fulfill its payment obligations. A performance bond generally runs in favor of the owner and/or general contractor and provides a remedy in the event of subcontractor or contractor nonperformance or defective performance.

One should pay attention to the applicable timeframes for claims.

Whether a payment and/or performance bond was required on a project is a function of either contractual obligations or statutory requirements. Immediately ask your clients if they have a copy of the applicable bond(s). If they do not, explore the options that may be available to obtain a copy of the bond(s). Some jurisdictions require that bonds be publicly filed when the project exceeds a certain size. *See, e.g.*, N.Y. Gen. Obl. Law § 5–322.3 (Consol. 2010) (requiring the filing of a bond where the value of the contract exceeds $100,000). For federal projects, the Miller Act sets forth a procedure for obtaining a copy of the applicable bond. *See* 40 U.S.C. § 3133 (2010). Alternatively, one can contact the surety or sureties with whom the defaulting party normally contracts and demand a copy of all bonds applicable to the particular project.

Once a copy of the bond has been obtained, it is critical to identify and comply with all notice and timing requirements set forth therein. In the private project context, the bond often dictates the timeframe within which a claim must be asserted and/or an action on a bond must be filed. *See, e.g.*, Mass. Ann. Laws ch. 149, § 29A (LexisNexis 2010) (indicating that one can sue on a bond issued on a private project in accordance with the terms of the bond itself). Bonds are generally interpreted under the same principles as any other contract. *See, e.g.*, *Cates Constr. v. Talbot Partners*, 980 P.2d 407, 413 (Cal. 1999) ("Performance bonds, like all contracts of surety, are construed with reference to the same rules that govern interpretation of other types of contracts"). In the case of public projects, however, a bond is often a creature of statutory law, and the enforcement of the same may be governed by the same statute. *See, e.g.*, N.J. Stat. Ann. §§ 2A:44-143–47 (LexisNexis 2010) (New Jersey Bond Law); Mass. Ann. Laws ch. 149, § 29 (LexisNexis 2010) (Massachusetts Bond Law); Conn. Gen. Stat. § 49–41 (2010) (requiring payment bond for public construction contract larger than $100,000); *see also* 40 U.S.C. §§ 3131–3134 (2010) (known as the Miller Act, which is applicable to federal projects).

Is the Claim Lienable?

By statute, most jurisdictions permit contractors and/or subcontractors to file liens against the real property to which the improvements were made for amounts unpaid to the lienor. Depending on the jurisdiction, this statutory-based lien is referred to as a mechanic's lien or a construction lien. *See, e.g.*, N.J. Stat Ann. §§ 2A:44A-1 to -38. (LexisNexis 2010) (New Jersey Construction Lien Law); Fla. Stat. Ann. §§ 713.001 to .37 (LexisNexis 2010) (Florida Construction Lien Law); N.Y. Lien Law §§ 3–65 (Consol. 2010) (New York Mechanic's Lien Law); Cal. Civ. Code §§ 3109–3154 (Deering 2009) (California Mechanic's Lien Law). On public projects, to the extent there is an applicable lien law, the lien will attach to the funds of the public project and will not be a lien on the real property being improved. *See, e.g.*, N.J. Stat Ann. §§ 2A:44-125–42 (LexisNexis 2010) (New Jersey Municipal Mechanic's Lien Law); N.Y. Lien Law § 5 (Consol. 2010) (a lien attaches to monies appropriated and not yet expended by a public entity for the public improvement).

It is incumbent upon practitioners to immediately consult the applicable statutes to determine whether the claim is lienable and calculate the timeframes for filing and perfecting lien claims. Getting information from a client as soon as

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

possible about the last date of work performed and the status of the overall project will help determine the deadlines. Strict compliance with the timeframes and other requirements set forth in the applicable lien law is essential. *See, e.g.*, N.J. Stat. Ann. § 2A:44A-15 (LexisNexis 2010) (failure to file a lien in "substantially the form or in the manner or at a time not in accordance with the provisions" of the Construction Lien Law will result in a forfeiture of lien rights); *Browning-Ferris, Inc. v. Rockford Enters.*, 642 A.2d 820 (Del. Super. Ct. 1993) (concluding that the lien law requires strict construction).

When representing a contractor or subcontractor with claims related to a residential construction project, particular attention should be paid to any special or additional requirements imposed on a lienor when trying to place a lien on residential real estate. *See, e.g.*, N.J. Stat. Ann. §§ 2A:44A-20–21 (LexisNexis 2010) (requiring the additional steps of filing a notice of unpaid balance and obtaining an arbitration award before a lien can be filed against residential real estate).

Once the lien is filed and perfected, practitioners should observe the timeframes for taking action to enforce the lien through the filing of a complaint. As with the filing of a lien, enforcement actions are governed by strict deadlines. *See, e.g.*, Cal. Civ. Code § 3147 (Deering 2009) (an action must be brought to trial within two years of commencement); Fla. Stat. Ann. § 713.22 (LexisNexis 2010) (a lien will last one year unless an action to enforce is filed during that period).

Are Other Statutory Remedies Available?

In addition to laws pertaining to bonds and liens, some jurisdictions have other statutory provisions that afford contractors and subcontractors additional remedies. For example, many jurisdictions have prompt payment statutes applicable to public and/or private projects. *See, e.g.*, Md. Code Ann. Real Prop. §§ 9-301–05 (LexisNexis 2010) (the prompt payment act applies to private projects only); Ohio Rev. Code Ann. § 4113.61 (LexisNexis 2010) (the prompt payment act is applicable to public projects that only inures to benefit subcontractors, not contractors waiting on payment from the owner); N.Y. Gen. Bus. Law § 756 (Consol. 2010) (the prompt payment act is applicable to private projects). Prompt payment statutes will dictate the time periods in which contractors and/or subcontractors must be paid and the remedies available to them if payment is not made in a timely manner and no notice of the reason for withholding is provided. For example, a contractor or subcontractor may be entitled to interest and/or attorney fees if successful on a prompt payment claim. *See, e.g.*, N.Y. Gen. Bus. Law § 756-b(1)(a) and (b) (Consol. 2010) (allowing recovery of 1 percent interest on late payments); N.Y. Gen. Bus. Law § 756-b(2) (Consol. 2010) (permitting the suspension of work for nonpayment when the opportunity to cure is provided); 73 Pa. Stat. Ann. § 505(d) (LexisNexis 2010) (providing for 1 percent interest on unpaid amounts); 73 Pa. Stat. Ann. § 512(b) (LexisNexis 2010) (permitting the recovery of attorney fees by substantially prevailing party on prompt payment act claim).

Similarly, many states have trust fund acts that provide that the monies received by the owner from certain sources (i.e., construction loans) or received by the contractor from the owner are to be held in trust for the benefit of those at lower tiers. *See, e.g.*, R.I. Gen. Laws § 34-27.2-1 (2010) (The Rhode Island Construction Trust Act); N.Y. Lien Law §§ 70–79 (Consol. 2010) (Trust Fund Act). Failure to comply with trust fund acts often gives rise to additional remedies. *See, e.g.*, N.Y. Lien Law § 77 (Consol. 2010) (enumerating potential relief in action to enforce a trust including an order distributing trust funds); Va. Code Ann. § 43–13 (2010) (providing that failure of a contractor to pay funds held in trust for subcontractors could result in a larceny charge). As with bonds and liens, close attention should be made to all timing and form requirements when proceeding with trust fund or prompt payment claims.

The timing and form of notice dictated by the contract should be strictly observed.

Do Other Provisions Dictate the Contractor's Rights?

In addition to the dispute resolution provisions mentioned above and the statutes applicable to construction projects, the contract will likely contain notice provisions. The timing and form of notice dictated by the contract should be strictly observed. Contracts may also contain indemnification and insurance provisions that should be analyzed to determine if any additional remedies in the form of indemnification or insurance coverage (i.e., as an additional insured) is available. Practitioners should determine the appropriate time and manner in which to put insurers on notice of any potential claims as to avoid any delay or claim of prejudice by the insurer. All such contractual provisions should be analyzed to determine if the same will be enforceable under the applicable law. *See, e.g.*, *Dresser Industries, Inc. v. Page Petroleum, Inc.*, 853 S.W.2d 505, 509 (Tex. 1993) (holding that indemnification language was too conspicuous to be enforceable). Similarly, contract provisions related to limitations on liability (i.e., caps on liability or waivers of consequential damages) should also be identified immediately to determine whether the applicable law will enforce such limitations on liability and manage the client's expectations on the type of recovery available. *See, e.g.*, *Valhal Corp. v. Sullivan Assoc., Inc.*, 44 F.3d 195, 204 (3d Cir. 1995) (citing *Posttape Assoc. v. Eastman Kodak Co.*, 537 F.2d 751 (3d Cir. 1976)) (explaining that setting the cap on liability too low can create a situation where one is effectively avoiding liability for its conduct); *Behrend*

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

v. Bell Tel. Co., 363 A.2d 1151, 1167 (Pa. Super. Ct. 1976) (opining that willful or wanton conduct may render a limitation of liability clause void).

Who Are the Potential Parties to Litigation?

Another step in evaluating a client's potential claims and determining a course of action is identifying the party or parties from whom the client may recover. In some jurisdictions, an aggrieved contractor and/or subcontractor may have the right to pursue claims against not only those with whom they have contracted, but also entities with which they are not in direct contractual privity. *See, e.g., Onorato Constr., Inc. v. Eastman Constr. Co.*, 711 A.2d 1363, 1366 (N.J. Super. App. Div. 1998) (explaining that a subcontractor may have a direct cause of action against an owner where the owner made an independent commitment to pay). Therefore, it is important to quickly identify the contractual relationships of the project participants and the duties that may be owed to one another.

Careful examination of the applicable jurisdiction's law will help determine who may be and who must be named in litigation. For example, in some lien enforcement actions, all other lien claimants must be named in the litigation, *see, e.g.*, N.Y. Lien Law § 44 (Consol. 2010) (enumerating a litany of necessary parties to lien foreclosure action in New York), and if the lien is bonded, the surety may be named as well. *See, e.g.*, *Harley v. Plant*, 104 N.E. 946, 947 (N.Y. 1914) (holding that the surety that bonded off the lien was a proper, but not necessary, party to a lien enforcement action). In actions to enforce payment and/or performance bonds, the surety and the principal on the bond are necessary parties. Additionally, in some jurisdictions, contractors and/or subcontractors may have a cause of action directly against a design professional for professional negligence or negligent misrepresentation where the contractor reasonably relied upon the completeness and accuracy of the design professional's drawings. *See, e.g., Bilt-Rite Contractors, Inc. v. The Architectural Studio*, 866 A.2d 270, 285–87 (Pa. 2005) (permitting a contractor to maintain a negligent misrepresentation claim directly against a design professional even in the absence of contractual privity); *Tommy L. Griffin Plumbing & Heating Co. v. Jordon, Jones & Goulding, Inc.*, 463 S.E.2d 85, 89 (S.C. 1995) (permitting a contractor to assert a claim directly against a design professional for negligent design claims); *Robert & Co. Assocs. v. Rhodes-Haverty P'ship*, 300 S.E.2d 503 (Ga. 1983) (finding that a contractor is entitled to pursue claims against a design professional because the contractor was within a class of foreseeable persons that would rely upon a report prepared by the design professional).

What Type of Experts Might Be Necessary?

It is also important to identify the areas in which expert opinion may be required and the potential experts early in the evaluation process. Experts can assist in the initial recommendations to clients on the strength of the claims, provide assistance in preparing discovery requests, and educate practitioners and clients on relevant issues and industry standards. Be sure to observe the applicable jurisdiction's discovery rules regarding experts and use caution when communicating with the experts or preparing drafts. Among other areas, experts may be essential to understanding, analyzing, and proving delay claims, claims for extra costs, and design-related claims. Accordingly, experts in the fields of scheduling, design, and cost accounting are widely available. If you are asserting claims directly against a design professional for professional malpractice, you should also note that many jurisdictions have an affidavit of merit requirement. Depending on the jurisdiction, the party asserting the professional negligence claim must, in a timely manner, file and/or serve an affidavit from a design professional setting forth that he/she believes that the work was performed negligently. *See, e.g.,* Pa. R.C.P. No. 1042.3 (requiring a certificate of merit to be filed within 60 days of filing the complaint); Tex. Civ. Prac. & Rem. Code Ann. § 150.002 (LexisNexis 2010) (providing that a certificate of merit must be filed with the complaint). In light of the affidavit of merit statutes, it is important to have your design expert retained very early in the pre-litigation process and observe all applicable deadlines related to the same.

What Types of Project Documents Are Available?

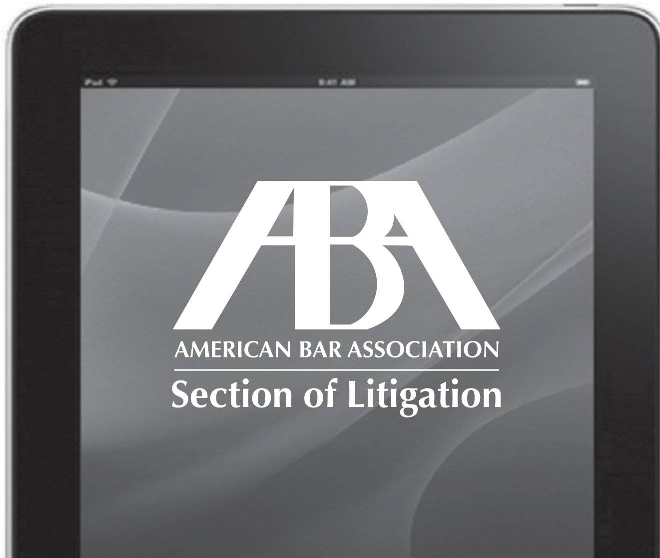
Document collection, including electronic files, is critical in all litigation and should begin at the outset of the new engagement. Interviewing those individuals involved in the construction project to ascertain the types of documents prepared and received by the client and the manner in which the project records were stored will prove invaluable. In construction cases, gathering the voluminous amount of documents can be time-consuming. Practitioners are wise to issue litigation hold notices to all those who may be in possession of relevant project files, and the hold should apply to hardcopy and electronic files, including email. Depending on the size and sophistication of a client's IT department, one can often use the assistance of the client's in-house personnel to help in the data collection and ensure that backup files are maintained through the duration of the litigation. Having an early handle on a client's project files will assist in identifying what materials may need to be produced and what additional materials may need to be discovered through disclosure mechanisms, including subpoenas to nonparties once the litigation has commenced. Careful document management by a client during the course of the project itself can greatly reduce the costs and time associated with responding to discovery in a subsequent litigation. ■

Stephanie L. Jonaitis is a member of Pepper Hamilton's Construction Practice Group.

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

WE'RE GOING DIGITAL!

By Fall 2011, the ABA Section of Litigation will distribute all newsletters via email only.



Visit **abanet.org/myaba** to:

- Join up to 37 Committees to receive practice-specific e-newsletters
- Add or update your email address

Copyright Issues in the Digital Age

(Continued from page 5)

copyrighted work in the first place. For example, architects and developers typically enter into owner/architect agreements because, without agreements addressing these issues, the author architect typically retains all copyrights, which may not be suitable to a developer. The American Institute of Architects (AIA) offers standard forms of agreement between owners and architects that address copyright issues. These agreements generally attempt to strike a balance between the architect and developer's interests and are, at a minimum, good starting points for addressing these issues.

Maintaining high professional and ethical standards can go a long way in preventing some of the copyright-related problems that architects, contractors, and developers may face. Additionally, taking safeguards by proactively registering copyrights with the Copyright Office, entering agreements with others (i.e., contractors and developers) that clearly define copyright ownership and rights of use, and implementing sound employee agreements prohibiting the unauthorized transfer of architectural files (i.e., to new employers) can also help prevent infringement or provide a number of options should copyright infringement occur. Hopefully, these and other similar steps can keep architects, contractors, and developers focused on changing our skylines and communities with new and original building designs, instead of asserting or defending claims of copyright infringement. ■

Andrew Crain is a partner in the Litigation group at Thomas, Kayden, Horstemeyer & Risley, LLP, in Atlanta, Georgia, and chair-elect of the IP Section of the State Bar of Georgia. He can be reached at andrew.crain@tkhr.com. Melissa Rhoden is an associate in the Litigation group at Thomas Kayden and can be reached at melissa.rhoden@tkhr.com.

 © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.

ABA Section of Litigation
AMERICAN BAR ASSOCIATION

LITIGATION PRACTICE SOLUTIONS
Sponsor of the ABA Section of Litigation
LexisNexis®

NONPROFIT
ORGANIZATION
U.S. POSTAGE
PAID
AMERICAN BAR
ASSOCIATION

American Bar Association
321 N. Clark Street
Chicago, IL 60654

COMMERCIAL & BUSINESS
LITIGATION
Volume 12 Number 2 ▪ Winter 2011

In This Issue

1 Legislative and Judicial Intervention in Construction Litigation in Texas

1 A Road Map to Preparing Claims on Behalf of Contractors and Subcontractors

2 Letter from the Chairs

2 Letter from the Editor

4 Copyright Issues for Architects, Contractors, and Developers in the Digital Age

6 It's a Technologicality: The Law Is Challenged with Accommodating New Developments

8 *Bankers Trust*, *Brown*, and Exclusion 3(a): The Insurability of Mechanic's Liens

10 Banks' Priority Rights over Mechanic Lien Claims for Unlienable Work

20 - Published in *Commercial & Business Litigation*, Volume 12, Number 2, Winter 2011. © 2011 by the American Bar Association. Reproduced with permission. All rights reserved. This information or any portion thereof may not be copied or disseminated in any form or by any means or stored in an electronic database or retrieval system without the express written consent of the American Bar Association.