CONSTRUCTION DAMAGES AND THE ECONOMIC LOSS RULE

by: Michael J. Carita, Esquire

Homes or other buildings are often damaged by alleged defects in construction or repairs done to the building in question. When a building owner (or their insurer) seeks to recover monetary damages for the loss, they are usually met with a full or partial defense of the case based upon the “Economic Loss Rule.” A fuller understanding of the “Economic Loss Rule” can assist building owners and their insurers in properly assessing whether they have a recoverable claim against the allegedly faulty contractor, and in selecting the proper theory on which to base their case.

When it comes to construction cases, the “Economic Loss Rule” holds that where a building damages itself because one of its component parts is defective, it is deemed a purely economic loss, and is not considered property damage. In such a case there will be no tort cause of action against the builder of the building, rather, the only cause of action is one for breach of contract.

The application of the Economic Loss Rule over the past 15 years has resulted in many claimants alleging that the damage to the building occurring by the defect in construction was not actually damage to the building work, but rather property damage to an object which was not part of the “building” or “work” itself. This theory resulted in much confusion between the various courts, as defendants would move to strike tort-based claims under the Economic Loss Rule and plaintiffs would argue that the damage at issue in the lawsuit was to “property” and not the “work.”

Recently in the case of Filak v. George, 267 Va. 612 (2004), the Virginia Supreme Court has given some additional guidance in the Economic Loss Rule. The Filak Court reasserted that losses suffered as a breach of a duty assumed only by agreement rather than a duty imposed by law would only be recoverable in a breach of contract claim, not a tort or negligence claim. The Court also pointed out that when a defendant’s duty arises solely from a contract, the only cause of action which would be allowed is one for breach of that contract, not a claim of negligence. The Filak Court attempts to shift the focus of the Economic Loss Rule from whether or not the damaged home constituted “property” or “the work itself” and instead focused on the source of the duty between the parties. Where the parties involve-ment arises out of contract, the only cause of action against the defendant will be one of contract, and not tort.

Lessons Learned in the Synthetic Stucco Litigation

By: Stephen A. Horvath, Esquire

Starting in the early 1990’s an exterior cladding for houses known as “EIFS” (Exterior Insulation Finish System) became popular in the Washington Metropolitan area. The product had a number of advantages. It looked like stucco, but did not have the weight of stucco, and would not crack like stucco. It had an insulation quality to it. There was a layer of a Styrofoam type product which made it as though you were wrapping your house in a Styrofoam cooler. It was decorative and could be easily shaped, to add attractive features to the exterior of the house. Finally, its finish was impervious to water, and would in theory keep water out.

The use of this popular cladding resulted in a large number of subcontractors being trained by the manufacturers of the product to install it on houses. Although some very strict installation requirements were set up, the subcontractors would frequently not follow the requirements. As a result, water could infiltrate between the house sheathing, and the EIFS, and the water would be trapped. Over time, the elevated moisture levels would cause rotting of the wood sheathing and framing.

In the mid to late-1990’s, as a result of newspaper articles and TV programs, the public became aware of a number of serious potential problems. For many of the homeowners the time for which to make a warranty claim under their purchase agreement had expired. Plaintiffs’ attorneys were left to try a number of novel approaches, including alleged fraud, or violation of consumer protection acts to develop a theory for recovery. With leaky homes and huge bills for repair, the homeowners were sympathetic plaintiffs.

The fraud allegation usually went like this: “I contracted to buy stucco. Stucco should be a cement based product which has been used for hundreds of years. The product you put on my house is Styrofoam and plastic. You have lied to me.” Hundreds of lawsuits were filed alleging stucco defects in the Northern Virginia area. The Fairfax Circuit Court created a special three judge panel to hear the stucco cases, to provide for uniformity in the decision making.

This firm handled almost one half of these cases, representing both the subcontractors and the general contractors. We were successful in either having the cases dismissed, or reaching resolutions on the cases, and paying only a small amount of the damages claimed. A number of lessons were learned in how to handle the homeowner building defect cases, and new law was developed by the Circuit Court and Virginia Supreme Court.

The first two cases that were tried by other firms in Fairfax County resulted in verdicts of approximately $1.4 million and $1 million. In those cases, there were no aggressive challenges to the plaintiffs’ expert and the attorneys “ran away” from the benefit and quality of the EIFS product. The third case in Fairfax County, which was tried by this firm, resulted in a $17,000 verdict, which was reduced to zero because of a prior settlement with the installer. While the Court did award costs and attorney’s fees, the attorney’s fees awarded were one-seventh of the amount requested.

Successful handling of these cases depended upon a number of factors: First, at the pleadings stage, the allegations were aggressively challenged by use of demurrers and motions craving dismissal. While the plaintiffs’ attorneys attempted to sue subcontractors directly, through successful use of motions, most, if not all, the claims directed against the subcontractors were ultimately dismissed. Second, although EIFS did have its problems, the idea behind EIFS was excellent. It was a good idea, but had to be carefully installed. Attorneys who attempted to shift the burden to EIFS on behalf of their defendants, or who agreed that the product was fraught with problems, continued to have problems with their defenses. If the product was embraced, and it was explained that there were a few minor problems which could
Worker's Compensation Corner

By: Benjamin J. Trichilo, Esquire

1. Death of claimant allows insurer to withdraw settlement

Liability settlements are generally governed by principles of contract law: timely acceptance of an offer creates a binding agreement. The parties for settlements under the Virginia Workers’ Compensation Act are much different. Settlements are not binding until approved by the Virginia Workers’ Compensation Commission. Even after the settlement Order is entered, the Commission has discretion to deny the settlement if it is not in the interest of justice. The insurer also has the right to appeal the settlement Order.

In a recent Full Commission decision, Pringle v. WMATA, VWC File Number 186-92-40 (February 5, 2005), the claimant’s beneficiaries learned that the Commission procedures do not always favor the claimant. The claimant and the insurer entered into a settlement agreement and submitted the executed documents to the Commission on November 12, 2004. Ten days later, the claimant’s counsel advised the Commission that the claimant died three days earlier. Counsel requested that the settlement Order be vacated.

The Full Commission disagreed. The general rule is that only final Orders are appealable to the full Commission or Court of Appeals. However, the Virginia Workers’ Compensation Commission has created an exception in certain cases where it has allowed interlocutory appeals. Where there is a significant question of law or fact, an interlocutory appeal will be allowed. This means that the aggrieved party can pursue the appeal even though compensability of the case has not yet been determined.

However, not every legal or evidentiary issue justifies an interlocutory appeal. Normally, the interlocutory appeal will be allowed only if an appeal of the full Order is not possible or the aggrieved party needs to pursue the appeal as soon as possible. When the purchaser would later claim fraud in reliance on the representations of the seller, the contract was voided. When the purchaser would later claim fraud in reliance on the representations of the seller, the contract was voided.

Continued from page 1

2. When are employers subject to the Act?

Every employer that regularly employs three or more employees in the Commonwealth of Virginia is subject to the jurisdiction of the Virginia Workers’ Compensation Commission, and is required to carry Workers’ Compensation insurance for its employees. Where an employer is required to carry insurance, the employer has the burden of proving that the employer does not regularly conduct business with three or more employees.

The majority held that “an employer cannot be allowed to escalate between coverage and exemption as its labor force exceeds or falls below the minimum from day to day.” The employer regularly employed more than three employees for three years prior to the accident, and the mere fact that it employed only two employees for a period of seven to eight months was due to “transient factors.” What may have most persuaded the majority however, is the fact that the owner hired, his own expense, another individual to help construct his residence during 2003 and 2004. This individual was not placed on the payroll of R & T Construction. After the construction however, this individual and another employee were added to the payroll of the company.

The dissenting opinion would have affirmed the Commission’s factual finding that the employer’s actions caused the time of the accident did not require three or more employees. A re-hearing has been granted, and a final decision will be rendered by the entire Court of Appeals later this year. That decision will be reported in one of our future newsletters.

LITIGATION REPORT-
Quarterly Publication

Published by: Trichilo, Bancroft, McGavin, Horvath & Judkins, P.C.
3920 University Drive
Post Office Box 92
Fairfax, Virginia 22030-0092
703.385.1000
703.385.1555 fax
www.vadctriallaw.com
email: Letters to the Editor
mkatz@vadctriallaw.com
© 2005 All Rights Reserved

TRICHILO, BANCROFT, MCGAVIN, HORVATH & JUDKINS, P.C.
(703) 385.1000 • Fax (703) 385.1555 • www.vadctriallaw.com

Not so well known facts-

PRESIDENT’S QUIZ

So far this year we have inaugurated a new president and celebrated president’s day. The history of the Oval Office, and its varied occupants, is often fascinating. You can test your familiarity about some well-known facts, and some that are not well-known, in the quiz that follows:

1. At 5’ 4”, he was our shortest President.
2. He was the only President to participate in three duels and the only President to kill an opponent in one of those duels.
3. His wife grazed sheep on the White House lawn.
4. The heaviest President (350 pounds) and the only one to become stuck in a bath tub at the White House.
5. The first President born under the flag of the United States.
6. His mother told him “never sue for assault or slander, settle them cases yourself.” This President became an attorney, and followed the advice of his mother.
7. Our youngest President (age 43).
8. The only President who was an only child.
9. This President said “my friends, some years ago the federal government declared war on poverty - - and poverty won.”
10. When his daughter received a poor review for a musical performance, this President wrote the following note to the critic: “Some day I hope to meet you. That when happens, you’ll need a new nose, a lot of beef steak for black eyes, and perhaps a supporter below!”

Answers to President’s Quiz: 1. James Madison. 2. Andrew Jackson. 3. Woodrow Wilson. 4. William Howard Taft. 5. Martin VanBuren. Earlier Presidents were born earlier than 1789, and were never born on the 4th of July.

S. Truman.

Not so well known facts-

Answers on page 1 in reverse at bottom of page.

When the purchaser would later claim fraud in reliance on the representations of the seller, the contract would be voided. When the purchaser would later claim fraud in reliance on the representations of the seller, the contract would be voided. When the purchaser would later claim fraud in reliance on the representations of the seller, the contract would be voided. When the purchaser would later claim fraud in reliance on the representations of the seller, the contract would be voided.
Consort, And the Company Car

By: Jennifer L. McRobbie

Whether the issue is workers’ compensation benefits, insurance coverage, or general liability, employers and insurers frequently want to know when an employee is liable for the torts of his or her employees in Virginia. There is no fail-safe, quick test to determine if an employee is acting within the scope of his or her employment; however, the following principles may assist you in determining whether coverage should be afforded:

Virginia courts employ a two part test to determine if a principal is liable for torts committed by an agent:

(1) Does a principal-agent relationship exist? The answer to this question is as simple as A-B-C:

A. Assent. There must be an agreement between the principal and agent to conduct work.
B. Benefit. The agent’s conduct must be for the principal’s benefit or on behalf of the principal.
C. Control. The principal must have the power to supervise or direct the manner of the agent’s work.

(2) Was the agent acting within the scope of the relationship? To determine if the act occurred within the scope of the principal-agent relationship, the following must be answered in the affirmative:

A. Was the conduct “of the kind” the agent was hired to perform?

This is a factual question that should be answered by comparing the actions of the employee to the type of work the employee was hired to perform or the type of work that is incidental to an employee’s job. This is troublesome to many insurers because of the omission clause requirement under Virginia Code § 38.2-2204 to extend coverage to any person legally operating a motor vehicle with the express or implied permission of the owner. If an employee was not acting within the scope of his or her employment, however, the actions will not be deemed to be within the permission of the owner.

However, there are some instances when an employee may be liable even if his employee was operating a vehicle without permission. If an employee entrusts his vehicle to an employee that is knowingly an unfit driver, the employer may be liable despite the fact that the employee was outside the scope of employment. See, e.g., McNeil v. Sprider, 191 Va. 685 (1950) (where no proof shown that driver was unfit); see also Crowell v. Duncan, 145 Va. 489 (1926) (where father ought to have known son was unfit driver).

B. Did the tort occur “on the job”?

If a tort occurs “on the job,” then the actions of an employee will be deemed to be within the permission of an owner. Likewise, if a tort is committed outside the scope of employment, the actions will be deemed outside the permission of the employer. To determine whether an action is “on the job” or not, you must determine whether the employee’s actions constituted a “frivolous” or a “detour.”

A frivots is a new and independent journey. A detour, on the other hand, is a mere deviation from an assigned task. Here are some examples:

TRICHLIO, BANCROFT, MCGAVIN, HORVATH & JUDKINS, P.C.

(703) 385-1300 • Fax (703) 385-1555 • www.vadctriallaw.com
PREFERENCE ACTIONS: WHEN PAYMENT BY A DEBTOR OR CAN BE TAKEN AWAY!

By Stephen A. Marshall, Esquire

The United States Congress created the preference powers under Section 547 to ensure that an unsecured creditor receiving payment immediately prior to the debtor's bankruptcy filing would not receive more than its unsecured creditor status. The creditors seeking to have their claims allowed are represented by the United States trustee, or the United States Attorney in the case of a “Trustee In Possession.” These are a type of mini-action in a bankruptcy lawsuit, called “Adversary Proceedings.”

Why are these preference actions so noteworthy? Their effect on businesses, like yours, are substantial and there are an increasing number of these actions appearing in the bankruptcy courts. The preference action arises from a federal statute in Title 11 of the United States Code (commonly known as the Bankruptcy Code).

Briefly, 11 U.S.C. § 547 holds a trustee (or any of the entities mentioned above) may avoid any transfer of an interest of the debtor (in bankruptcy) that the debtor made to a creditor within ninety days of the filing of the (bankruptcy) petition, while the United States Code (commonly known as the Bankruptcy Code). The debtor was insolvent. This three month period is extended to an entire year if the creditor is considered an “insider” of the debtor.

There is a rebuttable presumption of insolvency for any transfers the debtor made during this period.

What can this mean for your business? Well, say you know (or do not know) your client is undergoing financial difficulty, and you are concerned that he will not be able to pay for overdue services, supplies or goods that are due to you. You are concerned that the client may enter bankruptcy and have heard that often creditors, like your business, rarely recover the full amount of the payment that the client owes you. In fact, if you have an unsecured credit interest with the client, you know that you will get just pennies on the dollar, or worse, nothing at all. The worst part of this is yet to come. After the debtor/ client receives a discharge, you will be no longer liable on those debts incurred prior to his bankruptcy discharge. This includes the monies owed to your business. You are understandably concerned.

Then, the clouds begin to part. The client surprises you by paying part or all of the amount due to your business. A month later, the client files for bankruptcy protection. You figure, “That was a好 call, one.” We just recovered some of the debtor’s property.

You receive a letter from the Bankruptcy Trustee several months later that states your business has been named a defendant in a preference action and it is apparent that the Trustee seeks to disgorge the payment that it believes to be due to the months before he filed bankruptcy. To make matters worse, your response to the lawsuit is due in thirty days, assuming you have diligently opened today’s mail. Unlike most lawsuits that require a defendant to be personally served with notice of a lawsuit, the Federal Rule of Bankruptcy Procedure 7004(b) allows the Adversary Proceeding Plaintiff to serve the Defendant by U.S. mail. It need not even be sent certified, with return receipt required. It may even be sent to a P.O. Box, branch location, or a specific officer of your business. Default judgment is a very real possibility in preference actions and can be devastating to your business.

To you and your business, a preference action seems to be inequitable and unfair. It is also unwarranted. You entered into your business to provide goods and services and expect to be fairly compensated for them. In this case, you have only received payment that is rightfully due to your business for work that has already provided to the client/debtor. Now the Bankruptcy Trustee seeks to strip you of the compensation to which you are rightfully entitled.

The United States Congress created the preference powers under Section 547 to ensure that an unsecured creditor receiving payment immediately prior to the debtor’s bankruptcy filing would not receive more than its unsecured creditor status. The creditors seeking to have their claims allowed are represented by the United States trustee, or the United States Attorney in the case of a “Trustee In Possession.” These are a type of mini-action in a bankruptcy lawsuit, called “Adversary Proceedings.”

Proceedings.”

The first is a contemporaneous exchange between the creditor and debtor for new value given to the debtor. This is a two-pronged test. First, a creditor must show that it and the debtor had the requisite intent to make a contemporaneous exchange for new value. Establishing the debtor’s intent is the most crucial element in this defense. Second, the exchange must actually be contemporaneous. The second defense is a transferee that was made in the ordinary course of business or financial affairs of the debtor and the creditor. This payment must be for a debt incurred by the debtor in the ordinary course of business and must be made according to ordinary business terms.

The third defense is transfers made to create a security interest in the property acquired by the debtor. This is commonly known as the “enabling loan.” This is most common for purchase money security interests (PMSI). Another common defense is transfers that are made to avoid a preferential transfer. This defense is a defeasance action and it is always nice when the proceeds of the inventory. This is known as the “floating lien.”

Section 547 provides other defenses to the preference action, but the ones referenced above are the most common. The basic proofs defense, however, to a preference action is active defense against the claim. Obtain legal counsel when faced with a potential preference problem and resolve the matter quickly. Otherwise, a preference action may cost the client’s business, and have little time to conduct discovery. All the normal rules for federal discovery apply in an Adversary Proceeding. Therefore, use the same strategy to propose means upon the Trustee to assess the strength of the preference claim. Discovery will also cause the Trustee to compromise or dismiss preference claims that are found to be weak or without merit. Above all, take control of the preference action to resolve the matter as quickly as possible to avoid delays and disgorged payments.

If you are faced with a preference action, please do not hesitate to contact counsel. We must move more quickly than a U.S. Navy SEAL. If it need not even be sent certified, with return receipt required. It may even be sent to a P.O. Box, branch location, or a specific officer of your business. Default judgment is a very real possibility in preference actions and can be devastating to your business.

In certain cases, time is of the essence in investigating the scene or objects leading to the claim. Although ideally an expert would best be selected if the case has been referred to defense counsel, some claims require immediate attention and review by a qualified individual who may later be required to testify. In those times when it is necessary to obtain an expert early in the case, here are a few tips of what to do and not do when trying to find the right expert:

Do . . .

1. Review the resume or curriculum vitae of the expert

Although it may seem obvious, one of the most important things to do before retaining an expert to review his or her qualifications. Look at the individual’s training and experience to make sure that your expert’s background matches the exact field in which you are looking for testimony and expertise! Although some persons holding themselves out as experts may have a great deal of knowledge, they may be lacking in practical or useful experience in the field which could hinder their ability to testify. Aim for a resume that appears well written, experience, and prior expert testimony.

2. Be as specific as possible

The closer you get in experience and training to the exact field of testimony, the better. General experience in engineering is not as helpful as bio-mechanical engineering or electrical engineering, etc. If your case requires specific scientific or medical testimony, the best expert will be the one whose expertise is in the specialized area of the testimony.

3. Talk to the expert

A qualified expert with massive experience and extensive training does not automatically lead to the best testimony. Presenting testimony to a jury requires the ability to effectively communicate and express ideas, as well as using language and examples from which the subject matter comprehensible to a jury. Take the time to put a call in to your expert to personally discuss the issues the jury need addressed and make your own determination as to how that person will appear to a jury.

4. Consider location

When looking for an expert, keep in mind the venue in which suit may eventually be filed. It will save you and defense counsel time and money to pick an expert that is geographically located in the area where the case will be tried.

Don’t . . .

1. Use an “expert for all seasons”

Be wary of individuals who hold themselves out to be an expert in many fields in various areas of study. Self-proclaimed experts may assert knowledge and expertise that they do not have to the degree that you would want for your case. Make sure to do a little digging into the expert’s background to make sure there is support for the assertions that your expert is making and that they are familiar with the issues you need addressed. For example, one member of our firm interviewed an expert with a degree in polymer science who was unable to explain when asked what a polymer actually was. We did not retain that expert.

2. Rely solely on an expert database or service

Although expert services may be helpful in providing proposed names or avenues to explore for expert witnesses, they should not be relied on solely. These services are a good place to start, but it is still necessary to do the research on any individual that is provided to ensure that the person meets your needs. The database services categorize experts into field names that may not exactly fit what you are looking for - do not rely on them exclusively.

One member of our firm shared a story in which opposing counsel had used an expert service and designated an expert in the field of heating and air conditioning for our client. The opposing counsel had determined that this individual was not qualified and had no idea what licensing requirements were needed to be a technician. He further did not know what technique of installation the technician in question had been using and could not say what was required to keep the relevant system running properly.

Relying solely on an expert with these qualifications can lead to serious problems in a case, or may help the opposing party strike your expert. Make sure to do your own homework before allowing these services to help.

Note on medical experts...

Although in general a medical expert or doctor to perform an independent medical examination will not be necessary until after suit is filed, in certain cases it may become important to obtain a doctor early in. In these cases, consult with defense counsel to get a recommendation for the type of specialist you may need. In most cases, the more a defense attorney becomes familiar with a case, the more options available. After all, your business has worked hard to obtain its interests and assets. Make sure you protect them. You can survive the preference action in bankruptcy.

Picking an Expert – What to look for and what to avoid.

by: Sandy M. Jack, Esquire

(703) 385.1000  •  Fax (703) 385.1555  •  www.vadctriallaw.com

TRICHLÒ, BANCROFT, MCGAVIN, HORVATH & JUDKINS, P.C.