A DISCUSSION OF SENATE BILL 1271 – THE REVISED ARIZONA PDA STATUTE AND ANTI-INDEMNITY

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Senate Bill 1271 (the Act), signed into law on April 10, 2019, introduces sweeping changes to portions of the Arizona Purchaser Dwelling Act, A.R.S. §12-1361 et seq. (PDA), strengthens Arizona's anti-indemnity statute, and implements a comparative indemnity scheme in Arizona. Taken together with the amendments to Arizona's indemnity statutes, this iteration of the PDA arguably contains the most dramatic alteration of the law to date.

The PDA mandates a pre-litigation notice, inspection, and repair process in residential construction defect actions. The PDA's intent initially was to limit the number of homeowner construction defect actions, and to provide an opportunity (and later a right) to repair by homebuilders and general contractors. Whether the PDA has succeeded is up for debate, but one thing is certain: the statute has created confusion and related litigation amongst interested parties and practitioners on both sides of the "V." The Act may compound the problem by creating additional conflict amongst first and second tier defendants. Important pronouncements in the statute are outline below.

ENHANCED SUBCONTRACTOR INVOLVEMENT IN THE PDA REGIME

The PDA's application to "Sellers," i.e., entities "engaged in the business of designing, constructing or selling dwellings" (builders), is broadened to include "Construction Professionals" (subcontractors), contemplating more robust subcontractor involvement from the outset. A subcontractor is now provided a right to inspect, test, and repair a property which was previously provided to the general contractor in the 2015 revisions (A.R.S. §12-1363 (B)-(C)). Although the statute now specifically applies to builders and subcontractors, ambiguity reigns. For example, the revised statute does not specify if "Purchasers" (homeowners) are required to notify a "Seller's Construction Professional" (a subcontractor) of a "Dwelling Action." It is clear, however, that a "Seller" (builder) must immediately send the PDA Notice to subcontractors (A.R.S. §12-1363(A)).

Presumably implied, but not clearly delineated is whether (1) the subject property's inspection by builders and subcontractors must occur simultaneously, or (2) the involved parties must present a joint offer to repair or replace. A close reading reveals certain instances where

"Seller" is mentioned and "Seller's Construction Professional" is not, as in A.R.S. §12-1363 (D): "If the *seller* does not provide a written response to the purchaser's notice within sixty (60) days, the purchaser may file a dwelling action."

Whether a subcontractor is really bound to provide an offer, or to participate in one as a pre-requisite to suit, or whether a subcontractor can satisfy the Act's intent by presenting a repair offer in the absence of a builder's offer remains unclear. Regardless, subcontractors are now intended to participate in the PDA from the outset. We understand that the intent of the drafters was to promote a generally more cooperative process between the builder and subcontractors, and to promote earlier settlement discussions. This change is laudable, but it is also ambitious given the unchanged 30-60-30 day deadlines, particularly due to the typical involvement of multiple subcontractors.

TRIAL BIFURCATION

Only a small handful of multi-party construction defect cases have actually been tried in Arizona – significantly more have been arbitrated or processed otherwise through ADR provisions commonly seen in modern purchase agreements or homeowner's association CC&Rs. And the introduction of OCIP and WRAP insurance products in the marketplace in the early 2000s reduced the instances of third-party litigation. But where multi-party litigation has occurred, the decision whether to try a third party action simultaneously with the primary dispute, and the mechanics of the trial itself have been essentially left to the parties and trial courts.

The Act changes this by providing a procedural process that mandates bifurcation of the primary homeowner dispute and any subcontractor or third-party contribution action. The judge or arbitrator is instructed to bifurcate unless either deems bifurcation inappropriate. We understand from those involved in the legislative process that the intent was to have one proceeding, with all of the parties together, and for the trial to incorporate three phases: phase one: the existence of defects (to weed out the bad ones); phase two: the amount of damages relating to the remaining defects and the identity of those involved; and phase three: apportionment. But the statute does not necessarily communicate this intent. In fact, the statute seems to say the opposite by relying on the term "bifurcate." When the term 'bifurcate' is used in the law, it more than implies separating a proceeding into two or more parts. Thus, we predict the use of the term 'bifurcate' will inspire at least some practitioners, and some courts, to assume two entirely separate forums, which runs contrary to the intent of those who pushed for the legislative changes.

The language of the statute itself may also promote confusion. The legislature's intent, spelled out in A.R.S. §12-1362 (E), is worded a bit differently than the process detailed in A.R.S. §12-1262 (D). Section E explains: "it is the legislature's intent that the bifurcation process

prescribed in subsection D of this section be used and that the issues of existence of a construction defect, damages, causation **and apportionment of fault** be **tried in one trial** unless the Court finds that the circumstances of the particular case at issue render bifurcation inappropriate." On the other hand, Section D says in relevant part: "the trier of fact in any dwelling action…shall first determine if a construction defect exists and the amount of damages caused by the defect and identify each seller or construction professional whose conduct…may have caused…any construction defect….The trier of fact shall thereafter determine the relative degree of fault of any defendant or third party defendant…. **The determination of whether a construction defect exists, the amount of damages caused…, and who may have caused… the construction defect shall be bifurcated from and take place in a separate phase of the trial…from the determination of the relative degree of fault** of any defendant or third party defendant unless the Court finds that bifurcation is not appropriate."

Questions loom. For example, is there a difference between "apportionment of fault," and "relative degree of fault?" Did the legislature intend to include apportionment of fault in the primary trial, as set forth in section E? Or did the legislature intend to separate the finding of "relative degrees of fault" into a separate proceeding, as set forth in section D? Does the Act impact common law evidentiary restrictions by requiring apportionment, which can be more easily proven through the use of expert allocation evidence?[1] How involved will subcontractor counsel be in the trial of the primary dispute between the plaintiff and the builder? Will subcontractor counsel be satisfied sitting out the primary trial and ending up with a verdict form that implicates their clients, even if in a general way? Will the subcontractors be vouched in to the primary verdict, which implicates them on a defect by defect basis? Will the same jury allocate fault amongst previously implicated parties? Or will the second phase be better conducted by the Court? Time will tell. For now, the take away is clear: the devil is in the details. In our opinion, the various sections of the statute can be harmonized and one trial can suffice as long as the subcontractors are bound to the results of the first two phases. Assuming this, the same jury can switch gears and allocate in the third phase, or, if the parties waive a jury for the apportionment phase, the Court can do it. But we can predict differing opinions depending on the needs of each respective case and the parties involved.

ANTI-INDEMNITY AND COMPARITIVE INDEMNITY – ALL AT ONCE

Perhaps the most ambitious result of the Act is the strengthening of anti-indemnity, and the imposition of comparative indemnity. Notwithstanding the unpublished 2017 Court of Appeals decision in *Amberwood Development, Inc. v. Swann's Grading, Inc.* 1CA-CV 15-0786, which found a subcontractor responsible for indemnity obligations greater than its scope of work, RFLG has been predicting a comparative indemnity system. After all, Arizona adopted a

[1] See, *Webb v. Omni Block, Inc.*, 216 Ariz. 349, 166 P.3d 140 (Ct. App. 2007), and Arizona Rules of Evidence, Rule 701, et. seq.

comparative negligence system long ago with UCATA (the Uniform Contribution Amongst Tort Feasors Act). Arizona judges, arbitrators and practitioners usually think in terms of comparative fault. So, despite the previous "all or nothing" indemnity system that has arguably existed for years in Arizona[2], our tried and arbitrated construction cases have typically morphed into some form of comparative indemnity. At the very least, the common law has trended toward a discussion of fault rather than a black or white, all or nothing proposition. Now, we have more than just a trend, we have a statute.

Previously, Arizona's anti-indemnity statute proscribed indemnity for the promisee's (builder's) sole negligence. Now, the Act prohibits a builder to be indemnified for its own negligence – **any** amount of its own negligence. But the Act does **not** prohibit a builder from enjoying indemnity relief for the negligence of the promisor (subcontractor). In other words, a builder can be indemnified for loss or damage "resulting from the negligence of" a subcontractor, but not for its own negligence, hence: comparative indemnity. A.R.S. § 12-1159.01 (A).

A subcontractor's contractual duty to defend a builder is impacted, however, a subcontractor's contractual duty to defend a builder remains broader than the duty to indemnify. A subcontractor is now obligated to defend claims "arising out of" or "related to" the subcontractor's "work or operations." A.R.S. § 12-1159.01 (D). This language is interpreted more broadly than the "resulting from" language that now defines indemnity.

The $86,000.00 is: does this really change the playing field? In our opinion, it does, but not substantially. We have always approached our cases conservatively in the context of proving subcontractor fault. The changes do eliminate the possibility that a builder can secure complete indemnity in the face of its own active fault, but if a builder is fault free, or even passively negligent, a builder can still end up passing through 100% of liability for defects proven to be the fault of others. The revised indemnity scheme is now in line with well settled Arizona common law permitting a promisee to be indemnified for its passive negligence, but not its active negligence.[3] The Act confirms the same basic approach we have taken, with a new emphasis on allocation.

The Act sets forth in more detail the evidentiary burdens on each party, although there is plenty of room for interpretation. The Plaintiff is charged with the burden to prove the existence and extent of defects and the amount of damage with regard to each involved assembly (windows, roofs, soils) in the initial phase of the trial, which should result in a verdict form. Depending on how the statute is interpreted, the plaintiff and/or the builder must then identify the

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[2] *See, Washington Elementary Sch. Dist. No. 6 v. Baglino Corp.*, 169 Ariz. 58, 817 P.2d 3 (1991); *Cunningham v. Goettle Air Conditioning, Inc.*, 194 Ariz. 236, 980 P.2d 489 (1999).

[3] See*, Estes Company v. Aztec Construction, Inc*., 139 Ariz. 166, 677 P.2d 939 (App. 1983) (Review Denied)

parties involved with any particular assembly deemed defective in the second phase of the trial. The details here are murky, such as the extent to which evidentiary support will be needed to identify involved parties and scopes of work in advance of the prove-up phase. We assume these details will be determined on a case by case basis. It seems likely that at least some evidence will be necessary to prove that specific parties performed work on the project and that the work is related to damages proven by the plaintiff.

To the extent it does not occur during the second phase of the trial, the bifurcated third phase will presumably involve the presentation of evidence in the form of subcontracts, scope of work addendums, payment records, and expert testimony relating to the relative degrees of responsibility for each defect. Based on this evidence, the fact finder will then be asked to determine a specific allocated number per subcontractor. The basic elements of proving contribution are essentially the same as before, but the element of allocation has been added. This more than suggests an invitation by the legislature to present expert testimony and other evidence of percentage allocation. How else does the legislature expect a fact finder to determine the "relative degrees of fault," or "allocation of fault" of multiple parties in a complex construction case? It is certainly possible to do, but asking a group of jurors with likely no experience in construction to allocate percentages without expert assistance, given the new statutory language, begs an appeal.

It is important to note that the Act imposes additional burdens on parties to amend their construction contracts. To comply with the anti-indemnity language of the statute, interested parties in the construction arena will need to tailor their (master) contracts, and/or general conditions to account for the anti-indemnity expansion, and to more clearly define the impact of comparative indemnity.

The extension of anti-indemnity and comparative indemnity concepts will also impact insurers. The Act specifies that an insurer does not owe indemnity to an additional insured (AI) for the additional insured's own negligence. This mirrors the indemnity rule discussed above, and is not a watershed. An insurer is still obligated to defend an additional insured to the extent it has in the past, that is, the duty to defend is still broader than the duty to indemnify. A.R.S. § 12-1159.01 (C). Just as insurers are required to provide a complete defense for covered and non-covered claims, an additional insured is still entitled to a defense for each of the claims asserted against it, whether or not indemnity relief is ultimately found to be owed. As before, insurers are required to treat the initial PDA notice as the equivalent of a notice of claim. However, the relevant definition has been expanded to include notice by a subcontractor to an insurer. There can be no mistake here: the legislature specifically intended insurers of builders, and now subcontractors, to become involved immediately on receipt of the initial PDA Notice.

ATTORNEYS FEES AND COST SANCTIONS ARE BACK

The 2002 PDA allowed a party that beat their "best and final" PDA offer to argue prevailing party status, i.e. the prevailing party could recover reasonable attorney's fees, expert fees and taxable costs as a sanction. The 2015 revisions repealed this section, and eliminated attorney's fees, expert fees and taxable costs from the PDA. The 2019 amendments reinstate the ability of the prevailing party to recover reasonable attorney's fees. But it does not allow for the recovery of expert fees – with one notable exception – single home actions. In all other cases, a party that "beats" the final PDA offer "with respect to a contested issue" can argue prevailing party status and recover reasonable attorney's fees and taxable costs. A.R.S. § 12-1364 (A).

With the addition of "contested issue" language, the Act goes further than previous iterations by specifying criteria on which the Court must base the prevailing party decision. In other words, the court is now directed to consider whether a party prevailed on a discrete issue. This section was intended to mirror the language of A.R.S. § 12-341.01 (Arizona's attorney's fee statute) by providing criteria for use by the court including the substance of an offer or response, the timing of the offer, fees incurred in relation to the obtained relief, and fees incurred in responding to unsuccessful motions, claims or defenses.

The addition of "contested issue" language seems to suggest a move toward discouraging a shotgun approach to defect litigation. For example, if a plaintiff alleges that decorative fencing is defective, along with other more significant defects, and the plaintiff cannot prove that the decorative fencing is defective, the builder is permitted to argue prevailing party status as to that issue. This is important because a party can presumably offset fees incurred defending meritless issues from fees incurred by the opposing party prosecuting valid ones. Most defect cases involve a variety of discrete issues. Conceptually, a party can prevail on one or more "contested issues," but not others. The term "contested issue" is defined by the statute as: "an issue that relates to an alleged construction defect and that is contested by a purchaser following the conclusion of the repair and replacement procedure…" A.R.S. § 12-1364 (E)(1). So, even if proper repairs are made, the Act contemplates a purchaser's ability to "contest" the issue and file suit to recover monies relating to that repair. This implies a more detailed process of documenting repair offers. Properly managed, we anticipate that certain advantages will flow to responsible builders and subcontractors who make reasonable, well organized offers.

RFLG has developed a comprehensive PDA evaluation program over the past decade that enables clients to take full advantage of the fee shifting mechanism under the Act. We have successfully recovered fees as the prevailing party in multiple cases using this approach.

NO RELEASE FOR REPAIRS – ONLY FOR MONETARY SETTLEMENTS

The 2019 amendment does not fundamentally change the impact of repairs on the ability to secure a release. As before, a Seller is not entitled to a release in exchange for repairs, but repairs accompanied by a monetary offer allow for a negotiated release.

CONDUCT DURING PDA PROCESS ADMISSIBLE AT TRIAL

The Act reiterates that offers, responses to offers, and the parties conduct in general during the PDA process can be admitted into evidence at trial or arbitration. Rule 408 of the Arizona Rules of Evidence generally protects settlement offers from admission into evidence, but PDA offers are not considered privileged. Stated differently, everything that occurs during the PDA process is fair game later in litigation. So, parties engaged in the PDA process should proceed with the knowledge that their conduct can and likely will be used against them. But parties involved in a PDA action should not despair. On the contrary, in the event a case cannot be resolved with repairs or monetary offers during the PDA process, this section provides an opportunity for parties to position themselves properly for fee shifting, especially with the revival of attorney's fees and costs.

PURCHASER'S RIGHT OF REFUSAL

One of the most problematic sections of the PDA concerns the right to repair. Stated simply: there is none. And this is nothing new. The Act maintains a homeowner's right to refuse any builder or contractor involved in the original construction from actually performing repairs. As before, a builder has the right to hire a construction professional that was not involved in the original construction to perform repairs. This limitation creates a "right to pay for repair" process at best. In other words, the builder can choose the repair contractor, and the purchaser cannot unreasonably refuse that selection, but the builder cannot enforce its ability to perform repairs, just as the builder cannot enforce the ability of its subcontractors to perform repairs. The result is that if a builder wants to pursue repairs, but a purchaser refuses to allow a builder to perform repairs, the builder is forced to pay an independent contractor to perform them.

REPAIR CONTRACTORS BEWARE

In the event an independent repair contractor is retained to perform repairs, the Act permits the purchaser to add the repair contractor to a revised PDA notice, and then to sue the repair contractor if the purchaser takes issue with the repairs. The Act also limits the repair contractor's liability to the purchaser or the seller. This begs the question: will a specific call-out impact the available pool of repair contractors willing to make repairs during the PDA process? We understand the intent of this provision is to actually limit the potential liability of repair contractors to the purchaser and the seller, and to restrict claims by others. Obviously, any

repair contractor can expect to warrant its work, but the language specifying the ability of a purchaser to add a repair contractor to the ongoing PDA process may impact the willingness of contractors to get involved in the first place.

TOLLING OF THE STATUTE OF LIMITATIONS/REPOSE

The statute of limitations is tolled during the notice of repair process as to all involved parties including the purchaser and all contractors and design professionals until thirty days after substantial completion of the repairs for all defects properly alleged. The Act clears up a previously troublesome area of the law here by tolling the statute of limitations for third party claims from the date the builder receives notice of defects until nine months after the builder is served with a formal complaint. Previously, a builder was not protected in this way. For example, if a homeowner decided to wait until the last day before the statute of repose ran, and sent a defect notice to a builder, the builder would have to file a complaint against potentially implicated subcontractors immediately to trigger the tolling of the statutes of limitation and repose, assuming the applicable statute did not run in the meantime. Now, the statute is tolled as to all involved parties, which provides necessary relief to builders. This is a positive change, because it allows builders and other potential third party plaintiffs a meaningful opportunity to properly evaluate third party exposure prior to filing formal complaints.

A HOMEOWNER AFFIDAVIT IS NOW REQUIRED

A homeowner will now be required to submit an affidavit with the Complaint certifying that the homeowner plaintiff has read the Complaint, agrees with the contents (and the allegations), and has not been promised anything of value in exchange for filing of the dwelling action. It remains to be seen whether the failure by a plaintiff to comply with this section will be sanctioned and to what extent.

APPLICABLE DATE AND RETROACTIVITY

The revised Act is due to take effect 90 days after the current legislative session ends. Because the current session is scheduled to end in late May or early June, 2019, the Act will become law sometime in September, 2019. The Act is designed to apply retroactively. We do not believe this means the statute will apply retroactively to currently pending cases that are in the PDA process or in litigation/arbitration. But we do believe the Act will apply to any case where a PDA Notice is initiated after the Act takes effect even if the operative contracts or CC&Rs were created prior to the effective date of the revised Act.

PREEMPTION

A detailed discussion of the issue of preemption is beyond the scope of this article, however, the impact of alternative dispute resolution (ADR) provisions on the applicability of the PDA is worth noting here. ADR provisions are commonly seen in operative purchase contracts and/or CC&Rs. The Act does not alter the language from previous versions relating to the impact of commercially reasonable ADR procedures on the applicability of the PDA. The statute states in relevant part as follows: "At the conclusion of any repairs or replacements, the purchaser may commence a dwelling action or, … the dispute resolution process." Assuming ADR provisions are commercially reasonable, the question becomes whether those contractual provisions preempt the PDA. The answer depends on whether the Federal Arbitration Act (FAA) is specifically contemplated in the ADR provision. If the ADR provision does not reference the FAA, the presumption is that the PDA applies to any dwelling action at least until the repair or replacement process has been completed. However, at least one Maricopa County trial court division has held that the FAA preempts the right to repair. The Court reasoned that the PDA frustrates the goal of the FAA to promote a speedy and expeditious dispute resolution process by forcing "two sequentially separate resolution procedures." See, minute entry dated May 19, 2017 in *Pulte Development Corporation v. Robert Lewis*, CV 2016-009475. Obviously, there is no appellate decision on which to base a settled interpretation of this issue, but the declaratory ruling in *Lewis* is at least instructive.

LIMITATIONS OF THIS ARTICLE

The Act is a comprehensive change to Arizona law. This article discusses selected highlights, and is for discussion purposes only. There are other portions of the Act that impact the playing field in construction litigation not detailed in this article. This communication is not intended as a legal opinion or to provide specific legal advice on any particular case. For more information, or to discuss a specific legal issue, you are invited to contact Righi Fitch Law Group at (602)385-6776.

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