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CREATIVE USES OF DECLARATORY JUDGMENT IN THE CONSTRUCTION LITIGATION CONTEXT

The author's firm recently represented a consortium of banks that financed construction of a 32-story beachfront high-rise condominium project. After the building was topped-out and, according to the pay applications, was approximately 75% complete, the project was found to suffer severe structural problems stemming from abnormal differential settlement of the building's core foundation which had sunk up to 19 inches. The problems were so serious that major structural columns and beams were cracking, spalling and crumbling. For safety reasons, all work had been halted on the recommendation of experts retained by the owner and general contractor ("GC"), some of whom claimed the project was in danger of imminent collapse. Because of the delays in construction and other reasons, the owner/borrower could not meet its obligations under the terms of the financing and the GC and numerous subcontractors were demanding payment. Additionally, much of the project was open and exposed to the elements meaning that each day of delay produced more deterioration of mechanical systems and interior finishes.

These facts presented a host of complex issues and serious problems for everyone involved in the project. Of course, experts and consultants had to be retained to look into the nature and causes of the problems and consideration had to be given to initiating claims against those believed to be responsible. Furthermore, as with any major project under serious stress, the potential for allegations of lender liability had to be considered.

Typically in cases like this, threatening demand letters are exchanged and, eventually, a party files suit to collect on unpaid payment requests, foreclose on liens, allege negligence or some other contract or tort claim. While none of that is necessarily inappropriate, the typical course of action may not be the most efficient way to obtain relief for your client. We must be careful not to fall into the trap of thinking about, and handling, each case just like the one before. The point of this note is to encourage you to step back and think creatively. The author and his firm recently did so with good results for everyone involved.

As mortgagee, the client bank was a named payee on a Builders' Risk insurance policy covering the project. Some comfort was taken from the fact that a timely Notice of Claim had been submitted to the builders' risk carrier. However, the extent of damage to the project and the number of potential causes strongly suggested the carrier would likely raise numerous defenses to coverage. This was confirmed when the reservation of rights letter was received and indications were that it could take many months before the carrier would complete its investigation and stake out its position as to coverage. At this point, our options included wait for the carrier to make a decision on the claim or wait for the owner/borrower or the GC to file suit and intervene on behalf of the lender. Any of these options represented delay which simply was not acceptable. Rather than wait for others to make a move, the decision was made to take the somewhat unusual step of filing our own declaratory judgment action on the Builders' Risk policy under CPRC Chapter 37, The Uniform Declaratory Judgments Act. The decision to file the declaratory judgment action was initially greeted with harsh protests and criticism from the other parties who stated they preferred to wait for the carrier to adjust the claim.

The vast majority of declaratory judgment cases on insurance coverage issues are filed by the carrier and a rudimentary survey of declaratory judgment cases on insurance coverage reported in the last two years confirmed this. Even so, there is no reason this valuable legal tool should be left only to the insurers. Often, there are good, strategic reasons to file the claimant's suit first.

It is simply a fact that venue can be an extremely important factor in the outcome of litigation. Like most complex construction cases, this case presented multiple venue options and we wanted to choose the one most

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favorable to our client rather than wait for the carrier or the GC to make its own venue choice. In our case, because the owner/borrower was local, and this was a high-profile project employing many local trades, we placed a premium on litigating this matter where the project was located. Additionally, rather than assert the bank's affirmative claims as defenses or counterclaims, we concluded it would be advantageous to our client to be cast in the role of an aggrieved plaintiff complaining about problems plaguing this well-publicized project.

Actions under the Declaratory Judgments Act do not necessarily involve a jury. A jury can be had if the proceeding involves the determination of any factual issues.[2] In our case, all of the insurance coverage issues turned on factual matters, so we knew we could get a good, local jury for the trial.

Our client was losing money in the form of unpaid interest every day and the unfinished project, which was the collateral for the loan, was sitting idle, exposed to the elements and wasting away. Furthermore, given its condition, the building represented a potential liability should anyone be injured while litigation dragged on. We did not have the luxury of sitting and waiting. Time, quite literally, was money, and delay was the enemy. We needed to bring matters to a head. Filing our own action allowed us to control the clock.

A fundamental requirement under Chapter 37 is the existence of a *justiciable controversy*. For a justiciable controversy to exist, the parties to the action must be seeking a declaration or clarification of their rights.[3] In the insurance context, there must be a dispute, but actual denial of coverage is not required.[4] As mortgagee, our client was a payee under the policy and the loan documents granted the bank the right to stand in the shoes of the owner. In our analysis, the bank had standing and we had an adequate controversy.

Another advantage to using Chapter 37 is the requirement that all persons who have or claim any interest that would be affected by the declaration sought by the suit must be made parties.[5] A declaratory judgment action gave us the opportunity to bring all the primary interested parties, owner/borrower, lender and GC before the same court, in the same case and created the potential to resolve all issues at one time. Additionally, we expected any lien holder would likely intervene in the case and this would afford an opportunity to address those claims as well. When all the essential players are in the same arena and focused in one case, there is potential for resolution. Interestingly, but not surprising, once the parties recognized that all the possible contract and tort claims were inextricably intertwined with issues relating to coverage under the builder's risk policy, everyone began to work toward resolution.

In conclusion, whether you represent an owner, general contractor, lender or insurer, never fail to take a fresh look at your client's litigation options. The Declaratory Judgments Act found at CPRC Chapter 37 is a tool that has uses beyond what may normally come to mind.

[2] *See* TEX. CIV. PRAC. & REM. CODE §37.007; *Burlington N.R.R. Co. v. Southwestern Elec. Power Co.,* 925 S.W. 2d 92, 99 (Tex.App.- Texarkana 1996), *aff'd* 966 S.W.2d 467 (Tex. 1998).

[3] *Brooks v. Northglen Ass'n*, 141 S.W.3d 158, 164-165 (Tex. 2004).

[4] *See J.E M. v. Fidelity & Casualty Co.,* 928 S.W.2d 668, 671 (Tex.App. - Houston [1st Dist] 1996, no writ).

[5] TEX. CIV. PRAC & REM. CODE ANN. §37.006.