

# TOP 60 CALIFORNIA CONSTRUCTION CASES 2007

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## **I. IMPLIED WARRANTY.**

*Builders and sellers of new construction should be held to what is impliedly represented – that the completed structure was designed and constructed in a reasonably workmanlike manner.*

### IMPLIED WARRANTY (COMMON LAW) ON NEW COMMERCIAL CONSTRUCTION

➤ *Pollard v. Saxe & Yolles Development Co.*, (1974)12 Cal. 3d 374.

Plaintiff sued the builder defendant for construction defects in a new apartment building. The defects included buckling ceilings, sticking doors, and improper drainage, which resulted in loss of rental income. The California Supreme Court held that plaintiff could sue on a breach of the implied warranties of quality and fitness. The rationale for the ruling was that the buyer of new construction does not usually possess the knowledge of the builder and is unable to fully examine the completed house, unlike the purchaser of an older building who has a chance to see how the building has fared over time. The Supreme Court held that builders and sellers of new construction should be held to what is impliedly warranted – that the completed structure was designed and constructed in a reasonably workmanlike fashion.

- “Likewise, a contract to build an entire building is essentially a contract for material and labor, and there is an implied warranty protecting the owner from defective construction. Clearly, it would be anomalous to imply a warranty of quality when construction is pursuant to a contract with the owner -- but fail to recognize a similar warranty when the sale follows completion of construction.” *Id.* at 378-9.
- “In the setting of the marketplace, the builder or seller of new construction -- not unlike the manufacturer or merchandiser of personalty -- makes implied representations, ordinarily indispensable to the sale, that the builder has used reasonable skill and judgment in constructing the building. On the other hand, the purchaser does not usually possess the knowledge of the builder and is unable to fully examine a completed house and its components without disturbing the finished product.” *Id.* at 379.
- “Further, unlike the purchaser of an older building, he has no opportunity to observe how the building has withstood the passage of time. Thus he generally relies on those in a position to know the quality of the work to

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be sold, and his reliance is surely evident to the construction industry." *Id.* at 379.

#### RECOVERY FOR DEFECTS WITHOUT MANIFESTATION OF DAMAGE: HICKS I

➤ *Hicks v. Kaufman & Broad*, (2001) 89 Cal.App.4th 908.

Plaintiff homeowners purchased homes with "inherently defective" concrete slabs made with Fibermesh. Many of the slabs had not yet cracked. The Plaintiffs sued the developer for cost of repair or replacement of the slabs and did not allege property damage.

The *Hicks* court allowed the claims for both express and implied warranty to proceed. The Court of Appeal held:

- If plaintiffs prove that their foundations contain an inherent defect which is substantially certain to result in malfunction during the useful life of the product, they have established a breach of the express and implied warranties.
- Proof of breach of warranty does not require proof the product has malfunctioned but only that it contains an inherent defect which is substantially certain to result in malfunction during the useful life of the product.
- "We conclude, therefore, if plaintiffs prove their foundations contain an inherent defect which is substantially certain to result in malfunction during the useful life of the product they have established a breach of Kaufman's express and implied warranties. It is not necessary for each individual homeowner to prove his foundation has already cracked or split or that he has suffered property damage as a result of the cracking or splitting. We see no reason why a homeowner should have to wait for the inevitable injuries to occur before recovering damages to repair the defect and prevent the injuries from occurring." *Id.* at 923.
- *Hicks* cites *Aas* as supporting a recovery in implied warranty for repair costs for defects that have not resulted in property damage.
- Rationale: Plaintiffs' warranty right was to a defect-free product, the defect itself is the injury, and the remedy is the cost of replacement.

#### IMPLIED WARRANTY: CCP §383 STANDING OVERCOMES PRIVACY FOR HOA SUIT

➤ *Windham at Carmel Mountain Ranch Assn. v. Superior Court*, 2003 109 Cal.App. 4th 1162

Plaintiff homeowner's association and an individual owner brought an action against the developer for breach of implied warranty, negligence, strict

products liability, and declaratory relief. The complaint alleged that the action was brought under Code of Civil Procedure §383. The developer demurred to breach of implied warranty because the HOA did not have privity for breach of implied warranty. The trial court sustained the demurrer without leave to amend. The Court of Appeal reversed, holding that the HOA had standing under CCP §383:

- By granting the HOA standing to sue as a real party in interest for damage to the common areas, §383 necessarily includes the grant of status as a party with the requisite privity of contract.
- Public policy supports the HOA's standing on a breach of implied warranty.
- The costs of prosecution would not be a common expense and would have to be borne by an individual homeowner, thus greatly increasing the difficulty of seeking redress against a corporate defendant.
- Waste of resources of courts and litigants would occur if each individual owner were required to join in the action.
- The HOA has the obligation to repair the common area, not the owner.
- The court's construction is consistent with Civil Code §945 that provides that associations having rights under §383 are considered "original purchasers" and shall have standing to enforce that section.
- Code of Civil Procedure §383, is not limited to "tort" actions.

The court's holding does not circumvent the holding of *Aas v. Superior Court* (2000) 24 Cal.4th 627. *Aas* did not address claims for breach of implied warranty or the issue of privity.

#### DISCLAIMER OF IMPLIED WARRANTY - UNCONSONABILITY

*Generally, a law established for a public reason cannot be contravened by a private agreement (Loughrin) Is it against public policy to disclaim the Pollard v. Saxe implied warranty for new construction?*

➤ *Greenman v. Yuba Power Products Inc.*, (1963) 59 Cal.2d 57.

Greenman was a landmark case imposing strict products liability against Yuba for injuries caused to Greenman by its defective wood lathe.

- Although in these cases strict liability has usually been based on the theory of an express or implied warranty running from the manufacturer to the plaintiff, the abandonment of the requirement of a contract between them, the recognition that the liability is not assumed by agreement but imposed by law and the refusal to permit the manufacturer to define the scope of

its own responsibility for defective products make clear that the liability is not one governed by the law of contract warranties but by the law of strict liability in tort.

- Accordingly, rules defining and governing warranties that were developed to meet the needs of commercial transactions cannot properly be invoked to govern the manufacturer's liability to those injured by its defective products unless those rules also serve the purposes for which such liability is imposed.
- The remedies of injured consumers ought not to be made to depend upon the intricacies of the law of sales (*Greenman* 63, 64)

#### PRIVITY IN CONTEXT

*If a warranty is a matter of tort, and if it can arise without any intent to make it a matter of contract, then it should need no contract and it may arise and exist between parties who have not dealt with one another.” Prosser Law of Torts, §97 p. 679*

*There is no need to borrow a concept from the contract law of sales (privity); and, it is “only by some violent pounding and twisting” that implied warranty can be made to serve that purpose at all. Prosser, Law of Torts, §97 p. 681*

#### PRIVITY ISSUES: THIRD PARTY BENEFICIARY

- *Gilbert Financial Corp. v. Steelform Contracting* (1978) 82 Cal.App.3d 65.

No privity is required where there is a third party beneficiary to the contract. In *Gilbert*, the owner sued the subcontractor under implied warranty without privity under the Civil Code. (Note that the UCC requires privity). Steelform, the roofing subcontractor had contracted with the general contractor and built the roof and roof parking deck which leaked after construction, damaging the building. Steelform was sued and asserted that the owner had no privity for breach of implied warranty since its contract was with the general contractor.

Held: Implied warranty is imposed without privity since the owner was the third party beneficiary of the contract between the general contractor and Steelform.

## **II. TORT LIABILITY: THE ECONOMIC LOSS RULE**

#### DENYING TORT RECOVERY FOR ECONOMIC LOSS THROUGH DICTA IN SEELY

- *Aas v. Superior Court*, (2000) 24 Cal. 4th 627.

Homeowner sued developer and contractor for negligence, strict liability,

breach of contract and breach of warranty. The trial court granted defendants' motion in limine to exclude evidence of defects that did not yet manifest damage as to negligence claim. The Court of appeal affirmed, holding that no negligence recovery is allowed for economic loss alone. The Supreme court held that "In actions for negligence, a manufacturer's liability is limited to damages for physical injuries; no recovery is allowed for economic loss alone" *Aas* at 636

- "Whatever the product, whether homes or automobiles, strict liability affords a remedy only when the defective product causes property damage or personal injury. The tort does not support recovery of damages representing the lost benefit of a bargain, such as the cost of repairing a defective product or compensation for its diminished value." *Id.* at 639.

"The distinction that the law has drawn between tort recovery for physical injuries and warranty recovery for economic loss is not arbitrary and does not rest on the 'luck' of one plaintiff in having an accident causing physical injury. The distinction rests, rather, on an understanding of the nature of the responsibility a manufacturer must undertake in distributing his products." *Id.* at 639.

- The court explained that any construction defect can diminish the value of a house. The difference between price paid and value received is the domain of contract and warranty law. The court left the door open for recovery of economic damages under implied warranty theories
- "Finally, *Aas* held that "construction defects that have not ripened into property damage, or at least into involuntary out-of-pocket losses, do not comfortably fit the definition of " 'appreciable harm, an essential element of a negligence claim. *San Francisco Unified School Dist. v. W.R. Grace & Co., infra*, 37 Cal. App. 4th 1318, 1327-1331 [the presence of asbestos products in buildings did not, prior to the release of friable asbestos, constitute actual and appreciable harm]." *Id.* 646

#### EXCEPTION TO ECONOMIC LOSS RULE WHERE SPECIAL RELATIONSHIP IS ESTABLISHED

➤ *J'Aire Corp. v. Gregory*, (1979) 24 Cal.3d 799.

Plaintiff tenant sued the general contractor for delay in the completion of a construction project on a negligent interference with prospective economic advantage claim. Plaintiff alleged that the delay caused him to suffer loss of business and resulting loss of profits. The trial court granted defendant's demurrer. The California Supreme Court affirmed, holding that a contractor owes a duty of care to the tenant of a building undergoing construction work to prosecute that work in a manner which does not cause undue injury to the tenant's business, where such injury is reasonably foreseeable.

- Supreme Court held that plaintiff could recover economic loss if a 'special relationship' is established with the 6 *Biakanja* factors
  1. The extent to which the transaction was intended to affect the plaintiff.
  2. The foreseeability of harm to the plaintiff.
  3. The degree of certainty that the plaintiff suffered injury.
  4. The closeness of the connection between the defendant's conduct and the injury suffered.
  5. The moral blame attached to the defendant's conduct.
  6. The policy of preventing future harm.
- After analyzing these factors, the *J'Aire* Court held that the contractor breached its duty of care owed to the tenant and allowed recovery for economic loss.
- This decision seems to leave the door open to recover for economic damages in tort if a special relationship is established. Subsequently, when the Plaintiffs in *Aas* attempted to use the *J'Aire* factors, the *Aas* court ruled that the #3 factor (degree of certainty that plaintiff suffered injury) is not met with economic construction defect losses.
- "The factors enumerated in *Biakanja* and applied in subsequent cases place a limit on recovery by focusing judicial attention on the foreseeability of the injury and the nexus between the defendant's conduct and the plaintiff's injury" *J'Aire* at 808. Note that both *Biakanja* and *J'Aire* are still good law.

#### NO PHYSICAL DAMAGE, NO TORT RECOVERY<sup>2</sup>

➤ *Seely v. White Motor Co.*, (1965) 63 Cal.2d 9.

Plaintiff commercial truck driver purchased a truck for "heavy duty" hauling. It bounced violently or "galloped." Unsuccessful repair attempts were made for 11 months. When slowing for a turn the brakes failed and the truck overturned. Plaintiff was not injured but the truck was severely damaged. Plaintiff served notice that he would make no further payments. The truck was repossessed and resold.

The court held that *Seely* was entitled to breach of express warranty damages for

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<sup>2</sup> See SB 800 (Civil Code §§895-945.5) allows recovery for defects without damage (economic loss) to newly constructed residential units completed after January 1, 2003, however, the new legislation involves a "trade off" which includes restrictions on the statutes of repose and builder's right to repair.

lost profits but could not recover economic losses under strict product liability claims because there was no property damage or injury. (There was no causal link that the galloping had caused the truck accident).

*Seely* traced the development of warranty and strict liability. Warranty grew as a branch of the law of commercial transactions and was aimed at controlling the commercial aspects of transactions. Warranty rules thus function well in a commercial setting, and adequately protected *Seely* who could have shopped around until he found the truck that would fulfill his business needs. (BUT QUERY: didn't *Seely* expect to buy a truck that didn't gallop?) *Seely* could thus be fairly charged with the risk that the truck would not match his economic expectations (unless the manufacturer warranted that it would). The truck purchased was unsuitable for *Seely's* heavy duty hauling needs but performed well for the subsequent purchaser.

The Supreme Court held:

- White is responsible for these losses because it warranted the truck to be "free from defects in material and workmanship under normal use and service."
- The trial court erred in denying strict liability for recovery of "physical damage to the truck itself."
- Even though the law of warranty governs the economic relations between the parties, the doctrine of strict liability in tort should be extended to govern physical injury to plaintiff's property as well as personal injury. Physical injury to property is so akin to personal injury that there is no reason to distinguish them."
- Finally, in *dicta*, *Seely* stated that "even in actions for negligence a manufacturer's liability is limited to damages for physical injuries and there is no recovery for economic loss alone." This *dicta* has now become the basis for the *Aas* decision and is now the law in California.

#### BROKEN FUEL TANK SUPPORTS: No Recovery For Damage to the Product Itself

- *Sacramento Regional Transit District v. Grumman Flexible*, (1984) 158 Cal. App. 3d 289.

Plaintiff bus operator bought new buses from defendant manufacturer. Plaintiff discovered broken fuel tank supports in some of the new Grumman buses and wound up removing and repairing all the fuel supports. Plaintiff sued defendant for strict liability and negligence. The Sacramento court held that plaintiff had knowledge and skill peculiar to goods involved in the transaction and that plaintiff was a merchant under the U.C.C., thus tort law did not apply

because the damages were economic in nature.

- “We believe the line between physical injury to property and economic loss reflects the line of demarcation between tort theory and contract theory. ‘Economic’ loss or harm has been defined as ‘damages for inadequate value, costs of repair and replacement of the defective product or consequent loss of profits -- without any claim of personal injury or damages to other property . . .” *Id.* at 294.

Moreover, the Sacramento court held the damaged fuel supports had to damage something other than themselves. That is, there could be no tort recovery for damage to the product itself.

- “Damaged property may consist of the product itself. But when defect and damage are one and the same the defect may not be considered to have caused physical injury.”
- Query: Had plaintiffs been able to prove that the fractured fuel supports had in fact caused damage to other parts of the bus (the gas tank, the suspension the frame, etc) would the court have allowed a tort recovery?
- See *Sabella v. Wisler* (1963) 59 Cal.2d 21, (home was the product) and *Stewart v. Cox* (1961) 55 Cal.2d 857,(pool was the product) where recovery to the product itself was allowed.

#### PREMATURELY DETERIORATED SINKS: Damage to the Product Itself

➤ *Fieldstone Co. v. Briggs Plumbing Products, Inc.*, (1997) 54 Cal.App.4th 357.

Plaintiff developer installed hundreds of inexpensive sinks manufactured by defendant. Fieldstone sues Briggs to recover the costs of removing and replacing the sinks which had prematurely rusted and chipped due to spot welding and inadequate coating around steel overflow ducts.

- The Court of Appeal held that the developer could not recover on a products liability theory because the defect had not caused injury to “other property”.
- The Court held that Fieldstone was a “sophisticated” purchaser and could have purchased better quality sinks.
- The Court held that the doctrine of strict liability is not a tort substitute for contract and warranty law.
- Unless the parties specifically agree the product will perform in a certain way, the manufacturer is not responsible for its failure.
- “To the extent that *International Knights* may stand for the proposition that a merchant may sue in products liability for physical injury where the

injury consists of nothing more than the product defect upon which liability is founded, we decline to follow it.”

MICRO CRACKING: No Appreciable Damage: Damage to the Product Itself

➤ *Zamora v. Shell Oil Co.*, (1997) 55 Cal.App.4th 204.

Developer installed Polybutylene resin plumbing systems in homes. Some of the homes experienced water leaks. Others did not. The Court of Appeal held that the homes that had not yet experienced water leaks had no claim for negligence.

Plaintiffs argued that although the pipes had not leaked, they all had degraded and exhibited “micro-cracking.” The Court of Appeal held:

“Degradation and “micro-cracking” constitute solely damage to the defective product itself and Seely precludes a negligence cause of action.”

- ❖ But see SB 800 (Civil Code §§895-945.5) applicable to newly constructed residential units completed after January 1, 2003, which allows recovery of plumbing defects without damage.
  - ❖ §941(e) In order to make a claim for violation of the standards set forth in Chapter 2 (commencing with Section 896), a homeowner need only demonstrate, in accordance with the applicable evidentiary standard, that the home does not meet the applicable standard, . . . No further showing of causation or damages is required to meet the burden of proof regarding a violation of a standard set forth in Chapter 2
  - ❖ CC §896(14); The lines and components of the plumbing system, sewer system, and utility systems shall not leak.
  - ❖ CC 896(15); Plumbing lines, sewer lines, and utility lines shall not corrode so as to impede the useful life of the systems.
  - ❖ CC §(e) With respect to PLUMBING AND SEWER ISSUES: Plumbing and sewer systems shall be installed to operate properly and shall not materially impair the use of the structure by its inhabitants. . .
  - ❖ CC §896(3)(A); To the extent not otherwise covered by these standards, manufactured products, including, but not limited to, windows, doors, roofs, plumbing products and fixtures, fireplaces, electrical fixtures, HVAC units, countertops, cabinets, paint, and appliances SHALL BE INSTALLED SO AS NOT TO INTERFERE WITH THE PRODUCTS' USEFUL LIFE, if any.

## NO DAMAGE TO PRODUCT ITSELF DEFENSE WHERE NOX RODS DAMAGE LARGER PRODUCT

➤ *KB Home v. Superior Court*, (2003) 112 Cal.App. 4th 1076.

KB Home purchased 2,200 gas-fired horizontal forced air furnaces for homes it built. The manufacturer was Consolidated Industries Corp. Consolidated installed stainless steel NOx rods above the burners to be used to meet California requirements for limiting nitrous oxides emitted by residential furnaces in certain metropolitan areas. The U.S. Consumer Product Safety Commission issued a safety alert in September 2000 warning that the furnaces "presented a substantial risk of fire."

KB Home began inspection of homes and found that 80 percent had bent or melted NOx rods, cracked fire boxes, cracked heat exchanger, melted burners, separations at the control joints and rusted components. KB Home paid in excess of \$3 million to replace the furnaces.

KB Home sued Consolidated and others in tort for causes of action in negligence and strict products liability. The court issued an order regarding certain threshold legal issues. One of the legal issues was whether the economic loss rule barred KB Home's negligence and strict liability causes of action. The trial court ruled that the furnaces were "a single manufactured product and did not consider the component parts of that integrated product as separate products." The trial court also ruled that the damage was damage to the product itself, not damage to "other property" and was not properly recoverable under the economic loss rule. *Id.* at 1082.

The Court of Appeal reversed the trial court noting that the resolution of "whether the defective part is a sufficiently discrete element of the larger product that it is not reasonable to expect its failure invariably to damage other portions of the finished product" was a question of fact. *Id.* at 1087.

The Court of Appeal set forth the various factors claimed by Consolidated to be relevant to identifying the "product:"

"(1) Does the defective component (here, the NOx rod) perform an integral function in the operation of the larger product (the furnace)?

(2) Does the component have any independent use to the consumer, that is some use other than as incorporated into the larger product?

(3) How related is the property damage to the inherent nature of the defect in the component?

(4) Was the component itself or the larger product placed into the stream of commerce (or, viewed from the buyer's perspective, was the larger

integrated product or the component itself the item purchased by the plaintiff)?” *Id.* at 1086.

The Court of Appeal noted that KB Home disputed the relevance of some of these factors and argued that the NOx rod should be considered a separate product from the furnace itself and the other furnace components damaged by the defective rods because:

- “(1) Consolidated purchased the rods from another manufacturer for the purpose of adding them only to furnaces supplied to areas covered by the more stringent California emissions regulations;
- (2) Consolidated sold the identical furnaces in other markets without the NOx rods;
- (3) The rods can be readily removed from the furnaces; and
- (4) NOx rods have been used in other, non-furnace applications (for example, gas-fired water heaters) and were listed as separate parts in Consolidated's parts catalog.” *Id.* at 1087.

The court cited *Jiminez v. Superior Court*, (2002) 29 Cal.4th 473 favorably where manufactured windows were held to be a component part of the home.

In *Jiminez*, the manufacturer had argued that the entire house in which the windows were installed was the “product.” The Supreme Court disagreed:

- The economic loss rule does not bar recovery in tort for damage that a defective product causes to other portions of a larger product. (See *Jiminez* in Products Liability section.)

#### PHYSICAL DAMAGE, ECONOMIC LOSS: FIRE STOPS, SHEAR WALLS, DRY ROT, DEFLECTED SLABS

➤ *Huang v. Garner*, (1984) 157 Cal.App.3d 404.

Plaintiff bought a building that was defectively designed and constructed. Plaintiff brought an action for breach of implied warranty, negligence and strict liability against the original owner, designer and civil engineer of a defectively designed and constructed building. The trial court found for the plaintiff against the original owner and the developer. The parties agreed that the deflected and cracked beams and dry rot damages had caused physical damage and therefore were recoverable under a tort theory.

The dispute was whether the cost to repair the firewalls, shear walls, and fire stops that had not caused any physical damage was also recoverable under a tort theory. The trial court ruled that these defects had caused only economic loss and denied recovery in tort. The Court of Appeal reversed:

- To establish tort liability without privity, a special relationship establishing a duty of care must exist between parties for recovery of economic losses.

- Court applies *J'Aire* factors to determine that developer has a duty of reasonable care to subsequent purchasers of housing structures who live in the building, as well as those who utilize it for investment purposes.
- To recover economic damages under a negligence claim plaintiff must prove and establish the *Biakanja* factors.
  - ❖ Note that in *Aas*, the Supreme Court distinguished *Huang's* application of the test in *J'Aire Corp. v. Gregory*, (1979) 24 Cal.3d 799. "Accordingly, we disapprove *Huang* to the extent it is inconsistent with the views set out in this opinion." *Aas* at 649.
  - ❖ Moreover, the Legislature enacted SB 800 in 2003, which permits recovery for structural defects and code violations that have not yet caused damage.
    - ❖ §941(e) Causes of action and damages to which this chapter does not apply are not limited by this section. In order to make a claim for violation of the standards set forth in Chapter 2 (commencing with Section 896), a homeowner need only demonstrate, in accordance with the applicable evidentiary standard, that the home does not meet the applicable standard, . . . No further showing of causation or damages is required to meet the burden of proof regarding a violation of a standard set forth in Chapter 2§941(15) Structures shall be constructed in such a manner so as not to impair the occupants' safety because they contain public health hazards as determined by a duly authorized public health official, health agency, or governmental entity having jurisdiction.

RECOVERY IN TORT WHERE DUAL CONTRACT – TORT CLAIM, DESPITE ECONOMIC LOSS RULE

➤ *North American Chemical v. Superior Court*, (1997) 59 Cal.App.4th 764.

North American shipped 46 tons of bulk boric acid to Harbor Pac. Harbor Pac packaged and shipped the boric acid in sealed *felcon* bags. The boric acid was contaminated in the Harbor Pac silo. Harbor Pac shipped the contaminated boric acid to North American's customer NH Techno, Japan for Liquid crystal displays. NH Techno used the contaminated boric acid for 2 weeks for their LCD's and shut down the plant for 12 days to remove the contamination. North American paid NH Techno's claims and sued Harbor Pac for *negligent performance of contract, breach of contract* and economic loss.

The Court of Appeal recognized that the economic loss rule barred a plaintiff from recovering for economic damages unless such economic damages were accompanied by physical harm. Judicial hostility to the use of tort theory to recover purely economic losses predates the twentieth - century battle over products liability. The hostility arose from the fear of mass litigation and concern that traditional tort concepts were not capable of providing clear limitations on potentially limitless liability. The Court of Appeal held that the economic loss rule

did not apply to a contract relating to the performance of services (negligently performed) where the six factor *Biakanja/J'Aire* test established the existence of the special relationship, notwithstanding whether the parties were in privity. *Id.* at 781, 784.

QUERY: would the result be the same under *Aas* application? Did actual physical damage occur? *Mesa Vista* held submicroscopic cracking was *appreciable harm*.

## SB 800 RECOVERY FOR DEFECTS WITHOUT DAMAGE

CC§941(e) provides that "a homeowner need only demonstrate that the home does not meet the applicable standard in the code section and no further showing of causation or damages is required.

§941(e) Causes of action and damages to which this chapter does not apply are not limited by this section. In order to make a claim for violation of the standards set forth in Chapter 2 (commencing with Section 896), A HOMEOWNER NEED ONLY DEMONSTRATE, IN ACCORDANCE WITH THE APPLICABLE EVIDENTIARY STANDARD, THAT THE HOME DOES NOT MEET THE APPLICABLE STANDARD, subject to the affirmative defenses set forth in Section 945.5. NO FURTHER SHOWING OF CAUSATION OR DAMAGES IS REQUIRED TO MEET THE BURDEN OF PROOF REGARDING A VIOLATION OF A STANDARD SET FORTH IN CHAPTER 2 (commencing with Section 896), provided that the violation arises out of, pertains to, or is related to, the original construction.

### INCORPORATION OF DEFECTIVE MATERIAL / COMPONENT AS "PROPERTY DAMAGE"

- *Armstrong World Industries, Inc. v. Aetna Casualty & Surety Co. et al.*, (1996) 45 Cal.App. 4th 1; *Geddes & Smith, Inc., v. St. Paul Mercury Indemnity Co.* (1959) 51 Cal.2d 558; *Hauenstein v. Saint Paul-Mercury Indem. Co.*, 242 Minn. 354; *Eljer Mfg., Inc. v. Liberty Mut. Ins. Co.* (7th Cir. 1992) 972 F.2d 805; *Shade Foods, Inc. v. Innovative Products Sales and Marketing, Inc.* (2000) 78 Cal.App.4th 847

In *Armstrong*, the court held that installation of the insured's asbestos material constituted "physical injury" to the building, even before any release of asbestos fibers. Thus, where the defective work or material must be removed or repaired to comply with building code or health and safety standards, its presence or incorporation into the building constitutes "physical injury" to the building. i.e., the physical linking of the defective material to the building is the "physical injury." In *Geddes* the California Supreme Court adopted the "incorporation doctrine" for the first time. In *Geddes*, defective doors were installed in tract homes and began to show severe defects after they had been installed: some fell out; some could not be closed; and some locked in place. The *Geddes* court reasoned that these defects caused property damage other than to the doors themselves.

The *Geddes* court cited *Hauenstein* for this proposition. In *Hauenstein* the insured sold defective plaster that was used to plaster a house. The plaster shrank and cracked to such an extent that it was of no value and had to be removed. The court held that incorporation of the defective plaster was property damage.

In *Shade Foods*, physical damage was found by "incorporation" of wood splinters in the nut clusters, resulting in the destruction of that batch of nut

cluster cereal by General Mills. Shade relied on the *Geddes* line of cases as well as *Eljer*, where a defective plumbing system was held to be property damage at the time of installation.

*Eljer* held that the term "physical injury" covers "a loss that results from physical contact or physical linkage, as when a potentially dangerous product is incorporated into another and, because it is incorporated and not merely contained (as a piece of furniture is contained in a house but can be removed without damage to the house), must be removed, at some cost, in order to prevent the danger from materializing." *Eljer Mfg., Inc. v. Liberty Mut. Ins. Co.* (7th Cir. 1992) 972 F.2d 805, 810 cert. den. (1993) 507 U.S. 1005.

- ❖ These cases are discussed in greater detail herein and discussed in detail in the accompanying paper, *Incorporation: An Alternate Means of Establishing Damage*.

### **III. PRODUCTS LIABILITY**

#### DEFINING A PRODUCT DEFECT:

- *Barker v. Lull Engineering Co.*, (1978) 20 Cal.3d 413.

Plaintiff was injured at a construction site while operating a high-lift loader. Plaintiff sued the manufacturer for design defects. At trial, the Court instructed the jury that the plaintiff had to prove that the product was "unreasonably dangerous for its intended use" to prevail. The jury returned a defense verdict.

The California Supreme Court held:

- "Defect" is neither self-defining nor susceptible of a single definition that would apply in all contexts.

However, the Supreme Court identified two categories of defects:

- Manufacturing defect in which the product deviates from the manufacturer's intended result.
- Design defect is established by either of two theories:
  1. CONSUMER EXPECTATION TEST: product failed to perform as safely as an ordinary consumer would expect when the product is used as intended or in a reasonably foreseeable manner.
  2. RISK / BENEFIT BALANCING TEST: The product's design proximately caused the injury and defendant failed to prove that on balance the benefits of the challenged design outweighed the risk of danger inherent in such design. This test is used where the average consumer would not have an expectation as to performance of the product.

- “[t]hat to require an injured plaintiff to prove not only that the product contained a defect but also that such defect made the product unreasonably dangerous to the user or consumer would place a considerably greater burden upon him than that articulated in *Greenman*, California’s seminal product liability decision.” *Id.* at 423.
- “As this court has recognized on numerous occasions, the terms defect as utilized in the strict liability context is neither self-defining nor susceptible to a single definition applicable in all contexts.” *Id.* at 427.

### CONSUMER EXPECTATION TEST--EVERYDAY EXPERIENCE

➤ *Campbell v. General Motors Corporation*, (1982) 32 Cal. 3d 112.

Plaintiff was injured by being thrown to the floor in a bus that lacked ordinary handrails. In a products liability action against the bus manufacturer, the trial court granted defendant's motion for nonsuit because plaintiff introduced no expert evidence.

The California Supreme Court reversed, holding that plaintiff's lay evidence established a prima facie defect case. The lack of a handrail constituted defective design because it did not meet ordinary consumer safety expectations.

- "In many products liability cases, the plaintiff points to an alleged malfunction of the product as the cause of injury. In other situations, it is the absence of adequate warnings or directions which is asserted to be the cause of the injury. In still other contexts, the plaintiff seeks to establish causation on the basis of the manufacturer's failure to provide a particular safety device." *Id.* at 119-120.
- "In the ordinary case the question becomes one of what would have happened if [the product had been] otherwise. This is of course incapable of mathematical proof, and a certain element of guesswork is always involved." *Id.* at 120.
- "Whether proper construction of a building would have withstood an earthquake, whether reasonable police precautions would have prevented a boy from shooting the plaintiff in the eye with an airgun, whether a broken flange would have made an electric car leave the rails in the absence of excessive speed, whether a collision would have occurred if the defendant had not partially obstructed the highway, and many similar questions, cannot be decided as a matter of law." *Id.* at 120.

### CONSUMER EXPECTATION TEST --TOO COMPLEX FOR ORDINARY CONSUMER

➤ *Soule v. General Motors Corp.* (1994) 8 Cal. 4th 548.

Plaintiff was injured in a car accident and sued the vehicle manufacturer in strict liability for design defects. The jury found for the plaintiff. The Supreme Court affirmed the decision. Defects allowing a wheel to break free and smash the floorboard into Plaintiff's feet were too complex and not subject to ordinary consumer expectations. Instead, the risk - benefit balancing test is used (does risk inherent in the design outweigh the benefits of the design?).

- "The consumer expectations test is reserved for cases in which the everyday experience of the product's users permits a conclusion that the product's design violated minimum safety assumptions, and is thus

defective regardless of expert opinion about the merits of the design.” 567

- “An ordinary consumer of automobiles cannot reasonably expect that a car’s frame, suspension, or interior will be designed to remain intact in any and all accidents. Nor would ordinary experience and understanding inform such a consumer how safely an automobile’s design should perform under the esoteric circumstances of the collision at issue here.” *Id.* at 570.

The Supreme Court held that some products are so complex that a consumer may not have any minimum assumptions about its safe performance. In such a case, the jury should be instructed on a risk benefit analysis (determination whether the risk inherent in the design outweighs the benefits of the design).

### DEFINING A CONSTRUCTION DEFECT:<sup>3</sup>

#### INADEQUATE INSTALLATION

➤ *Kriegler v. Eichler*, (1969) 269 Cal.App.2d 224.

Plaintiff purchased a home from defendant developer. The heating subcontractor had used terne coated steel tubing instead of copper for radiant heating systems. Steel tubing was incorrectly installed. Corrosion caused failure of the heating system. The trial court entered judgment for plaintiff, finding that irrespective of negligence on the part of the homebuilder, it was responsible for strict liability because the heating system, as installed, was defective. The Court of Appeal affirmed, holding that a developer can be strictly liable for poor materials selection and faulty construction techniques.

- “The strict liability doctrine applies when the plaintiff proves that he was injured while using the instrumentality in a way it was intended to be used as a result of a defect in design and manufacture of which plaintiff was not aware and which made the instrumentality unsafe for its intended use.” *Id.* at 227 (quoting *Greenman v. Yuba Power Products, Inc.* 59 Cal. 2d 57)
- The *Kriegler* Court extended the *Greenman* doctrine of strict liability to the developers of mass-produced homes.
- The *Kriegler* Court relies on the New Jersey Supreme Court decision in *Schipper v. Levitt & Sons, Inc.*, (1965) 44 N.J. 70, in which the builder-vendor of mass-produced homes was strictly liable for injury caused by a faucet in the hot water system defectively installed without a mixing valve.

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<sup>3</sup> See SB 800 (Civil Code §§895-945.5) that defines a defect in newly constructed residential units completed after 1/1/03.

- ❖ CC§896 (E) (4) HEATING, if any, shall be installed so as to be capable of maintaining a room temperature of 70 degrees Fahrenheit at a point three feet above the floor in any living space. (SB 800)

#### DEVIATIONS FROM PLANS AND SPECIFICATIONS

- *Raven's Cove Townhomes, Inc. v. Knuppe Development Co.*, (1981) 114 Cal.App.3d 783.

Homeowner's association sued the developer in strict liability for defects in common area landscaping and in the exterior walls of the individual units.

Where a product is not inherently defective, negligent installation can constitute a defect. The Court of Appeal held that deviation from plans and specifications in the installation of a drainage and irrigation system constituted a defect allowing recovery of cost of repair

- The *Raven's Cove* court follows the holding in *Kriegler v. Eichler Homes*, holding the developer of mass-produced housing liable in strict liability for construction defects.
- "Other commentators agree that regardless of the theory of liability relied upon by a plaintiff, if judgment is rendered against the contractor for construction defects, the proper measure of damages is the cost of repair to the plaintiff's property." *Id.* at 802 (quoting Miller & Starr, *Current Law of Cal. Real Estate*, §9:20)

#### WRONG LOCATION

- *Del Mar Beach Club Owners Ass'n v. Imperial Cont. Co.*, (1991) 123 Cal.App.3d 898.

Del Mar Beach Club was a planned development comprised of 192 units on an ocean bluff in Solana Beach. The homeowner's association sued the developer because the project was built on unstable soils. The HOA alleged damages, including cracking and peeling of tennis court surfaces, rusting of exterior railings, sinking of pavement, and water leaks. The Court of Appeal held that a developer can be strictly liable for placing a non-defective product, planned development, in the wrong place. The developer built in a defective location, on the unstable soil.

- "The law should be based on current concepts of what is right and just and the judiciary should be alert to the never-ending need for keeping legal principles abreast of the times. Ancient distinctions that make no sense in today's society and that tend to discredit the law should be readily rejected." *Id.* at 911 (quoting *Kriegler v. Eichler Homes, Inc.*, (1969) 269 Cal. App. 2d 224)

## DEFECTIVE APPLICATION OF MATERIALS

- *Ault v. International Harvester Co.*, (1974) 13 Cal. 3d 113.

Plaintiff was injured in a vehicle accident. In a lawsuit against the vehicle manufacturer, plaintiff alleged that the vehicle's gearbox was made of 'aluminum 380,' a material that was defective for that purpose. Plaintiff offered evidence that malleable iron was stronger and less likely to fail. Subsequent to the accident, Defendant stopped using aluminum 380 in gearboxes.

- ❖ CC §896(3)(A) To the extent not otherwise covered by these standards, MANUFACTURED PRODUCTS, including, but not limited to, windows, doors, roofs, plumbing products and fixtures, fireplaces, electrical fixtures, HVAC units, countertops, cabinets, paint, and appliances shall be installed so as not to interfere with the products' useful life, if any. (SB 800)

## MANUFACTURER LIABILITY FOR INVOLVEMENT IN MARKETING ACTIVITIES

- *Bay Summit Community Association v. Shell Oil Co., et al.*, (1996) 51 Cal.App.4th 762.

After installation of polybutylene plumbing in a condominium project, homeowners began to experience plumbing leaks. The HOA sued the developer, the two manufacturers of the plumbing system, and Shell. Shell supplied polybutylene resin pellets used to make pipes. There was no evidence that the polybutylene resin supplied by Shell was defective.

The Court of Appeal held Shell liable on a products liability theory and established three factors used to determine manufacturer liability:

- "(1) The defendant received a direct financial benefit from its activities and from the sale of the product,
- (2) The defendant's role was integral to the business enterprise such that defendant's conduct was a necessary factor in bringing the product to the initial consumer, and
- (3) The defendant had control over, or a substantial ability to influence the manufacturing or distribution process."

SB 800 responds to *Aas* by permitting owners to plead and prove strict liability against a builder or developer for failure to meet a standard and "no further showing of damages is required." CC §941(e)

- ❖ §941(e) Causes of action and damages to which this chapter does not apply are not limited by this section. In order to make a claim for violation of the standards set forth in Chapter 2 (commencing with Section 896), a homeowner need only demonstrate, in accordance with the applicable evidentiary standard, that the home does not meet the applicable standard, . . . No further showing of causation or damages is required to meet the burden of proof regarding a violation of a standard set forth in Chapter 2

See also *Kasel v. Remington* (1972) 24 Cal.App. 3<sup>rd</sup> 711, where strict liability was imposed on a manufacturer who placed a defective exploding shell in the stream of commerce. The shell was manufactured in Mexico by an affiliated company.

#### PRODUCTS LIABILITY FOR SUPPLIERS AND SUBCONTRACTORS

➤ *Jiminez v. Superior Court*, (2002) 29 Cal.4th 473.

Defendant window manufacturer argued that a manufacturer of windows installed in mass-produced housing is not strictly liable in tort. The Supreme Court disagreed:

- Manufacturers of component parts, here windows, that are installed in mass-produced homes can be subject to strict products liability in tort when their defective products cause harm, disapproving *La Jolla Village Homeowners Assn. v. Superior Court*, (1989) 212 Cal.App.3d 1131; *Casey v. Overhead Door Corp.*, (1999) 74 Cal.App.4th 112.
- The Court in *Jiminez* (the same appellate district that produced *La Jolla Village*), held that subcontractors who provided products for inclusion in mass construction can be strictly liable in tort for product defects. The court's earlier rulings in *La Jolla Village* were "overstated" and "dictum." However, the court retained the common law distinction that persons providing services are generally, not subject to strict liability.
- Asserting the policy reasons cited in *Vandermark*, supra, the *Jiminez* court stated that "like manufacturers, suppliers, and retailers of complete products, component manufactures and suppliers are 'an integral part of the overall producing and marketing enterprise (*Id at 262*)'. For purposes of strict liability, there are 'no meaningful distinctions' between, on the one hand, component manufacturers and suppliers and, on the other hand, manufacturers and distributors of complete products; for both groups 'the overriding policy considerations are the same'". *Kriegler v. Eichler Homes, Inc.*, 269 Cal. App. 2d. at p. 227
- Moreover, the language in subdivision (1)(b) of § 402A of the Restatement Second of Torts, provides that the seller of a defective product "is subject to liability for physical harm thereby caused to the *ultimate user or consumer*, or to his property, if (b) it is expected to and does reach the user or consumer without *substantial change* in the condition in which it was sold." The defendant manufacturer in *Jiminez* argued that it should not be held strictly liable because their windows were *shipped in parts and assembled by, and installed by, others*. The *Jiminez* court disagreed:
- "The mere assembly of a product that is sold in parts is not a 'substantial change' in the product within the meaning of the Restatement. The issue

is not whether the product was sold fully assembled or in parts, but rather whether the defect that resulted in the alleged damage existed when the window left the manufacturer's control. *Jiminez at 480*

#### SUBCONTRACTOR LIABILITY TO OWNERS AND GENERAL CONTRACTORS.

- *The Stonegate Homeowner's Association v. T.A. Staben, et al. (2006) 144 Cal.App.4th 740.*

In a construction defect case involving waterproofing of walls, the trial court granted a nonsuit to the subcontractor and granted summary judgment on the general contractor's cross-complaint for indemnity. The trial court precluded expert testimony offered by the HOA on the standard of care in applying the waterproofing and that application of waterproofing fell below the standard of care. The trial court ruled that the standard of care did not apply and relied upon the fact that plaintiff did not present any evidence of facts with regard to the duties under the oral contract between the general contractor and waterproofing subcontractor.

On appeal, the court of appeal reversed. The court first noted that an owner has a cause of action in negligence against a subcontractor even though there was no privity of contract between the owner and subcontractor. The court next held that the trial court erred in precluding the HOA from presenting expert testimony on the standard of care. The expert testimony was relevant to the issue of whether the waterproofing subcontractor had performed the work within the industry standard of care. The nonsuit was reversed.

The court of appeal also reversed the trial court's grant of summary judgment. The trial court ruled that since the general contractor was satisfied with the work of the waterproofing subcontractor, there was no tort liability. The court of appeal held that the general contractor's satisfaction of the work of the waterproofing subcontractor did not absolve the waterproofing subcontractor of liability for the damage the HOA may have suffered as the result of the negligently performed work by the waterproofing subcontractor. The court of appeal noted that the waterproofing subcontractor had not presented any evidence of its duty of care and the burden never shifted to the general contractor. Even if the waterproofing subcontractor had presented evidence of its duty of care, the evidence by the general contractor of the failure to apply the waterproofing in a manner necessary to prevent the passage of water through retaining walls was sufficient to create a triable issue of fact.

#### PRODUCTS LIABILITY: COMMERCIAL USER WHERE MANUFACTURER RESPONSIBLE FOR DESIGN

- *Southern California Edison v. Harnischfeger Corp., (1981) 120 Cal.App.3d 842.*

Edison purchased a gantry crane from the manufacturer, Harnischfeger. The crane broke and dropped a 90 pound turbine damaging the power plant.

Edison was not an ordinary consumer, but a commercial party who purchased the crane in a commercial setting with equal bargaining power. Nonetheless, the court imposed strict liability against Harnischfeger because Edison only submitted a "standard set of functional guidelines" for the crane and did not design or manufacture the crane. Because of this, Harnischfeger remained responsible for the design and the accident that resulted from its defective design and its failure to warn.

#### NO PRODUCTS LIABILITY FOR COMMERCIAL ENTITIES WITH EQUAL BARGAINING POWER

➤ *Kaiser Steel Corporation v. Westinghouse Electrical Corporation*, (1976) 55 Cal.App.3d 737.

Plaintiff brought action for products liability, breach of express warranty, breach of implied warranties of fitness and merchantability and negligence against the manufacturer of a motor which was injured by defects in the welding rivets. The defective motor caused plaintiff's steel manufacturing plant to be shut down.

- "The rule of strict liability for defective products is an example of necessary paternalism judicially shifting risk of loss by application of tort doctrine because California's statutory scheme fails to adequately cover the situation." *Id.* at 747.
- "Judicial paternalism is to loss shifting what garlic is to a stew -- sometimes necessary to give full flavor to statutory law, always distinctly noticeable in its result, overwhelmingly counterproductive if excessive, and never an end in itself." *Id.* at 747.
- "The case at bench presents a situation in which the statutory principles of sales warranties work well so that to apply the tort doctrines of products liability will displace statutory law rather than bring out its full flavor. *Id.* at 747
- Products liability does not apply between parties who deal in a commercial setting from positions of relatively equal economic strength, who bargain on the design specifications of a product, and negotiate regarding the allocation of risk of loss from product defects.

#### NO RECOVERY WHERE PRODUCT WAS A NON-DEFECTIVE COMPONENT PART

➤ *Artiglio v. General Electric Co.*, (1998) 61 Cal.App.4th 830.

In *Artiglio*, plaintiffs' defect claims were defeated by the *component part doctrine*. General Electric was the manufacturer of silicone pellets that were used in breast implants. GE sold the pellets to Dow Corning that incorporated the silicone pellets in the breast implants. The Court applied factors derived from the "raw material supplier defense" and "the bulk sales/sophisticated purchaser rule,"

to determine when component suppliers are NOT liable to ultimate consumers. The Court set forth the following test to determine when a component supplier is not liable:

- The product is not defective or inherently dangerous.
- The product is substantially changed during the manufacturing process.
- The product is sold in bulk to a sophisticated end user who is under a duty to investigate the particular risks and hazards.

The *Artiglio* court found:

- Bulk silicone is used for many purposes. Silicone supplied in bulk was not inherently dangerous; it only became dangerous when used in implant devices. The Court identified other manufacturers that safely incorporated this material into other non-medical products.
- Supplier used express disclaimers to alert the implant manufacturer of its responsibility to assess the suitability of silicone as an ingredient in medical devices.
- Breast Implant manufacturers were “highly sophisticated buyers,” with a legal duty and in the best position to test and evaluate the potential risks of its products and their components.
- Materials are significantly altered during the manufacturing process over which the component supplier had no control.
- The supplier merely produced according to implant manufacturer specifications. The component part supplier did not exercise any control over design, testing or labeling of implants.

## COMPONENT PART DOCTRINE AT TIME PRODUCT LEFT FACTORY

➤ *Jenkins v. T & N PLC*, (1996) 45 Cal.App.4th 1224.

A man, diagnosed with mesothelioma, a latent asbestos related disease, and his wife, brought a strict products liability action against the bulk supplier of raw asbestos fiber he was exposed to. The supplier of the fiber argued that it was not liable on a products liability theory because a component raw material incorporated into a finished consumer product is not a product.

The Court of Appeal found that the supplier of a component part can be liable if the component part was defective at the time it left the factory.

- "Although raw asbestos is processed before it is sold to consumers, it is the raw asbestos and not some manufactured article that caused the harm...." Quoting *Hammond v. North American Asbestos Corp.* (1983) 97 Ill.2d 195.
- The court also held that since raw asbestos fibers do not change after becoming a component part in pipe insulation, raw asbestos fibers constitute a "product" under Section 402A of the Restatement Second of Torts, which was adopted in California.
- The tendency of asbestos to give off dust did not change from the time the raw asbestos fibers left the supplier until they reached the "ultimate user." Quoting *Hammond v. North American Asbestos Corp.*, (1983) 97 Ill.2d 195; *Menna v. Johns-Manville Corp.* (D.N.J. 1984) 585 F.Supp. 1178.

In 2003 the California Legislature enacted SB800 and attempted to define construction defects of every kind. Their omnibus attempt was less than successful and future trial and appellate courts will hereafter struggle with its varied provisions.

## SB 800 CHAPTER 2. ACTIONABLE DEFECTS DEFINED – CC §895 ET.SEQ.

➤ CC §896. IN ANY ACTION SEEKING RECOVERY OF DAMAGES ARISING OUT OF, OR RELATED TO DEFICIENCIES IN, THE RESIDENTIAL CONSTRUCTION, DESIGN, SPECIFICATIONS, SURVEYING, PLANNING, SUPERVISION, TESTING, OR OBSERVATION OF CONSTRUCTION, a builder, . . . shall, except as specifically set forth in this title, be liable for, and the claimant's claims or causes of action shall be limited to violation of, the following standards; . . .

(a) WITH RESPECT TO WATER ISSUES:

(1) A door shall NOT ALLOW UNINTENDED WATER TO PASS BEYOND, AROUND, OR THROUGH the door or its designed or actual moisture barriers, if any.

(2) Windows, patio doors, deck doors, and their systems SHALL NOT ALLOW WATER TO PASS BEYOND, AROUND, OR THROUGH the window, patio door, or deck door or its designed or actual moisture barriers, including, without limitation, internal barriers within the systems

themselves. For purposes of this paragraph, "systems" include, without limitation, windows, window assemblies, framing, substrate, flashings, and trim, if any.

(3) Windows, patio doors, deck doors, and their systems shall NOT ALLOW EXCESSIVE CONDENSATION to enter the structure and *cause damage to another component*. For purposes of this paragraph, "systems" include, without limitation, windows, window assemblies, framing, substrate, flashings, and trim, if any.

(4) Roofs, roofing systems, chimney caps, and ventilation components shall NOT ALLOW WATER TO ENTER THE STRUCTURE OR TO PASS BEYOND, AROUND, OR THROUGH THE DESIGNED OR ACTUAL MOISTURE BARRIERS, including, without limitation, internal barriers located within the systems themselves. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, and sheathing, if any.

(5) Decks, deck systems, balconies, balcony systems, exterior stairs, and stair systems SHALL NOT ALLOW WATER TO PASS INTO THE ADJACENT STRUCTURE. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashing, and sheathing, if any.

(6) Decks, deck systems, balconies, balcony systems, exterior stairs, and stair systems shall not allow UNINTENDED WATER TO PASS WITHIN THE SYSTEMS THEMSELVES AND CAUSE DAMAGE TO THE SYSTEMS. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashing, and sheathing, if any.

(7) Foundation systems and slabs shall NOT ALLOW WATER OR VAPOR TO ENTER INTO THE STRUCTURE so as to *cause damage to another building component*.

(8) Foundation systems and slabs shall not allow water or vapor to enter into the structure so as to LIMIT THE INSTALLATION OF THE TYPE OF FLOORING MATERIALS TYPICALLY USED FOR THE PARTICULAR APPLICATION. [Flooring, carpet, hardwood, tile etc]

(9) Hardscape, including paths and patios, irrigation systems, landscaping systems, and drainage systems, that are installed as part of the original construction, shall not be installed in such a way as TO CAUSE WATER OR SOIL EROSION TO ENTER INTO OR COME IN CONTACT WITH THE STRUCTURE so as to *cause damage to another building component*.

(10) Stucco, exterior siding, exterior walls, including, without limitation, exterior framing, and other exterior wall finishes and fixtures and the systems of those components and fixtures, including, but not limited to, pot shelves, horizontal surfaces, columns, and plant-  
ons, shall be INSTALLED IN SUCH A WAY SO AS NOT TO ALLOW UNINTENDED WATER TO PASS INTO THE STRUCTURE OR TO PASS BEYOND, AROUND, OR THROUGH THE DESIGNED OR ACTUAL MOISTURE BARRIERS OF THE SYSTEM, including any internal barriers located within the system itself. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashings, trim, wall assemblies, and internal wall cavities, if any.

(11) Stucco, exterior siding, and exterior walls shall NOT ALLOW EXCESSIVE CONDENSATION TO ENTER THE STRUCTURE AND CAUSE DAMAGE TO ANOTHER COMPONENT. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashings, trim, wall assemblies, and internal wall cavities, if any.

(12) Retaining and site walls and their associated drainage systems shall NOT ALLOW UNINTENDED WATER TO PASS BEYOND, AROUND, OR THROUGH ITS DESIGNED OR ACTUAL MOISTURE BARRIERS including, without limitation, any internal barriers, so as to cause

damage. This standard does not apply to those portions of any wall or drainage system that are designed to have water flow beyond, around, or through them.

(13) Retaining walls and site walls, and their associated drainage systems, shall only allow water to flow beyond, around, or through the areas designated by design.

(14) The lines and components of the plumbing system, sewer system, and utility systems shall not leak.

(15) Plumbing lines, sewer lines, and utility lines shall not corrode so as to impede the useful life of the systems.

(16) Sewer systems shall be installed in such a way as to allow the designated amount of sewage to flow through the system.

(17) Shower and bath enclosures shall not leak water into the interior of walls, flooring systems, or the interior of other components.

(18) Ceramic tile and tile countertops shall not allow water into the interior of walls, flooring systems, or other components so as to cause damage.

(b) WITH RESPECT TO STRUCTURAL ISSUES:

(1) Foundations, load bearing components, and slabs, SHALL NOT CONTAIN SIGNIFICANT CRACKS OR SIGNIFICANT VERTICAL DISPLACEMENT.

(2) Foundations, load bearing components, and slabs SHALL NOT CAUSE THE STRUCTURE, IN WHOLE OR IN PART, TO BE STRUCTURALLY UNSAFE.

(3) Foundations, load bearing components, and slabs, and underlying soils shall be CONSTRUCTED SO AS TO MATERIALLY COMPLY WITH THE DESIGN CRITERIA SET BY APPLICABLE GOVERNMENT BUILDING CODES, REGULATIONS, AND ORDINANCES FOR CHEMICAL DETERIORATION OR CORROSION RESISTANCE in effect at the time of original construction.

(4) A structure shall be constructed so as to MATERIALLY COMPLY WITH THE DESIGN CRITERIA FOR EARTHQUAKE AND WIND LOAD RESISTANCE, as set forth in the applicable government building codes, regulations, and ordinances in effect at the time of original construction.

(c) WITH RESPECT TO SOIL ISSUES:

(1) Soils and engineered retaining walls SHALL NOT CAUSE, in whole or in part, DAMAGE TO THE STRUCTURE built upon the soil or engineered retaining wall.

(2) Soils and engineered retaining walls shall not cause, in whole or in part, the structure to be STRUCTURALLY UNSAFE.

(3) Soils shall NOT CAUSE, IN WHOLE OR IN PART, THE LAND UPON WHICH NO STRUCTURE IS BUILT TO BECOME UNUSABLE for the purpose represented at the time of original sale by the builder or for the purpose for which that land is commonly used.

(d) WITH RESPECT TO FIRE PROTECTION ISSUES:

(1) A structure shall be constructed so as to materially comply with the design criteria of the applicable government building codes, regulations, and ordinances for fire protection of the occupants in effect at the time of the original construction.

(2) Fireplaces, chimneys, chimney structures, and chimney termination caps shall be CONSTRUCTED AND INSTALLED IN SUCH A WAY SO AS NOT TO CAUSE AN UNREASONABLE RISK OF FIRE outside the fireplace enclosure or chimney.

(3) Electrical and mechanical systems shall be constructed and installed in such a way so as not to cause an unreasonable risk of fire.

(e) With respect to PLUMBING AND SEWER ISSUES:

Plumbing and sewer systems shall be installed to operate properly and shall not materially impair the use of the structure by its inhabitants. . .

(f) With respect to ELECTRICAL SYSTEM ISSUES:

Electrical systems shall operate properly and shall not materially impair the use of the structure by its inhabitants. . .

(g) With respect to ISSUES REGARDING OTHER AREAS OF CONSTRUCTION:

(1) Exterior pathways, driveways, hardscape, sidewalls, sidewalks, and patios installed by the original builder SHALL NOT CONTAIN CRACKS THAT DISPLAY SIGNIFICANT VERTICAL DISPLACEMENT OR THAT ARE EXCESSIVE. . .

(2) Stucco, exterior siding, and other exterior wall finishes and fixtures, including, but not limited to, pot shelves, horizontal surfaces, columns, and plant-ons, SHALL NOT CONTAIN SIGNIFICANT CRACKS OR SEPARATIONS.

(3) (A) To the extent not otherwise covered by these standards, manufactured products, including, but not limited to, windows, doors, roofs, plumbing products and fixtures, fireplaces, electrical fixtures, HVAC units, countertops, cabinets, paint, and appliances SHALL BE INSTALLED SO AS NOT TO INTERFERE WITH THE PRODUCTS' USEFUL LIFE, if any.

CC§896 (E): ADDITIONAL DEFECTS

(4) HEATING, if any, shall be installed so as to be capable of maintaining a room temperature of 70 degrees Fahrenheit at a point three feet above the floor in any living space.

(5) LIVING SPACE AIR-CONDITIONING, if any, shall be provided in a manner consistent with the size and efficiency design criteria specified in Title 24 of the California Code of Regulations or its successor.

(6) ATTACHED STRUCTURES shall be constructed to comply with inter-unit noise transmission standards set by the applicable government building codes, ordinances, or regulations in effect at the time of the original construction. If there is no applicable code, ordinance, or regulation, this paragraph does not apply. However, no action shall be brought pursuant to this paragraph more than one year from the original occupancy of the adjacent unit.

(7) IRRIGATION SYSTEMS AND DRAINAGE shall operate properly so as not to damage landscaping or other external improvements. However, no action shall be brought pursuant to this paragraph more than one year from close of escrow.

(8) UNTREATED WOOD POSTS shall not be installed in contact with soil so as to cause unreasonable decay to the wood based upon the finish grade at the time of original

construction. However, no action shall be brought pursuant to this paragraph more than two years from close of escrow.

(9) UNTREATED STEEL FENCES AND ADJACENT COMPONENTS shall be installed so as to prevent unreasonable corrosion. However, no action shall be brought pursuant to this paragraph more than four years from close of escrow.

(10) PAINT AND STAINS SHALL BE APPLIED IN SUCH A MANNER SO AS NOT TO CAUSE DETERIORATION of the building surfaces for the length of time specified by the paint or stain manufacturers' representations, if any. However, no action shall be brought pursuant to this paragraph more than five years from close of escrow.

(11) ROOFING MATERIALS shall be installed so as to avoid materials falling from the roof.

(12) The LANDSCAPING SYSTEMS shall be installed in such a manner so as to survive for not less than one year. However, no action shall be brought pursuant to this paragraph more than two years from close of escrow.

(13) CERAMIC TILE AND TILE BACKING shall be installed in such a manner that the tile does not detach.

(14) DRYER DUCTS shall be installed and terminated pursuant to manufacturer installation requirements. However, no action shall be brought pursuant to this paragraph more than two years from close of escrow.

(15) STRUCTURES shall be constructed in such a manner so as not to IMPAIR THE OCCUPANTS' SAFETY BECAUSE THEY CONTAIN PUBLIC HEALTH HAZARDS AS DETERMINED BY A DULY AUTHORIZED PUBLIC HEALTH OFFICIAL, HEALTH AGENCY, OR GOVERNMENTAL ENTITY HAVING JURISDICTION. This paragraph does not limit recovery for any damages caused by a violation of any other paragraph of this section on the grounds that the damages do not constitute a health hazard. 897. The standards set forth in this chapter are intended to address every function or component of a structure. TO THE EXTENT THAT A FUNCTION OR COMPONENT OF A STRUCTURE IS NOT ADDRESSED BY THESE STANDARDS, IT SHALL BE ACTIONABLE IF IT CAUSES DAMAGE.

#### **IV. MEASURE OF TORT DAMAGES.**

##### COST OF REPAIR OR DIMINUTION, WHICHEVER IS LESS.

➤ *Mozzetti v. City of Brisbane*, (1977) 67 Cal.App.3d 565.

The owner of a motel and trailer park sued the city and city engineer for flood damage to plaintiffs' property. The trial court instructed the jury that the plaintiff was entitled to recover the reasonable costs of necessary repairs and loss of rentals and the difference between the market value of the property immediately before the damage and after the damage, after making the necessary repairs.

The Court of Appeal reversed noting that the instruction amounted to a double recovery. The Court noted that the rule for measuring tort damages to plaintiff's property is the cost of repair or diminution in value, whichever is less.

EXCEPTION: COST OF REPAIR RECOVERABLE IF PLAINTIFF HAS PERSONAL REASON TO REPAIR.

➤ *Orndorff v. Christiana Community Builders*, (1990) 217 Cal.App.3d 683.

Plaintiffs lived in their home since 1977. In 1985, the plaintiffs sued the builder because the house was built on fill and was settling. Plaintiffs' testimony was that it would cost \$243,539 to repair the defects and relocate the plaintiffs during the repairs. The appraiser testified that the diminution in the value of the home would be \$171,000. The trial court entered judgment in the amount of the cost to repair.

The Court of Appeal held that restoration costs may be awarded even though they exceed the decrease in market value if "there is a reason personal to the owner for restoring the original condition" or "where there is reason to believe that the plaintiff will, in fact, make the repairs."

The Court of Appeal also rejected defendants argument that the trial court had no power to award the amount needed to cure the defect as opposed to the amount needed to repair the damage. The evidence showed that future settlement was likely. Thus, the amount needed to repair the damage was the more costly pier and grade system.

THE ECONOMIC LOSS RULE DOES NOT BAR DAMAGES MEASURED BY COST OF REPAIR OR DIMINUTION IN VALUE.

➤ *Collins Development Co. v. D. J. Plastering, Inc.*, (2000) 81 Cal.App.4th 771.

After a jury trial awarded plaintiff \$3.5 million in damages for cost of repair, the plasterer argued the economic loss rule barred the award of damages for cost of repair. The Court of Appeal distinguished the economic loss rule relating to the nature of the injury from the measure of damage:

- "The fact that damages for this physical damage were calculated on the basis of the cost of repairing the stucco so that the damage to the other parts of the building would abate did not change the nature of the damage UCW suffered. As the court in *Transwestern Pipeline Co. v. Monsanto Co.*, (1996) 46 Cal.App.4th 502, 531 [53 Cal.Rptr.2d 887], stated: 'While economic loss is measured by repair costs, replacement costs, loss of profits or diminution of value, the measure of damages does not determine whether the complaint is for physical harm or economic loss . . . In other words, the fact that the measure of the plaintiff's damages is economic does not transfer the nature of its injury into a solely economic loss. . . .Physical harm to property may be measured by the cost of repairing the buildings to make them safe.' [Citation.]" *Id.* at 779.

EMOTIONAL DISTRESS: PHYSICAL INJURY NOT REQUIRED FOR NEGLIGENCE RECOVERY.

➤ *Potter v. Firestone Tire and Rubber Company*, (1993) 6 Cal.4th 965.

Plaintiffs lived near a landfill where defendant toxic waste producer dumped cancer-causing chemicals. The trial court found for plaintiffs and awarded emotional distress damages based on plaintiffs' fear of developing cancer as a result of exposure to toxic waste. Firestone argued that Potter could not recover for emotional distress without present physical injury. Potter showed that Firestone had violated California State Code by dumping toxic substances in a regular landfill, as opposed to a Class I Landfill required by law. The Supreme Court distinguished *Khan v. Shiley*, (where the pacemaker had not failed and killed the patient yet) because Firestone was not challenging the finding that it was liable for negligence.

The Supreme Court also held:

- There is no requirement of physical injury in analyzing emotional distress claims and adopted the 'more likely than not' standard to apply to fear of cancer cases.
- "We are satisfied that the more likely than not threshold for fear of cancer claims in negligence actions strikes the appropriate balance between the interests of toxic exposure litigants and the burdens on society and judicial administration." *Id.* at 997.
- "The physical injury requirement is a hopelessly imprecise screening device -- it would allow recovery for fear of cancer whenever such distress accompanies or results in any physical injury, no matter how trivial, yet would disallow recovery in all cases where the fear is both serious and genuine but no physical injury has yet manifested itself." *Id.* at 988.
- It was illogical to allow recovery where there is a trivial physical injury, but disallow it where the fear is serious and genuine but physical injury has not yet manifested.
- "Imposing a physical injury requirement represents an inherently flawed and inferior means of attempting to achieve these goals" *Id.* at 988.
- Potter was entitled to emotional distress and medical monitoring. The Supreme Court doubted it would be opening "Pandora's box." "We are confident that our holding will not open floodgates of litigation." *Id.* at 1009

#### EMOTIONAL DISTRESS: NO RECOVERY IN CONSTRUCTION DEFECT CASES

➤ *Erlich v. Menezes*, (1999) 21 Cal.4th 543.

Plaintiffs' house suffered from many water leaks. Plaintiffs sued for breach of contract, fraud, negligent misrepresentation and negligent construction. Plaintiffs lost on the fraud and negligent misrepresentation claims. Plaintiff husband suffered severe emotional distress and developed a permanent heart

condition as a result of the defects. Plaintiffs were awarded emotional distress damages on their breach of contract claim.

The Supreme Court held that plaintiffs cannot recover emotional distress tort damages on their breach of contract or tort claim because of the potential of converting every contract breach into a tort, including punitive damage claims. Plaintiff can still recover emotional distress for fraud, intentional concealment.

- "Contract damages are generally limited to those within the contemplation of the parties when the contract was entered into or at least reasonably foreseeable by them at that time; consequential damages beyond the expectation of the parties are not recoverable. This limitation on available damages serves to encourage contractual relations and commercial activity by enabling parties to estimate in advance the financial risks of their enterprise. In contrast, tort damages are awarded to [fully] compensate the victim for [all] injury suffered." *Id.* at 550.
- "While the purposes behind contract and tort law are distinct, the boundary line between them is not and the distinction between the remedies for each is not 'found ready made'. These uncertain boundaries and the apparent breadth of the recovery available for tort actions create pressure to obliterate the distinction between contracts and torts -- an expansion of tort law at the expense of contract principles which Grant Gilmore aptly dubbed 'contorts'." *Id.* at 551.
- "Plaintiff's theory of tort recovery is that mental distress is a foreseeable consequence of negligent breaches of standard commercial contracts. However, foreseeability alone is not sufficient to create an independent tort duty. Whether a defendant owes a duty of care is a question of law. Its existence depends upon the foreseeability of the risk and a weighing of policy considerations for and against imposition of liability." *Id.* at 552.

#### RECOVERY ALLOWED FOR EXPERT FEES INCURRED TO INVESTIGATE AND PREPARE REPAIR PLAN

➤ *Stearman v. Centex Homes*, (2000) 78 Cal.App.4th 611.

Plaintiffs brought an action against developer for strict liability, alleging that defendants constructed defective concrete slabs causing damage to the structure and diminishing the property's value. Plaintiffs also alleged that they had to incur expenses for remedial measures including employing various professionals to inspect and make repair recommendations. The Court of Appeal held that construction defect Plaintiffs can recover a portion of expert fees incurred to investigate and prepare a repair plan.

- Quoting from *Regan Roofing*: "The court correctly reasoned, "It would be

proper to view this \$250,000 expert expense as damages due for a portion of the cost of repair, which is an appropriate measure of damages in cases based on damage to real property.” *Stearman*. at 624.

- “Defendant asks us to disregard *Regan Roofing* because it involved a settlement, not a trial. We find no meaningful distinction.” *Id.* at 624.
- “The record is clear the court denied plaintiffs’ motion, not because it doubted the credibility of the expert witnesses, but because it believed the law did not allow it to require defendant to pay the expert fees, even if they were incurred solely in relation to the costs of repair. The court was wrong. Plaintiffs were entitled to be made whole.” *Id.* at 625.

## **V. STATUTES OF LIMITATIONS<sup>4</sup>**

### NO EQUITABLE TOLLING FOR 10 YEAR STATUTE OF REPOSE

#### ➤ *Lantzy v. Centex Homes* (2003) 31 Cal. 4th 363

The general rule is that no action for latent construction defects may be commenced more than 10 years after substantial completion of the construction project. (CCP §337.15) This absolute 10 year limitations period applies regardless of when the defect was discovered. Pre-1971 cases held that the discovery based limitations period or a latent defect suit alleging breach of an express or implied warranty is “tolled”—that is, halted and suspended in progress—while the defendants’ promises or attempts to honor the warranty by repairing the defect are pending .

In *Lantzy*, the homeowners alleged design and manufacturing defects including leaking windows and window systems that damaged their residences. The homeowners testified that as they discovered the defects Lantzy represented to them that it would correct all the problems. As a result, plaintiffs alleged that they failed to file their complaints until 10 years and 9 months after completion of the homes. Lantzy demurred on grounds that the 10 year limitations period in CCP §337.15 had expired. The homeowners alleged that the statute of limitations was “equitably tolled” due to Lantzy’s continued promises to fix the defects.

The Supreme Court agreed with *FNB Mortgage* (1999) 76 Cal.App 4<sup>th</sup>, 1116, that §337.15’s 10 year statute of limitations for latent construction defects is not subject to the general rule of equitable tolling. A broad tolling for repair rule would contravene the Legislature’s clear intent. Moreover, the extraordinary length of the limitations period set forth in §337.15 weighs strongly against the need for such a tolling rule as a matter of fair procedure.

Although the Supreme Court found no basis for equitable tolling of the 10

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<sup>4</sup> See SB 800 (Civil Code §§895-945.5) setting new statute of limitations for newly constructed residential units completed after 1/1/03.

year statute, they did not foreclose application of the distinct doctrine of equitable estoppel. A defendant whose conduct induced plaintiffs to refrain from filing suit within the ten year period might be equitably estopped to assert that the statute of limitations has expired. (Note: What happens with a 25 year warranty? §337.15

does not apply to manufacturers like the window manufacturer in *Jiminez*. Also, SB 800 excludes protections for manufacturers.)

- ❖ BUT SEE: SB 800 ON TOLLING: CC §941(e) Existing statutory and decisional law regarding tolling of the statute of limitations shall apply to the time periods for filing an action or making a claim under this title, except that repairs made pursuant to Chapter 4 (commencing with Section 910), with the exception of the tolling provision contained in Section 927, do not extend the period for filing an action, or restart the time limitations contained in subdivisions (a) or (b) if 7091 of the B&P Code.
- ❖ If a builder arranges for a contractor to perform a repair pursuant to Chapter 4 (commencing with Section 910), as to the builder the time period for calculating the statute of limitation in subdivisions (a) or (b) if Section 7091 of the Business and Professions Code shall pertain to the substantial completion of the ORIGINAL CONSTRUCTION and not to the date of repairs under this title.

#### BANKRUPTCY CODE TOLLING DOES NOT EXTEND 10-YEAR STATUTE OF LIMITATIONS

➤ *Inco Development Corp. v. Superior Court (2005)* 131 Cal.App.4<sup>th</sup> 1014

Developers moved for summary judgment on the 10-year statute of limitations on 157 of the 216 homes. Notices of completion were recorded on or before May 16, 1993. The first of the lawsuits were filed on May 16, 2003. Inco filed bankruptcy on October 15, 1999, and the bankruptcy action was dismissed and the stay lifted on May 24, 2001.

Although the court of appeal stated that a bankruptcy stay under Code of Civil Procedure §356 is a statutory prohibition that is not counted as part of the limitations time, the court held that section 337.15 is a special statute of repose to which the statutory stay does not apply. Inco argued that the statutory tolling provision contained in section 356 should not apply for the same reason that equitable tolling should not apply. The court of appeal noted that *Lantzy v. Centex Homes* did not expressly refer to section 337.15 as a statute of repose, two court of appeal decisions have and concluded that neither a continuing nuisance theory or the discovery rule may override the statute of repose.

Relying on the language in *Lantzy* that the Legislature intended the 10-year limit to be absolute, no matter what limitations periods might otherwise apply. The Legislature must have been aware that contractors and other professionals involved in the construction industry are subject to financial vicissitudes including bankruptcy and the length of time given is sufficient to discovery construction defects and bring suit despite these circumstances.

The court of appeal noted that under federal bankruptcy law this result would not be the same if the defendant had been in bankruptcy for the entire 10 years or was in bankruptcy at the end of the 10-year period. There is no suggestion that the bankruptcy filing by Inco was a bad faith attempt to thwart plaintiffs' lawsuits.

The court of appeal also based its holding on the rule of statutory construction that a later, more specific statute controls over an earlier, general statute. The court of appeal further based its ruling on the statutory purpose of having a firm cutoff date for construction defect lawsuits because of the effect on indemnity cross-complaints. Under these circumstances, a contractor might be unable to seek indemnity from a subcontractor who is most responsible for that defect.

The court of appeal looked at federal bankruptcy law and held that it did not compel extension of the 10-year period for the 19 months that Inco was in bankruptcy but would compel an extension if the bankruptcy was pending at the expiration of the 10-year period. Here, the bankruptcy action was concluded years before the plaintiffs filed their actions and at a time when their claims were unknown and unforeseeable by Inco.

[NOTE: The Supreme Court in *Regents of the University of California v. Hartford Accident & Indemnity Co.* (1978) 21 Cal.3d 624 rejected the argument that section 337.15 is not an ordinary procedural statute of limitation, but a substantive limit upon the plaintiff's cause of action. "Nothing in the placement or language of section 337.15 supports that interpretation of the section. Section 337.15 is not part of a statute creating a new substantive liability, but is codified in that portion of the Code of Civil Procedure which sets out procedural limitations on the commencement of common law actions. (Compare 2 Witkin, Cal. Procedure (2d ed. 1970) Actions, § 232 and cases there cited.) Neither does the fact that actions which fall within section 337.15 may also be subject to other periods of limitation suggest a substantive effect for section 337.15."]

#### INTENTIONAL MISCONDUCT TOLLS THE TEN-YEAR STATUTE OF LIMITATIONS

➤ *Acosta v. Glenfed Development Corp.* (2005) 128 Cal.App.4th 1278

59 plaintiffs brought a construction defect action against Glenfed Development. Summary judgment motions on the 10-year statute of limitations was brought against 47 of the plaintiffs. In opposition to the motions, the plaintiffs submitted declarations by their experts identifying the defects and then stating that the defects:

"(1) involved conspicuous failures to comply with applicable building code provisions, with the city-approved building plans, and with basic construction industry practices;

- (2) were of a type that inevitably would have been recognized by any competent construction supervisor conducting even minimal day-to-day inspections of the type required in a construction project such as the one involved here, and would have caused the construction supervisor to require the responsible subcontractors to remedy the defects immediately, before work could proceed on the houses; and
- (3) had the financial impact of producing, in defendants' favor, substantial cost savings."

The experts were of the opinion that the defects were not negligently caused. Rather, the defects appeared to be the result of willful misconduct by defendants in that they were "so serious and prevalent that they were either the result of [a] deliberate decision to 'cut corners' for cost savings or the result of a near total, virtually reckless, failure by the developer to adequately supervise subcontractors." The experts expressed the view that it was not reasonably possible for the builder, and the builder's contractors, agents and employees, to have failed to observe or been aware of the defects. "[The defects] are all things that could not possibly be present absent either the express or tacit approval of the builder or as a result of a complete failure by the builder to exercise even minimal supervision and conduct even minimal inspections of the work in progress." However, none of these defects would be apparent to the average home buyer or the average realtor when inspecting a home prior to purchasing it.

The trial court found that plaintiffs had not established a triable issue of fact and that the 10-year statute of limitations barred the action. Glenfed argued that if there was any misconduct in the construction process, it was done by the subcontractors and there was no evidence that Glenfed had any knowledge or participation in the misconduct. The trial court agreed with Glenfed and ruled that plaintiffs had failed to show that Glenfed engaged in actual construction or supervision of the construction of the homes such that Glenfed would have observed the defects but chose to ignore them or that Glenfed was responsible for supervision of construction and failed to carry out their duties.

The court of appeal held that plaintiffs bear the burden of producing evidence of willful misconduct but disagreed that the plaintiffs had not met their burden to raise a triable issue of material fact. The court of appeal noted that as a matter of law owners and contractors have supervision over the construction, including the work of the subcontractors, the duty is nondelegable duty, and owners and contractors cannot avoid liability by having an independent contractor assume responsibility for the work. This duty appears in the licensing statutes that hold that the contractor is deemed to have notice of the misconduct even if not informed of by the RME or RMO and is required to rectify the problem.

The court of appeal continued that it was sound public policy to hold the general contractor/developer liable for any willful misconduct involved in the construction project because the general contractor/developer is strictly liable for construction defects regardless of fault. Imputing the subcontractor's willful misconduct is consistent also with principles of respondeat superior that hold a principal liable for both the negligent and intentional acts of the agent.

The court concluded that as a matter of public policy, when a developer or general contractor receives the economic benefits of the willful misconduct, then as between the innocent purchaser and the developer/general contractor, the developer/general contractor should bear the burden associated with the misconduct. The language of Code of Civil Procedure §337.15(f) only requires that the action be based on or arise from willful misconduct by someone; it does not matter who committed the misconduct.

#### ACCRUAL OF A CAUSE OF ACTION

➤ *Siegel v. Anderson Homes, Inc. (2004) 118 Cal.App.4th 994*

Anderson moved in limine to exclude evidence of the defects and the damage on the ground they had given rise to causes of action that arose during the ownership of the original purchasers such that, absent an assignment of rights by the original owners to them, Siegel and Sanchez each lacked "standing" to bring the action. The trial court, in reliance on *Krusi v. S.J. Amoroso Construction Co.* (2000) 81 Cal.App.4th 995 (Krusi), granted the motion and dismissed the complaint.

The Court of Appeal framed the issue as follows:

"The owner of a home containing latent construction defects may maintain an action in tort against the builder for any resulting damages. But when there are several successive owners, to which of them does the cause of action belong: to the person who owns the home when the structure first sustains some appreciable but undetected harm, or to the subsequent owner who first discovers the harm? Put another way, does the cause of action accrue when the structure suffers physical damage, or when the owner suffers a compensable economic injury as a result? Has the owner suffered an injury, for example, if he or she is unaware the wooden framing within the walls is slowly deteriorating from water damage?"

The Court of Appeal's response was that the cause of action belonged to the owner who first discovered, or ought to have discovered, the property damage. It is only then that some entity capable of maintaining a legal claim will have suffered a compensable injury, e.g., the cost of repair and/or the loss in the

property's value (inasmuch as the owner then has a duty to disclose the damage to potential buyers).

After reviewing several cases involving the accrual of the statute of limitations for latent defects, the Court of Appeal remarked that although it was difficult to distill a consistent rule from these cases regarding when a cause of action for latent construction defects accrues, the court held that *Leaf v. City of San Mateo* (1980) 104 Cal.App.3d 398 and the other underground trespass cases were the most closely analogous cases, and the underlying equitable principle expressed there ought to apply here as well, i.e., it would be "manifestly unjust to deprive plaintiffs of a cause of action before they are aware that they have been injured."

The Court of Appeal concluded:

"The inequitable consequences of the trial court's ruling in this case are manifest. If the discovery of latent defects were relevant only to the commencement of the statute of limitations, and not to accrual of the cause of action, Siegal's discovery of the water damage in his roof and walls would have started the limitations period to run on a cause of action he did not own, but which belonged instead to the original owner of his house. But the original owner, assuming he or she learned of this theoretical windfall within the next three years, would have no cause of action against Anderson as a practical matter and so nothing of value to assign to Siegel, because that owner would have suffered no compensable injury. There would, in effect, be no remedy for the defects in Siegel's and Sanchez's homes. This cannot be the law. A cause of action cannot have accrued before there was someone in a position to actually assert it."

#### THE STATUTE OF LIMITATIONS BEGINS WHEN THE DAMAGE IS "SUFFICIENTLY APPRECIABLE"

➤ *Mills v. Forestex Co.* (2003) 108 Cal.App 4<sup>th</sup> 625

In 1990, plaintiffs Robert and Lori Mills, hired Wunder Construction to build a home for them. About a year later the Mills hired Wunder once again to build a garage. The siding on the home and garage was a wood product manufactured by Forestex Co. and installed by Wunder. On March 20, 1991, the Notice of Completion for the home was filed. In 1991 or 1992, Lori Mills first noticed warping and buckling. She contacted Wunder and Wunder told the Mills he would "take care of it". In the winter of 1992 -1993, Mr. Mills first noticed the siding was warping and buckling, and he spoke with Wunder about it. In the spring of 1993, the siding was getting worse and the evidence showed the siding was "certainly buckling" at this time. In summer of 1993, the Mills noticed additional warping of the siding and the paint was peeling off, and Wunder

attempted to make repairs, however they were unsuccessful. Over the next year the warping had extended to three sides of the home. In the winter of 1994-1995, the warping had become “really extreme.”

On September 15, 2000, plaintiffs filed a complaint against both Forestex and Wunder Construction. Wunder and Forestex filed motions for summary judgment on the ground that the statute of limitations barred the plaintiffs’ claim against both Wunder and Forestex. The principal issue in the case was when was the damage to the siding on the Mills house sufficiently appreciable to give a reasonable person notice he or she had a duty to pursue legal remedies?

Applying the four year statute of limitations in Commercial Code §2725 to the claims against Forestex, the Court of Appeal held that the breach of warranty cause of action had to be brought within four years of discovery that the siding was not performing properly. With respect to the claims against Wunder, the trial court and the parties proceeded from the premise that the defect was patent and that the four-year statute of limitations applied. The Court of Appeal, however, recognized that the trial court and the parties confused a construction defect with its subsequent manifestations. The Court of Appeal found that the defect, the absence of an adequate vapor barrier, was a latent defect, and hidden from view beneath the siding. *Id.* at 646.

After concluding that the defect was latent, the Court of Appeal stated that the outward manifestations of the defect, the warping, buckling, and peeling should have put the Mills on notice that something was wrong with the siding and a further inquiry was necessary. The issue was when should the Mills have discovered the hidden defect.

The Court of Appeal held that discovery occurs and the statute of limitations begins to run “after the damage is sufficiently appreciable to give a reasonable man notice that he has a duty to pursue his remedies.” *Id.* at 646. Mills argued that because it was not until mid-1997 when they learned of the “improper installation” that the statute of limitation should begin to run.

The undisputed facts showed that siding indisputably was warping and buckling, and the paint was peeling off, by the summer of 1993. Around this same time, Wunder tried without success to correct the problem. That these measures were necessary was evidence enough something was wrong with their siding. Thus, the siding problem on the Mills home was **sufficiently appreciable** no later than the summer of 1993 to put them on notice to pursue their remedies, and consequently start the statute of limitations when the warping had become “extreme” and Wunder had attempted his repairs. *Id.* at 650.

The plaintiffs contended that the limitations period on their claims against Forestex was tolled, because they made a warranty claim to the company sometime in the middle of 1997 and engaged in negotiations continuously thereafter until August of 1998. The Mills, however, did not provide a separate statement in opposition to Forestex motion for summary judgment. In any event, the Court of Appeal held that even with the tolling period, the plaintiffs did not bring the lawsuit until September of 2000.

The plaintiffs contended that the limitation period on their claims against Wunder was tolled pending the resolution of the consumer complaint they filed with the Contractors State License Board on December 31, 1997. The plaintiffs improperly proposed this theory for the first time on appeal. Notwithstanding the four year limitations period, the limitations period had expired the summer before.

The Mills contended that Wunder was estopped to assert the statute of limitations, because he fraudulently concealed or failed to disclose important information. They argued that they relied upon Wunder's promises to repair until the end of 1997. The Court of Appeal agreed with the trial court that it would have been unreasonable to rely on Wunder to repair the siding after 1994, "when he quit working and failed to return to the job." At that time, the Mills still had a year or more to file a timely action. Moreover, the Mills' own testimony belied their contention that Wunder induced them to put off filing suit against him until after the statute had run. Mr. Mills testified that it was not his intention as late as December of 1997 to sue Wunder but rather to get Wunder to support the Mills' claims against Forestex. The Mills plainly could not have been induced to refrain from doing something they had not contemplated doing. *Id.* at 656.

Finally, the Mills argued that Wunder had a duty to disclose the warranty claim against Forestex and therefore he should be estopped to assert the statute of limitations. The Court of Appeal held, however, that no fiduciary relationship existed between a building contractor and a person who engages his services. *Id.* at 657.

CAUSE OF ACTION DOES NOT ACCRUE UNTIL PLAINTIFF DISCOVERS THE INJURY AND ITS NEGLIGENT CAUSE

- *San Francisco Unified School District v. W.R. Grace & Co.*, (1995) 37 Cal. App. 4th 1318.

Plaintiff property owner sued defendant asbestos manufacturer because asbestos-containing materials presented hazard to the buildings' occupants. The trial court dismissed the action as untimely under the 3-year statute of limitations (CCP §335) because plaintiff had knowledge of the asbestos. The Court of Appeal

reversed holding that in strict liability or negligence, the compensable injury is physical harm to persons or property. Contamination by friable asbestos was the harm that triggered the statute of limitations.

- "In tort actions, the statute of limitations commences when the last element essential to a cause of action occurs. The statute of limitations does not begin to run and no cause of action accrues in a tort action until damage has occurred. If the last element of the cause of action to occur is damage, the statute of limitations begins to run on the occurrence of 'appreciable and actual harm, however uncertain in amount,' that consists of more than nominal damages." *Id.* at 1326.
- "The common law rule that a cause of action accrued on the date of injury has been modified by the discovery rule. Under the discovery rule, a cause of action does not accrue until the plaintiff either discovers the injury and its negligent cause or could have discovered the injury and cause through the exercise of reasonable diligence." *Id.* at 1326.
- "Thus, the limitations period should not be interpreted to bar a victim of wrongful conduct from asserting a cause of action before he or she could reasonably be expected to discover its existence." *Id.* 1332.
- "Contamination by friable asbestos is the physical injury and the actual, appreciable harm that must exist before a property owner's strict liability or tort cause of action against an asbestos manufacturer accrues and the limitations period commences." *Id.* at 1335.

The Court of Appeal held:

- Statutes of limitations will not be applied inflexibly where principles of equity and justice favor the application of equitable tolling.
- Repairs undertaken by a developer toll statutes of limitations agreeing with *Cascade Gardens Homeowners Assn. v. McKellar & Associates*, (1987) 194 Cal.App.3d 1252 and *Grange Debris Box & Wrecking Co. v. Superior Court*, (1993) 16 Cal.App.4th 1349 and disagreeing with *FNB Mortgage Corp. v. Pacific General Group*, (1999) 76 Cal.App.4th 1116.

#### DIFFERENT STATUTE OF LIMITATIONS FOR DIFFERENT AREAS OF DAMAGE.

- *Winston Square Homeowner's Association v. Centex West*, (1989) 213 Cal.App.3d 282.

Plaintiff homeowner's association sued the developer and subcontractors for various construction defects including defects involving drainage, plastering, gutters and downspouts, chimney crickets, valley gutters, trim boards and balcony railings. The association argued that all of these defects constituted a single breach of duty and the statute of limitations in CCP §§337.1 and 337.15

applied to the cause of action, not to individual areas of damage. The court disagreed holding that the statute of limitations applied to separate areas of damage.

CROSS-COMPLAINT FILED MORE THAN 10 YEARS AFTER SUBSTANTIAL COMPLETION NOT BARRED BY 10-YEAR LATENT DEFECT STATUTE.

➤ *Fleck v. Bollinger*, (1997) 54 Cal.App.4th 926.

Plaintiffs brought suit against the Bollinger builder and against Prudential, the manufacturer of the building pad that had developed the lot in the 1970's. Plaintiffs settled with Bollinger and obtained an assignment of its rights against Prudential. The issue before the court was whether Bollinger could assign its rights and whether the 10-year statute barred the assigned rights.

The court recognized that plaintiffs could not proceed directly against Prudential because of the 10-year statute of limitations. However, plaintiffs could proceed on the indemnity rights held by Bollinger if plaintiffs had timely sued the Bollinger builder. *Id.* at 932; *Time for Living, Inc. v. Guy Hatfield Homes/All American Development Co.*, (1991) 230 Cal.App.3d 30, 36-39.

CC §941, LIMITATION OF ACTION; TOLLING

(a) Except as specifically set forth in this title, no action may be brought to recover under this title more than 10 years after substantial completion of the improvement but not later than the date of recordation of a valid notice of completion.

(b) As used in this section, "action" includes an action for indemnity brought against a person arising out of that person's performance or furnishing of services or materials referred to in this title, except that a cross-complaint for indemnity may be filed pursuant to subdivision (b) of Section 428.10 of the Code of Civil Procedure in an action which has been brought within the time period set forth in subdivision (a).

(d) Sections 337.15 and 337.1 of the Code of Civil Procedure shall not apply to actions under this title.

(e) Existing statutory and decisional law regarding tolling of the statute of limitations shall apply to the time periods for filing an action or making a claim under this title, except that repairs made pursuant to Chapter 4 (commencing with Section 910), with the exception of the tolling provision contained in Section 927, do not extend the period for filing an action, or restart the time limitations contained in subdivisions (a) or (b) if 7091 of the Business and Professions Code. If a builder arranges for a contractor to perform a repair pursuant to Chapter 4 (commencing with Section 910), as to the builder the time period for calculating the statute of limitation in subdivisions (a) or (b) if Section 7091 of the Business and Professions Code shall pertain to the substantial completion of the ORIGINAL CONSTRUCTION and not to the date of repairs under this title. The time limitations established by this title DO NOT APPLY TO ANY ACTION BY A CLAIMANT FOR A CONTRACT OR EXPRESS CONTRACTUAL PROVISION.

CC §896: TIME SHORTENED FOR CERTAIN CONSTRUCTION DEFECTS

(e) With respect to PLUMBING AND SEWER ISSUES: Plumbing and sewer systems shall be installed to operate properly and shall not materially impair the use of the structure by its inhabitants. However, no action may be brought for a violation of this subdivision more than FOUR YEARS AFTER CLOSE OF ESCROW.

(f) With respect to ELECTRICAL SYSTEM ISSUES: Electrical systems shall operate properly and shall not materially impair the use of the structure by its inhabitants. However, no action shall be brought pursuant to this subdivision more than FOUR YEARS FROM CLOSE OF ESCROW.

(g) With respect to issues regarding OTHER AREAS OF CONSTRUCTION:

(1) Exterior pathways, driveways, hardscape, sidewalls, sidewalks, and patios installed by the original builder shall not contain cracks that display significant vertical displacement or that are excessive. However, no action shall be brought upon a violation of this paragraph more than FOUR YEARS FROM CLOSE OF ESCROW.

CC §897 (E)

(7) IRRIGATION SYSTEMS AND DRAINAGE shall operate properly so as not to damage landscaping or other external improvements. However, no action shall be brought pursuant to this paragraph more than ONE YEAR FROM CLOSE OF ESCROW.

(8) UNTREATED WOOD POSTS shall not be installed in contact with soil so as to cause unreasonable decay to the wood based upon the finish grade at the time of original construction. However, no action shall be brought pursuant to this paragraph more than TWO YEARS FROM CLOSE OF ESCROW.

(9) UNTREATED STEEL FENCES AND ADJACENT COMPONENTS shall be installed so as to prevent unreasonable corrosion. However, no action shall be brought pursuant to this paragraph more than FOUR YEARS FROM CLOSE OF ESCROW.

(10) PAINT AND STAINS SHALL BE APPLIED in such a manner so as not to cause deterioration of the building surfaces for the length of time specified by the paint or stain manufacturers' representations, if any. However, no action shall be brought pursuant to this paragraph more than FIVE YEARS FROM CLOSE OF ESCROW.

(12) The LANDSCAPING SYSTEMS shall be installed in such a manner so as to survive for not less than one year. However, no action shall be brought pursuant to this paragraph more than TWO YEARS FROM CLOSE OF ESCROW.

(14) DRYER DUCTS shall be installed and terminated pursuant to manufacturer installation requirements. However, no action shall be brought pursuant to this paragraph more than TWO YEARS FROM CLOSE OF ESCROW.

## **VI. JOINT AND SEVERAL LIABILITY**

### JOINT AND SEVERAL LIABILITY FOR PARTIES WHO DESIGN / CONSTRUCT "INDIVISIBLE" COMPONENTS:

➤ *Bobrow/Thomas Associates v. Superior Ct.*, (1996) 50 Cal.App.4th 1654.

The plaintiff owner hired the architect defendant to design a hospital. The

architect hired a prime contractor who hired subcontractor to install floors. The foundation slab failed partly due to a defective architect design and partly due to installation problems. The owner settled with all parties but the architect. The settling parties attempted to limit the architect's liability to design defects and not seek to recover for construction defects so settling parties' insurers would not have to indemnify the architect. The architect challenged the good faith determination.

The appeals court held that the owner can not divide its 'indivisible injury' into separate design and construction components, reversing the trial court. The injury was indivisible and therefore, the architect was jointly and severally liable with the contractors that installed the faulty drainage system that caused an indivisible injury (water damage) to the floors.

- "Under California law, defendants may be held jointly and severally liable for damages when there is one indivisible injury caused by two or more parties." *Id.* at 1661.
- "Where, as here, some joint tortfeasors settle, nonsettling defendants may be held liable for all the damages not satisfied by pretrial settlements, without regard to how a jury might have assigned fault among the defendants if none had settled." *Id.* at 1661.

## **VII. GOOD FAITH DETERMINATIONS – ALLOCATIONS**

### GOOD FAITH MOTIONS: ESSENTIAL ELEMENTS FOR GOOD FAITH ADJUDICATION

➤ *ALCAL ROOFING & INSULATION V. SUPERIOR COURT*, (1992) 8 Cal.App.4th 1121.

Crestview Condominium Association sued developer, Sears Saving Bank, and others for construction defects to a 227 unit development. Defects included: roofs, gutters, soil, foundations, landscaping. Developer cross complained against general contractor, architect, various subcontractors and suppliers involved in the project.

Under Special Master supervision, the Association settled with developer for \$4.4 million. Subcontractors paid \$1.3 million towards settlement. Only Alcal, the roofing subcontractor, did not settle. The settling parties agreed that \$100,000 of the \$4.4 million would cover roofing damages.

The court noted:

- Construction cases do not fit the usual pattern. In some, the amount of the offset is uncertain because the settled claims are for separate injuries, not all of which would be attributable to the conduct of the remaining defendants.
- There are settlements that are clouded by the inclusion of noncash

considerations into the settlement.

*Alcal* argued that this amount is unreasonably low and in bad faith. The *Alcal* court held that at a minimum, a party seeking confirmation must explain

1. Who has settled with whom.
2. The dollar amount of each settlement.
3. If any settlement is allocated.
4. How it is allocated between issues and or parties
5. What nonmonetary consideration is included
6. How the parties to the settlement value the nonmonetary consideration.

#### GOOD FAITH MOTIONS: ALLOCATIONS, VALUATIONS, ASSIGNMENTS

➤ *ERRECA'S V. SUPERIOR COURT*, (1993) 19 Cal.App.4th 1475.

The residential development consisted of 106 single-family homes in Encinitas, the Spyglass Project. Stone hired Erreca's to perform the grading. The complaint was a representative action filed by the homeowner's association (HOA) and a class action representing 88 of the homeowners. The complaint alleged strict liability, breach of warranty and negligence for construction defects. Plaintiffs amended their complaint to later include Stone and Erreca's as Doe defendants. HOA sought recovery for damages attributable to the negligent grading and filling of the developed lots, as well as damages caused by the defective construction of the residential structures. Costs to repair and diminution of value and stigma damages were alleged.

The HOA's preliminary repair costs were estimated at \$14,600,000. The developer's estimate was \$1,500,000. The HOA's settlement demand of \$8,500,000 was broken down as follows: \$6,500,000 for construction deficiencies in the residential structures, (nonsoils) and \$2,000,000 for damages arising from grading operations (the soils claims). The developers paid \$5,403,500 and the other settling parties paid \$1,096,500. The assigned claims were valued at \$300,000.

The *Erreca's* court held that there was an adequate evidentiary basis for \$1.5 million for the soils issues. The Special Master recommended an allocation of \$1.5 million. The *Erreca's* court also held that there was an adequate evidentiary basis for the valuation of \$300,000 to the assigned claims in light of the estimated costs to prosecute the claims, probability of prevailing on them and collection prospects. The court held that the assignment of rights did not amount to a double recovery, because the nonsettlers have been accorded a credit in the

direct action for the fair valuation of the assignment of rights.

Erreca's complained that the \$1,500,000 soils allocation together with the \$300,000 assigned claims should have provided a \$1,800,000 offset, instead of the \$500,000. The *Erreca's* court held that the trial court improperly applied comparative fault principles to limit the nonsettling defendants' credit of \$1.8 million to \$500,000. The *Erreca's* court granted the petitions for writs of mandate filed by two of the nonsettling defendants with directions to the trial court to vacate its order approving the settlement unless the order was modified to allow a \$1.8 million credit to the nonsettling defendants.

#### GOOD FAITH MOTIONS: ALLOCATIONS, VALUATIONS, OFFSETS, DOUBLE RECOVERY

➤ *Regan Roofing Company, Inc. v. Superior Court (Finkelstein)*, (1994) 21 Cal. App. 4th 1685.

Homeowners filed a construction defect action against the developer and many subcontractors, including roofing contractor, Regan Roofing. The Plaintiff and developer entered into a settlement for two million dollars and an assignment of developer's indemnity rights. The settling parties valued the assignment at \$5,000. The trial court found the settlement to be in good faith, pursuant to *Code of Civil Procedure* §877.6. Contractor Regan Roofing appealed the finding of good faith. The Court of Appeal affirmed except as to the evidence presented regarding valuation of the assigned claims. The Court of Appeal held that plaintiffs are entitled to collect on their direct construction claims and their assigned indemnity claims without fear of 'double recovery'.

- "In this court's recent published opinion in *Erreca's*, we discussed the two competing policies established by sections 877 and 877.6: (1) the equitable sharing of costs among the parties at fault; and (2) the encouragement of settlements." *Id.* at 1700.
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- "We believe the trial court was justified in concluding that the use of the pro rata formula to allocate settlement consideration among the various categories of defects was an adequate resolution of the credit or offset issue at the good faith settlement stage of the proceedings." *Id.* at 1704.
- Expert fee deduction: "It would be proper to view this \$250,000 expert expense as damages due for a portion of the cost of repair, which is an appropriate measure of damages in cases based on damage to real property." *Id.* at 1709.
- "Upon continued reflection, we confirm our initial approach to this matter in *Erreca's* was sound, as there is no possibility of 'double recovery' under these circumstances. The direct action for negligence and the derivative action for indemnity constitute wholly independent rights. A plaintiff who

recovers for negligent soils compaction directly from the soils subcontractor and who then recovers additional sums from that subcontractor by way of the assignment of the contractor's indemnity rights has not recovered twice, and the subcontractor has paid only once." *Id.* at 1703.

## **VIII. ARBITRATION, JUDICIAL REFERENCE, UNCONSCIONABILITY**

### ARBITRATION PROVISION UNCONSCIONABLE

➤ *Pardee Construction Co. v. Superior Court* (2002) 100 Cal. App. 4th 1081

The property owners bought single family entry-level residences from Pardee Construction Co. In buying those homes, the property owners signed agreements that included clauses waiving the property owners' rights to trial by jury and allowing for judicial reference. The property owners later sued the construction company for construction defects in the homes and underlying lots. The construction company sought to have appointed a judicial referee, and the trial court denied the motion. The construction company then sought a writ of mandate.

- The Court of Appeal evaluated whether the contract was one of adhesion. Pardee acknowledged that none of the hundreds of home purchasers struck out the judicial reference provision, effectively admitting the parties' agreements were adhesive. Further, as potential buyers interested in Pardee's entry-level homes, plaintiffs were unlikely to have significant economic bargaining power against developer Pardee.
- Moreover, since judicial reference provisions were contained in agreements for purchase of all homes in Pardee's large development, plaintiffs had little choice other than to sign those agreements as presented by Pardee. Pardee presented each buyer with "a take-it-or-leave-it proposition."
- The Court of Appeal recognized that each buyer was "buying a house," not "a piece of sporting equipment" and that "for most people" it is "the biggest purchase they will ever make in their life."

Because of the above, the Court of Appeal found that the parties' agreements were adhesive contracts. The Court of Appeal noted that even if the parties' agreements were deemed not to be adhesive, plaintiffs have established the judicial reference provisions of those agreements were unconscionable at the time such agreements were made.

The judicial reference provisions of the parties' agreements were procedurally unconscionable because (1) there was no real bargaining about

those provisions, (2) paragraph 15 was difficult to read and misleading, and (3) the agreements omitted mention of the economically significant matter of referee's fees.

The judicial reference provisions were also substantively unconscionable. Paragraph 15's terms effecting a waiver of the right to recover punitive damages, albeit potentially severable from the remainder of that paragraph, were substantively unconscionable as, in practical reality, only for Pardee's benefit.

Recognizing that a party may waive a right to a jury trial, Pardee had not shown that in San Diego County cases would be heard appreciably sooner in judicial reference than a court of jurisdiction or that proceedings once started in judicial reference would be appreciably shorter than in a jury trial that would in fact result in any significant saving of time or costs. Moreover, nothing in the record suggested that buyers otherwise gained anything from waiving their substantial constitutional right to a jury trial. Thus, since Pardee gave the buyers nothing in return for such waiver, the judicial reference provisions of the parties' agreements were so one-sided as to be substantively unconscionable.

#### ARBITRATION PROVISION IN CC&R'S UNCONSCIONABLE

➤ *Villa Milano Homeowners Association v. Il Davorge: (2000) 84 Cal.App.4th 819)*

Defendant developed Villa Milano condominium complex in Huntington Beach and recorded CC&R's governing property use and maintenance. The CC&R's created and governed the Villa Milano Homeowner's Association. Its terms held that the CC&R's were equitable servitudes against the property that bound all owners of interest, individually and as an Association. The CC&R's contained a binding arbitration clause that subjected construction and design defects to arbitration.

The Court of Appeal found that the arbitration clause was procedurally unconscionable. The Villa Milano CC&R's was drafted entirely by the developer and recorded years before the purchasers ever came to buy. There was no possibility that individual buyers could negotiated CC&R amendments. There was absolutely no opportunity to negotiate as to the terms of the CC&R's. As to the surprise component, the CC&R's are 70pages long and well buried in a heap of paper. In short, there was nothing to bring the purchaser's attention to the binding arbitration of disputes.

The Court of Appeal also found that the arbitration clause was substantively unconscionable. By agreeing to the CC&R's the homeowners waived their constitutional right to a jury trial by way of a stealthy device of the developer that is prohibited by public policy.

Public policy can be found in various constitutional and statutory provisions and in particular CC§'s 1298-1298.8 CC§'s 1298-1298.8 were enacted to ensure that arbitration clauses within real property sales contracts met certain requirements:

1. An arbitration clause must be clearly titled: "Arbitration of Disputes";
2. It must meet certain print size and capitalization requirements;
3. It must contain a prominent notice provision that is outlined in §1298, which must be initialed by parties if they agree to arbitration.

Defendant's attempts to deny purchasers' statutory rights, by using the CC&R's, which are not mentioned in §1298.7, to impose an arbitration scheme, conflicts with legislative intent to allow plaintiffs a judicial forum for these claims and shocks the conscience of the court.

The Department of Real Estate currently requires arbitration clauses in CC&R's to comply with California Code of Regulations, Title 10, § 2791.8. Although this regulation was enacted six years after defendant's CC&R's were recorded, the court found that § 2791.8 demonstrated an intent to make arbitration provisions in CC&R's fair.

The Association met its burden of showing that the arbitration clause violated public policy because; 1), the provision was hidden in a lengthy form, and 2), the defendant attempted to circumvent statutory homebuyer protections in construction and design defect claims.

#### JUDICIAL REFERENCE PROVISION ENFORCEABLE

- *Woodside Homes of California, Inc. v. Superior Court* (2003) 107 Cal.App.4th723.

Homeowners, original purchasers, brought a lawsuit against the builder. The builder moved to compel submission to judicial reference. The purchase agreement contained a provision that any lawsuit be submitted to *judicial reference* pursuant to Code of Civil Procedure §§638 (1), and 641 through 645.1.

Distinguishing *Pardee Construction Co. v. Superior Court* (2002) 100 Cal.App.4th 1081, the Court of Appeal held:

- The agreement was enforceable, because it lacked most, if not all, of the procedurally unconscionable factors found to exist in *Pardee*.
- Plaintiffs did not establish a high level of substantive unconscionability.

#### ARBITRATION - JUDICIAL REFERENCE NOT UNCONSCIONABLE

- *Greenbriar Homes Communities, Inc. v. Superior Court* (2004) 117 Cal. App. 4th 337

Plaintiffs are the owners of single-family residences. Of the 69 homes in the lawsuit, 43 were owned by plaintiffs who purchased their homes from Greenbriar. The remaining 26 purchased from Greenbriar's predecessor and thus were not in privity of contract with Greenbriar.

Greenbriar brought a motion to compel reference to a referee for all the homes. The trial court denied the motion on the ground that it would cause a multiplicity of actions.

The Court of Appeal initially determined that the reference provision was not procedurally unconscionable. There is no evidence the original parties had no meaningful choice not to agree to the reference, or that any of them attempted to negotiate this provision and were rebuffed. There also is no element of surprise in the provision. The provision is written clearly in the same sized font as the rest of the agreement, and is easily understood. The provision was not buried in the agreement, but in fact appeared at a location where the purchaser was almost certain to see it--immediately above where the purchaser would sign the agreement.

The Court of Appeal also held that the provision was not substantively unconscionable. Its terms were not so one-sided as to "shock the conscience," nor are they harsh or oppressive. It did not limit the amount or type of relief the original purchasers could obtain. By means of judicial reference, the provision attempted to ensure the parties would have their rights enforced and arguments resolved in as efficient and fair a manner available to them, consistent with the rules of procedure and evidence that apply to a trial. Even the referee's fees were to be shared equally.

The Court of Appeal minimized the risk of multiple actions proceeding in different forums, because Greenbriar contractually bound all of its subcontractors to join in actions against it no matter the forum. As a result, the trial court has the means both to enforce the valid reference provisions and to ensure a plaintiff's rights are not litigated concurrently in different forums.

The Court of Appeal also enforced the reference provision against the original purchasers. Relying on Code of Civil Procedure §1281.2, plaintiffs argued that the trial court had discretion not to enforce the reference provision. Greenbriar argued that since the provision was not unconscionable or otherwise invalid, the trial court had no authority to ignore the valid agreement between the parties on the basis of multiplicity of actions. The court of appeal agreed:

"Had the Legislature intended to allow judicial reference agreements to be invalidated on the basis of other pending or multiple actions, it could have adopted a statute so stating. Without such statutory authorization, however,

both the trial court and we lack authority to invalidate an otherwise valid contractual agreement." *Id.* at 348.

ARBITRATION: FEDERAL ARBITRATION ACT PREEMPTS CODE OF CIVIL PROCEDURE §1298.7

➤ *Basura v. U.S. Home Corp.*, (2002) 98 Cal.App.4th 1205.

Homeowners, original purchasers, brought a lawsuit against the developer. The purchase agreement contained an arbitration provision. The developer moved to compel arbitration arguing that the Federal Arbitration Act preempted Code of Civil Procedure §1298.7. The trial court denied the petition.

The Court of Appeal reversed. The Court of Appeal held:

- Section 1298.7 directly conflicted with section 2 of the Federal Arbitration Act.
- The transactions substantially affect interstate commerce implicating the FAA.
- The trial court should determine on remand whether the defendant should be bound even though defendant failed to initial the arbitration provision in 28 of the agreements.

## **IX. INSURANCE**

INCORPORATION OF DEFECTIVE PART CONSTITUTED "PROPERTY DAMAGE" UNDER POLICY

➤ *Armstrong World Industries, Inc. v. Aetna Casualty & Surety Co. et al.*, (1996) 45 Cal.App. 4th 1.

The court dealt with claims against an asbestos manufacturer for personal injury and property damage. The court held that installation of the insured's asbestos material constituted "physical injury" to the building, even before any release of asbestos fibers. Thus, where the defective work or material must be removed or repaired to comply with building code or health and safety standards, its presence or incorporation into the building constitutes "physical injury" to the building. i.e., the physical linking of the defective material to the building is the "physical injury."

"(P)hysical injury' covers a loss that results from physical contact . . . , as when a potentially dangerous product is incorporated into another and . . . must be removed, at some cost, in order to prevent the danger from materializing . . . (T)he damages allegedly suffered by the building owners from the presence of (asbestos materials) cannot be considered solely economic losses . . . The fact that the measure of damages is economic does not preclude a physical injury." *Armstrong* at 91-93.

*Armstrong* may not be limited to installation of toxic material (asbestos). The court cited with approval out-of-state cases relating to defective plumbing systems and defective heat exchangers. *Armstrong* at 92.

*Armstrong* may also not be limited to claims against a manufacturer or supplier. Its discussion of "property damage" could apply to anyone who causes property damage including the contractor or subcontractor who installed the defective material.

#### COVERAGE FOR DAMAGE TO PROPERTY OTHER THAN INSURED'S WORK / PRODUCT

➤ *Economy Lumber v. Insurance Co. of North America* (1985) 157 Cal.App.3d 641

Economy Lumber was the insured that manufactured defective siding that was sold to a general contractor, A&P, who installed it on single family residences. Within a day or two it became apparent that the siding had been milled. The pieces were not of uniform size and caused the exterior of the homes to take on a very unsightly appearance. The siding was unique in that it was rarely used in California and was essentially worthless for resale because of its defects. Economy Lumber estimated it would incur a loss of \$80,000 if A&P refused to keep the lumber. Economy and A&P agreed to use a small amount of the defective siding to finish eight houses and that Economy would "re-mill" the remaining siding at Economy's expense. The court held that there was an occurrence affecting the eight houses to which the siding was first applied. It was the initial application of the defective siding which caused unforeseen damage.

"Furthermore, a denial of coverage on the basis that additional defective siding was knowingly used to finish the 8 houses penalizes Economy Lumber for mitigating its losses, since the alternative option of replacing the flawed siding would have been most costly. The policy of the courts is to encourage mitigation of damages. See generally *Geddes & Smith v. St. Paul Mercury Indem. Co.* (1965) 63 Cal.2d 602, 605. . . ." *Id* at 648.

➤ *Hauenstein v. Saint Paul Mercury Indem. Co.* (1954) 242 Minn. 354.

In *Hauenstein*, the court allowed recovery for damage caused by the application of defective plaster. The damage was the loss in value of the building and the loss was found to be to "other property." The insured was the supplier and it was held he assumed liability only for damage to the defective product itself (the plaster) but not for the damage to the building.

➤ *Geddes & Smith, Inc. v. St. Paul Mercury Indem. Co.* (1959) 51 Cal. 2d 558, 565  
*Geddes & Smith, Inc. v. St. Paul Mercury Indem. Co.* (1965) 63 Cal. 2d 602, 605

Similarly in *Geddes I and II* the California Supreme Court allowed a contractor to recover from the insurer of his supplier the amount of a judgment he had obtained against the supplier of defective doors.

Geddes, a contractor, had ordered 760 aluminum doors, door jambs and hardware for a new housing development. The doors began to show severe defects after they had been installed: some fell out; some could not be closed; and some locked in place. The court in *Geddes I* reasoned that these defects caused property damage other than to the doors themselves:

"in the present case . . . it was necessary to remove the defective doors before they could be replaced, thus permitting recovery for damages to the homes. "In addition to the cost of removal of the doors and loss of use of the houses, it included the other cost of handling the defective doors and their replacements." *Id* at 885

Also see *Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.* (2000) 78 Cal. App. 4th 847 (coverage permitted for wood splinters that contaminated nut clusters in breakfast cereal) But see *F&H Construction b. ITT Hartford Ins. Co.* (2004) 118Cal.App.4<sup>th</sup> 364 (under-designed steel pile caps did not constitute physical damage to tangible property because the only injury shown was the welded structure's failure to perform as intended – welding the caps to the piles did not damage the piles or any other property) *Goodyear Rubber & Supply Co. v. Great American Ins. Co.* (9th Cir. 1973) 471 F.2d 1343, 1344-46 (ship's defective hatch gaskets constitute property damage); *University Mechanical Contractors, Inc. v. Puritan Ins. Co.* (1986) 150 Ariz. 299, 302-03 (damage from installation of faulty O-rings into a pipe system constitutes property damage; *Marathon Plastics, Inc. v. International Ins. Co.* (1987) 161 Ill.App.3d 452, 461-65 (defective pipe and gaskets that were integrated into a water system constitute property damage); *Thomas J. Lipton, Inc. v. Liberty Mutual Ins. Co.*, (1974) 34 N.Y.2d 356, 359-60 (contaminated macaroni noodles destroyed soup).

#### CONTINUOUS OR PROGRESSIVE PROPERTY DAMAGE OR PHYSICAL INJURY

➤ *Montrose Chemical v. Admiral Insurance*, (1995) 10 Cal.4th 645.

California cases have taken different positions under "occurrence" policies as to what fact or event "triggers" the insurer's duties to indemnify and/or defend the insured. The issue is largely one of timing--what must take place within the policy's effective dates for the potential of coverage to be 'triggered'?" The Supreme Court held:

- Where losses are of a progressive and continuing nature and successive policies are on the risk, each policy in effect when the loss or damage occurred has the duty to provide a defense to the insured. *Id.* at 666.

#### CONTINUOUS PROPERTY DAMAGE WITH MULTIPLE CARRIERS

➤ *Ins. Co. of North America v. Nat'l American Ins. Co. of California*, (1995) 37 Cal. App.4th 195.

The case involves a dispute between two insurance carriers that insured a single insured. The insured was the roofing contractor on a condominium project and the roofing failed. *NA/CC* provided coverage for the first two years and *INA* provided coverage for the next two years. *INA* sought reimbursement because part of the property damage was manifested during *NA/CC*'s policy periods. Under these cases, all "on risk" insurers, from the first exposure until the time the property damage ceases, is liable, with the loss equitably allocated among all liable carriers.

The court noted that the condominium project was built in nine phases. The first three phases were completed during *NA/CC*'s policy periods. *NA/CC* argued that only its first policy was implicated based on the manifestation rule. Relying on *Montrose*, 10 Cal.4th 645, the court remarked:

- The key issue is whether property damage occurred during the policy period. A key predicate to deciding which policy is implicated is that some damage has actually been suffered during the relevant policy period and correctly ruled that both of *NA/CC*'s policies were implicated.

#### COVERAGE FOR PROPERTY DAMAGE CAUSED BY WORK OF SUBCONTRACTORS.

➤ *Maryland Casualty Co. v. Reeder*, (1990) 221 Cal.App.3d 961.

The liability insurance company for the property owner, brought suit against its insureds alleging that there was no coverage for soil subsidence that damaged condominiums. The insurer held that the plaintiff homeowners and association had not alleged property damage within the meaning of the property damage provisions of the policy. The court noted that plaintiff homeowners and association had alleged that soil subsidence had cracked concrete floor slabs, foundations, retaining walls, interior and exterior walls and ceilings and exterior concrete patio areas and had alleged that the roofing system allowed rain water to damage building structures and the contents of living areas. The court held:

- This damage constituted "physical injury to or destruction of tangible property."

The insurer also argued that there was no coverage because of the "products exclusion" contending that the products exclusion applied to the entire condominium project. The court rejected the contention.

- The insureds provided services, not a product. In addition, the insurer claimed there was no coverage because the condominiums constituted the work and the insureds had no coverage for the work they performed. The court held that the broad form endorsement was designed to provide coverage for damage to the insured's work which resulted from the negligence of the insured's subcontractors. *Id.* at 971-74.

### COVERAGE FOR BREACH OF CONTRACT CLAIM

- *Vandenberg v. Superior Court*, (1999) 21 Cal.4th 815.

An insured sued two CGL insurers for refusal to defend and indemnify an underlying action arising out of contamination of the soils and groundwater underlying the property. Following an arbitration and confirmation of the award in a superior court judgment that awarded damages for breach of lease, insurers rejected Vandenberg's request for indemnification on the ground that the CGL policy did not cover losses pled as contractual damages.

Overruling a long line of decisions, the Supreme Court held that it was the nature of the damage and risk that control coverage, not the form of the legal action. The Supreme Court based its decision on the phrase "legally obligated to pay as damages" is broad enough to include damages that the insured is obligated to pay for breach of contract as well as tort.

### HORIZONTAL EXHAUSTION

- *Community Redevelopment Agency v. Aetna Casualty*, (1996) 50 Cal.App.4th 329.

In a continuous or progressive loss case, the issue is when does a primary insurer exhaust its policy limits requiring an excess or umbrella insurer to drop down and defend the insured. Based upon the language of the policy, the Court of Appeal adopted a horizontal exhaustion approach. The excess carrier had no duty to drop down and defend the insured until the insured had exhausted the limits of all its primary insurance policies.

### ADDITIONAL INSURED COVERAGE

- *Pardee Construction Co. v. Ins. Company of the West*, (2000) 77 Cal.App.4th 1340.

Pardee was the developer and general contractor for a multi-phase condominium project. Pardee hired subcontractors to construct and install each of the components and in the subcontracts the subcontractors were to name Pardee as an additional insured for work on the project including completed operations. After Pardee was sued, Pardee tendered the defense of the lawsuit to each insurer. Eventually Pardee settled the lawsuit and then sued the insurers who had refused to defend and indemnify it.

The Court of Appeal interpreted the language of the additional insured endorsements, concluded that the language was unambiguous and provided Pardee with coverage for the completed operations of the named insured

subcontractors. The Court of Appeal noted that the insurers could have limited coverage by express language that coverage was limited to claims arising from work performed during the policy period and that in 1993 the Insurance Services Office revised the language of the endorsement to restrict coverage to "ongoing operations."