

# CONSTRUCTION DEFECT - INITIAL OVERVIEW

## I. RECOVERY FOR DEFECTS WITHOUT DAMAGES

### WARRANTY CLAIMS

- 1) Prior to the Supreme Court's decision in *Aas v. Superior Court* (2000) 24 Cal. 4<sup>th</sup> 627, the use of express and implied warranty causes of action were all but forgotten. The post *Aas* state of construction defect litigation reveals that warranty claims are alive and well in California for recovery on defects that have not yet resulted in property damage.
- 2) California courts have determined that warranty law ensures that the consumer receives a product that is of a reasonable quality and functions in a reasonable manner.
- 1) EXPRESS WARRANTY - CONTRACT DOCUMENTS: Contract documents often warrant how the work will be performed. A.I.A. General Conditions, Art. 4.5.1 (1976 edition) is an example of a generally-accepted provision:

*The Contractor warrants to the Owner and the Architect that all materials and equipment furnished under this Contract will be new unless otherwise specified, and that all Work will be of good quality, free from faults and defects and in conformance with the Contract Documents. All Work not conforming to these requirements, including substitutions not properly approved and authorized, may be considered defective*

An Illinois appellate court held that a contractor's warranty that the repairs would result in a leak-proof roof was breached when the roof leaked. *Miller v. Racine Trust*, 65 Ill.App.3d 207, 214-215; 382 N.E. 2d 41 (1978).

2. MANUFACTURERS EXPRESS WARRANTIES: Liability on a theory of express warranty may be based upon brochures supplied by the manufacturer.

In *Herman v. Bonanza Buildings, Inc.*, 223 Neb. 474; 390 N.W.2d 536 (1986), a manufacturer had prepared a brochure given to the owner extolling the virtues of the steel building and expressly promising that the manufacturer "*would replace or repair defects resulting from poor workmanship.*" The brochure created an express warranty, such that the statements became part of the basis of the bargain. *Id.* at 483-484.

In *Little Rock School District of Pulaski County v. Celotex*, 264 Ark. 757; 574 S.W.2d 669 (1979), an architect prepared the plans and specifications based upon information supplied to the architect by the manufacturer that the two-ply system was the equivalent of a four-ply conventional roof, would be bonded for up to 20 years, and would provide excellent weather protection. *Id.* at 763. The roof began leaking almost immediately. The Court held that these representations were sufficient to submit the issue of breach of express warranty to a jury. *Id.* at 766-767.

4. BREACH OF IMPLIED WARRANTY: The most common implied warranties are:
  - 1) Implied warranty of reasonable workmanship
  - 2) Implied warranty of habitability
  - 3) Implied warranty of fitness

## CONSTRUCTION DEFECT - INITIAL OVERVIEW

- 4) Implied warranty of merchantability
- 5) Implied warranty of quality
5. *Pollard v. Saxe & Yolles Development Co.*, 12 Cal. 3d 374; 115 Cal.Rptr. 648 (1974) was the first California case to apply the Uniform Commercial Code doctrine of implied warranties of quality and fitness to commercially owned property.
  - 1) In *Pollard*, apartment units in a complex suffered physical damage caused by the contractor's removal of center posts and installation of undersized headers and inadequate support beams.
  - 2) The court held that if timely notice is given, "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." *Green v. Superior Court*, 10 Cal. 3d 616; 111 Cal.Rptr. 704 (1974); *Kuitens v. Covell*, 104 Cal. App. 2d 482; 231 P.2d 552 (1951).
6. CONTINUED APPLICATION OF IMPLIED WARRANTY: Since *Pollard*, California courts have applied implied warranty concepts to the construction and sale of residential and commercial real property. An important limitation is that the implied warranties may only apply to *new construction*. *East Hilton Drive Homeowners' Ass'n v. Western Real Estate Exchange*, 136 Cal. App. 3d 630; 186 Cal.Rptr. 267 (1982).
7. BREACH OF IMPLIED WARRANTY ALLOWS RECOVERY FOR ECONOMIC DAMAGES: Prior to the *Aas* decision, construction defect lawyers all but forgot about the breach of implied warranty cause of action. Because recovery of economic damages is allowed under warranty law, implied warranty causes of action will become more important than ever.
  - a) In *Hicks v. Kaufman & Broad Home Corp.* (2001) 89 Cal. App. 4<sup>th</sup> 908, the Plaintiff / Homeowners had "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.
    - (a) The *Hicks* Court allowed the claims for both express and implied warranty to go proceed.
    - (b) Phrased as a question of malfunction rather than manifest property damage, the court held that 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.
    - (c) *Hicks* cites *Aas* as supporting a recovery in warranty of costs to repair defects that have not resulted in property damage.
    - (d) Rationale: Plaintiffs' warranty right was to a defect-free product, the defect itself is the injury, and the remedy is the cost of replacement.

## CONSTRUCTION DEFECT - INITIAL OVERVIEW

8. NO PRIVITY REQUIRED: Although the general rule is that a cause of action for breach of implied warranty requires privity of contract, *Civil Code* §1559 and the cases interpreting it permit a third party beneficiary of a contract to bring a cause of action for breach of implied warranty. *Gilbert Financial Corp. v. Steelform Contracting Co.* (1978) 82 Cal. App. 3d 65.
9. DOES NOT APPLY TO DESIGN PROFESSIONALS: In the absence of an express warranty, warranty claims do not apply to services performed by design professionals (i.e. architects, engineers). *Gagne v. Bertran* (1954) 43 Cal. 2d 481. Courts view design professionals as providers of services and the general rule is that those who sell their services for the guidance of others are not liable in the absence of negligence or intentional misconduct. *Allied Properties v. John A. Blume & Assoc.* (1972) 25 Cal. App. 3d 848.
10. NOTICE REQUIREMENT: The Supreme Court has imposed that notice be given to a defendant before an implied warranty claim will lie. Notice is required because it gives one the opportunity to repair the defective item, reducing damages, avoiding defective products in the future, and negotiating settlements. *Pollard v. Saxe & Yolles Development Co.* (1974) 12 Cal. 3d 374.

## II. RECOVERY FOR DEFECTS WITHOUT DAMAGES

### CONTRACT CLAIMS

1. CONTRACT: Parties may also recover economic damages under contract causes of action. Contract remedies are available whether or not the welds have fractured or shown any other manifestation of physical damage, if “ductile” weld metal was specified for the building and “brittle” weld metal was substituted. Economic damages are recoverable under both breach of contract and express warranty theories. *Seely v. White Motor Co.*, 63 Cal.2d 9; 45 Cal.Rptr. 17 (1965).
2. TYPES OF BREACHES: The language of a construction contract may impose liability on a general contractor for substituting materials that are not equal to or better than materials called for in the plans or specifications. Thus, breach of contract liability may exist on the basis that inferior materials were substituted.
  - 1) EQUAL OF BETTER SUBSTITUTIONS: Washington and Oregon courts have held that substitutions that were not equal to or better than the materials specified in the contract constituted a material breach of contract.

In *Beik, et al. v. American Plaza Co., et al.*, 280 Or. 547; 572 P.2d 305 (1977), there was liability where the sales agreement provided that the condominiums would be built according to the plans and

## CONSTRUCTION DEFECT - INITIAL OVERVIEW

specifications and the developer substituted sliding glass doors and air conditioning units, and the windows leaked. *Id.* at 559.

- 2) SUBSTITUTION OF SPECIFIED MATERIALS: The following are cases where substitution of specified materials constituted a breach of contract:
  - (1) In a Washington case, liability was imposed where the contractor substituted Perlite light-weight aggregate in place of the specified sand. In *City of Seattle v. Kuney, et al.*, 50 Wash.2d 299; 311 P.2d 420 (1957), the court held that although the architect approved the substitution, the material was nevertheless improper, because the *contractor guaranteed that the substitute material was equal or better in all respects than the material specified and it was not.* *Id.* at 302-303.
  - (2) INSULATION AND DRAINS: In a New York case, a contractor was ordered to pay the cost of installing styrofoam insulation and footing drains called for by the contract but which the contractor thought were unnecessary and did not install. *Roudis v. Hubbard*, 176 A.D. 2d 388, 389; 574 N.Y.S. 2d 95 (1991).
  - (3) CAST IRON SEWER LINE: In *Midland Motels, Inc. v. Central Plumbing & Heating Company*, 252 So.2d 729 (La. App. 3d Cir. 1971), the Louisiana Court of Appeal held that the evidence supported liability where the plans and specifications had called for the outside sewer piping to be cast iron and the contractor had installed a clay pipe that sagged and collapsed in the area of a motel driveway. *Id.* at 731.
  - (4) ROOFS AND FLOORS: In Colorado, the court held that the contractor's construction of a roof and floor failed to comply with plans and specifications, where the contractor installed a 15 year roof instead of the specified 20 year roof; roof joists were not constructed as shown on the plans; the floor was not constructed to the thickness specified in the plans; the contractor had not installed stone or gravel under the floor; and the wire mesh was not properly imbedded in the concrete. *Summit Construction Co. v. Yeager Garden Acres, Inc.*, 28 Colo. App. 110, 118-119; 470 P.2d 870 (1970).
- 3) MATERIAL DEVIATIONS: In *Shell v. Schmidt*, 164 Cal.App.2d 350; 330 P.2d 817 (1958), the general contractor was found to have made "*material*" deviations from the plans and specifications by substituting lath paper and chicken wire for wood sheathing on the exterior walls, by substituting one 35,000 B.T.U. capacity furnace for two 30,000 B.T.U. unit furnaces, and by substituting sheet rock with tape joints on interior walls for gypsum lath and plaster. *Id.* at 358.
- 4) FAILURE TO CONFORM WITH CONTRACT DOCUMENTS: In *Idaho State University v. Mitchell*, 97 Idaho 724, 552 P.2d 776 (1976), the Supreme Court of Idaho reviewed A.I.A. Document 201. Noting that Article 13.2.2 deals with work *not in accordance with the contract*

# CONSTRUCTION DEFECT - INITIAL OVERVIEW

*documents*, the court remarked that the contract “appears to impose liability without fault in claims arising under this provision.” *Id.* at 728 (emphasis added.). Thus, the owner needs not prove negligence of the contractor. *The contractor is liable for damages incurred because of work that does not conform to the contract documents.*

## I. PRODUCTS LIABILITY

1. DEFECT DEFINITION: Although California courts separate manufacturing defects from design defects, they have refused to limit the definition of a defect. *Barker v. Lull Eng'g Co.*, 20 Cal.3d 413; 143 Cal.Rptr. 225 (1978).
  - 1) MANUFACTURING DEFECTS: Manufacturing defects are those defects which deviate from the manufacturer's intended result. For example, a broken gear tooth constituted a manufacturing defect in *Montez v. Ford Motor Co.*, 101 Cal.App.3d 315; 161 Cal.Rptr. 578 (1980).
  - 2) DESIGN DEFECTS: Design defects involve either products that fail to perform as safely as the ordinary consumer would expect (consumer expectation test) *Campbell v. General Motors*, 32 Cal.3d 112; 184 Cal.Rptr. 891 (1982) or products as to which the *risk of danger inherent in the design outweighs the benefits of the design* (risk / benefit test). *Barker v. Lull Eng. 'g Co.*, *supra*, 20 Cal.3d 413.
  - 3) CONSUMER EXPECTATION TEST: If a product is something that an ordinary consumer would use, the consumer expectation test is the proper test to determine whether a design defect exists. For example, an ordinary consumer would not expect air bag inflation in a low speed collision to break the driver's arm. *Bresnahan v. Chrysler Corp.*, 32 Cal.App.4th 1559; 38 Cal.Rptr. 2d 446 (1995).
  - 4) NO CONSUMER EXPECTATION: But, not all products are subject to ordinary consumer expectations.. Some products are so complex that a consumer may not have any minimum assumptions about its safe performance. In such a case, the risk benefit test applies. *Soule v. General Motors Corp.*, 8 Cal. 4th 548; 34 Cal.Rptr. 2d 607 (1994).
2. CONSTRUCTION DEFECTS: Defects in construction cases are not merely deviations from plans and specifications, but can be established in a variety of ways including but not limited to:
  - 1) INADEQUATE INSTALLATION: A developer can be strictly liable for poor materials selection and faulty construction techniques, for example where the defect was an incorrectly installed radiant heating system in the building's cement floor. *Kriegler v. Eichler Homes, Inc.*, 269 Cal.App.2d 224; 74 Cal.Rptr. 749 (1969).
  - 2) CONSTRUCTION OF BUILDING PADS IN WRONG LOCATION: A developer can be strictly liable for placing a nondefective product in the wrong place. In a California case, neither the condominiums nor their component parts were defective, however, they were built on unstable soils and the court found the improper location to constitute a “defect.”

## CONSTRUCTION DEFECT - INITIAL OVERVIEW

*Del Mar Beach Club Owners Association v. Imperial Contracting Co.*, 123 Cal.App.3d 898; 176 Cal.Rptr. 886 (1991)

- 3) NON DEFECTIVE COMPONENT PLACED IN WRONG LOCATION: A product may function safely in one location or use but the product, though faultlessly made, may not function safely in another location or use and therefore be defective. See, *Hyman v. Gordon*, 35 Cal.App.3d 769; 111 Cal.Rptr. 262 (1973).
  - 4) DEVIATIONS FROM THE PLANS AND SPECIFICATIONS: Even if a product is not inherently defective, the manner of installation can be defective. Where the *drainage and irrigation system installed varied from the plans and specifications* the court found the deviation from the plans and specifications constituted a defect and awarded the association cost of repairs. *Raven's Cove Townhomes, Inc. v. Knuppe Development Co.*, 114 Cal.App.3d 783; 171 Cal.Rptr. 334, (1981).
  - 5) DEFECTIVE MATERIALS FOR IMPROPER APPLICATION: A manufacturer was held liable where a defective 'aluminum 380' gearbox contributed to an auto accident. The gearbox material was held defective *for that purpose* because of high engine heat and because malleable iron which could have been used, was stronger and less likely to fail. Plaintiff successfully introduced evidence that three years after the accident defendant substituted malleable iron for aluminum 380. The court held that the evidence of the substitution was admissible. *Ault v. International Harvester Co.*, 13 Cal. 3d 113; 117 Cal.Rptr. 812 (1974).
3. PRODUCTS LIABILITY FOR "MARKETING ACTIVITIES": While numerous cases have applied strict liability to the developer or owner of a building, the first California case to apply strict liability to a manufacturer of a *non-defective* building component was based on the manufacturer's marketing activities and involvement in creating a market for a new product.
- 1) In *Bay Summit Community Association v. Shell Oil Co., et al.*, 51 Cal.App.4<sup>th</sup> 762; 59 Cal.Rptr. 2d 322 (1996) after installation of polybutylene plumbing in a condominium project, the homeowners began to experience leaks in the plumbing systems. The polybutylene resin for the pipes was supplied in pellet form by Shell and was not defective. The homeowners association sued the developer, the two manufacturers of the plumbing system and Shell. Although *there was no evidence of a defect in the resin pellets* manufactured by Shell, the Court of Appeal held that Shell could be strictly liable if:

*"(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."* *Id.* at 776.
4. COMPONENT PART DOCTRINE:

## CONSTRUCTION DEFECT - INITIAL OVERVIEW

- 1) RECOVERY ALLOWED WHERE DEFECTIVE COMPONENT PART CAUSES INJURY TO STRUCTURE: In *Stearman v. Centex Homes* (2000) 78 Cal. App. 4th 611, plaintiff homeowners sued the developer in strict liability for defective foundation construction, resulting in slab deformation that caused extensive cracks throughout interior and exterior of homes.
  - (a) Plaintiffs alleged defective component part caused injury to other parts of home, but not to property apart from the structure. Defendant asserted this was only “injury to the product itself,” thus prohibiting recovery under the economic injury rule.
  - (b) Court found that damage to the other parts of the home falls outside economic loss and recovery in strict liability is allowed.
- 2) RECOVERY ALLOWED FOR SINGLE PURPOSE COMPONENT PART: In *Acosta v. Synthetic Industries, Inc.* (2001) 88 Cal. App. 4<sup>th</sup> 944 (Review granted 8/15/01), Plaintiff homeowners sued Synthetic Industries, the manufacturer of Fibermesh, used in slab foundations of the home. Synthetic represented that Fibermesh can be used as an adequate substitute for welded wire mesh. Synthetic also represented that Fibermesh was the substantial equivalent of welded wire mesh for slabs. In reality, Fibermesh causes more cracking than traditional wire mesh. The Court of Appeal held that the component part doctrine did not bar a strict liability claim.
  - (a) The *Acosta* Court distinguished *Artiglio v. General Electric* (1998) 61 Cal. App. 4<sup>th</sup> 830 in the following ways:
    - (i) Fibermesh is a single purpose product used only in the construction of concrete structures.
    - (ii) Builders are sophisticated, but were unable to know the unsuitability of Fibermesh because of Synthetic’s marketing involvement and materials.
    - (iii) Contractors did not alter or change the Fibermesh or its intended function. Any change was intended by Synthetic.
- 3) RECOVERY MAY NOT BE ALLOWED WHERE COMPONENT PART HAS MANY PURPOSES: In *Artiglio v. General Electric Co.* (1998) 61 Cal. App. 4<sup>th</sup> 830, GE manufactured silicone pellets that Dow Corning incorporated into breast implants. The court applied factors derived from the “raw material supplier defense” and “the bulk sales / sophisticated purchaser rule” to determine that GE is not liable to the ultimate consumer for the silicone pellets, which are only dangerous when used in breast implants.
  - (a) GE expressly informed implant manufacturer of its responsibility to assess suitability of silicone for medical purposes.
  - (b) Silicone pellets are significantly altered during the breast implant manufacturing process.
  - (c) GE did not exert any control over design, testing, or labeling of implants.

## CONSTRUCTION DEFECT - INITIAL OVERVIEW

### 5. RESIDENTIAL VERSUS COMMERCIAL CONSTRUCTION:

- 1) SINGLE FAMILY HOMES AND PLANNED DEVELOPMENTS: In *Kriegler v. Eichler Homes, Inc.*, *supra*, 269 Cal.App.2d 224, the court extended the doctrine of strict liability to builders and developers of mass-produced single family residences. In *Del Mar Beach Club Owners Ass'n v. Imperial Contracting Co.*, *supra*, 123 Cal.App.3d 898 the court further extended the doctrine to multi-unit, residential, planned development complexes.
- 2) BUILDERS AND DEVELOPERS OF COMMERCIAL BUILDINGS: California courts have not yet had occasion to apply the doctrine of strict liability to developers or builders of commercial structures. The same rationale however, would appear to apply, since the buyer relies on the builder's skill and expertise to insure that the building is built in a workmanlike manner and is reasonably fit for its intended purpose, and the buyer did not participate in or observe the design and construction.

5. JURY INSTRUCTIONS: Strict liability attaches for an injury proximately caused by a design or manufacturing defect which existed when the article left possession of the seller, provided that the injury resulted from a use of the article that was reasonably foreseeable by the seller. *BAJI Jury Instruction No. 9.00* (7<sup>th</sup> ed., 1994).

### **IV. GENERALLY NO RECOVERY FOR ECONOMIC DAMAGES IN TORT**

- 1) NEGLIGENCE RECOVERY FOR ECONOMIC LOSS: In California, defects that do not cause actual physical damage are classified as economic damages. Economic damages are not normally recoverable in products liability cases. However, California courts allow negligence recovery for economic damages, if a "special relationship" is shown by application of 6 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; and, 6) the policy of preventing future harm. *J'Aire Corp. V. Gregory* 24 Cal.3d 799,806 (1979); *Huang v. Garner* 157 Cal.App.3d 404, 419-420; 203 Cal.Rptr. 800 (1984); *Fieldstone Co. v. Briggs Plumbing Products Inc.* 54 Cal.App.4<sup>th</sup> 357,(1997)
- 2) RECOVERY ALLOWED WHERE DEFECTIVE COMPONENT PART CAUSES INJURY TO STRUCTURE: If a component part in a home causes damage to other parts of the structure, this is not considered economic loss, allowing recovery in tort. In *Stearman v. Centex Homes* (2000) 78 Cal. App. 4th 611, plaintiff homeowners sued the developer in strict liability for defective foundation construction, resulting in slab deformation that caused extensive cracks throughout interior and exterior of homes.
  - (a) Plaintiffs alleged defective component part caused injury to other parts of home, but not to property apart from the structure. Defendant asserted this was only "injury to the product itself," thus prohibiting recovery under the economic injury rule.

## CONSTRUCTION DEFECT - INITIAL OVERVIEW

(b) Court found that damage to the other parts of the home falls outside economic loss and recovery in strict liability is allowed.

### 3) COMPARE - NO NEGLIGENCE RECOVERY FOR ECONOMIC LOSS:

- a) In *Aas v. Superior Court* (2000), the California Supreme Court upheld the economic loss rule for negligence claims and maintained the line between tort and contract/warranty claims by rejecting a negligence cause of action for defects that had not yet caused appreciable physical damage.
  - i) Plaintiffs sought tort and contract remedies for defects that had not yet caused damage, including inadequate shear walls and discolored drain stoppers, and building code violations.
  - ii) Held: Until and unless defect sustains actual damage, there is no tort cause of action.
  - iii) *Aas* Court ruled that *J'Aire* special relationship factors had not been met.

4) INSURANCE: Economic damages may be excluded from third party insurance coverage under standard CGL policies as “*economic losses.*” This is because the definition of property damage requires “*physical injury to or destruction of tangible property.*” *Maryland Casualty Co. v. Reeder*, 221 Cal.App.3d 961, 968-971; 270 Cal.Rptr. 719 (1990).

## V. INVESTIGATIVE COSTS AS DAMAGES

### 1) INVESTIGATIVE COSTS TO FORMULATE REPAIR ARE RECOVERABLE AS DAMAGES:

- Because tort damages are designed to make the Plaintiff whole, expert costs incurred to investigate and formulate an appropriate repair plan are recoverable as part of the cost of repair. *Stearman v. Centex Homes* (2000) 78 Cal. App. 4<sup>th</sup> 611.
- a) *Stearman* Court relies on language in *Regan Roofing Co. v. Superior Court* (1994) 21 Cal. App. 4<sup>th</sup> 1685: “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.
  - b) Though *Regan Roofing* was a good faith settlement case, *Stearman* Court finds no distinction between settlement and trial cases.
  - c) Expert costs that are purely litigation related must be segregated from the recoverable expert costs per *Stearman*.