

# TOP CALIFORNIA CONSTRUCTION CASES 2011

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

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IMPLIED WARRANTY 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: Under implied warranty plaintiff had the right to a defect-free product, the defect itself is the injury, and the remedy is the cost of repair.

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 - UNCONSCIONABILITY

*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?*

#### UNCONSCIONABILITY IN DISCLAIMING DESIGN AND INSTALLATION

➤ *A & M Produce Co. v. FMC Corp.*, (1982) 135 Cal.App.3d 473.

A produce company brought suit against an agricultural equipment company from which it had bought a weight sizing machine, alleging breach of express and implied warranties. The machine had been purchased for use in processing the plaintiff's tomato crop and the action arose when it failed to operate properly, causing loss of the crop.

At trial, the court ruled that clauses in defendant's preprinted contract disclaiming all warranties and excluding consequential damages were unconscionable and evidence of such provisions was not presented to the jury. A general verdict in plaintiff's favor was returned by the jury, and the trial court awarded plaintiff attorney fees and prejudgment interest. The Court of Appeal affirmed.

The Court of Appeal first held that the doctrine of unconscionability was applicable to the warranty disclaimer, even though the Uniform Commercial Code (UCC) section on unconscionability had not been adopted as part of California's Commercial Code, since unconscionability is a common law doctrine which may be applied in the absence of specific statutory authorization. Moreover, Civil Code, §

1670.5, which is applicable to all contracts, contains language identical to the UCC section.

The Court of Appeal also held that the warranty disclaimer and the exclusion of consequential damages were properly found to be unconscionable, noting that procedural unconscionability requirements were satisfied in that:

- both clauses appeared on the back page of a long preprinted contract,
- the parties did not enjoy equal bargaining power, and
- defendant's salesmen were not authorized to negotiate any of the terms appearing on the reverse side of the contract.

As to substantive unconscionability, the court held that the disclaimer and exclusion of damages were both unreasonable under the circumstances. When non-negotiated terms on preprinted form agreements combine with disparate bargaining power, resulting in the allocation of commercial risks in a socially or economically unreasonable manner, the concept of unconscionability furnishes legal justification for refusing enforcement of the offensive result. *Id.*, at 493.

#### UNCONSCIONABILITY OF RELEASE, COMPELLING ARBITRATION

➤ *Lhotka v Geographic Expeditions Inc.*, (2010) 181 Cal.App.4th 816.

Jason Lhotka, 37 years old, died from altitude illness while on a GeoEx expedition up Mount Kilimanjaro with his mother, Sandra Menefee. Both Lhotka and Menefee signed a release form as a requirement of participating in the expedition, both lived in Colorado. It released GeoEx from all liability in connection with the trek and waived any claims for liability “to the maximum extent permitted by law”. Customers also had to agree to arbitration with a maximum recovery of the sum of the land and air cost, and to fully indemnify GeoEx for all of its costs (including attorneys' fees) if action or claim filed against GeoEx.

GeoEx' release form was mandatory and unmodifiable. It told plaintiffs that any other travel provider would impose the same terms. It required customers to execute an arbitration agreement on a take-it-or-leave-it basis. GeoEx argued that plaintiffs could have chosen not to sign on with the expedition. That option, like availability of market alternatives, is relevant to the existence, and degree, of oppression.

The fact that the recreational activity (mountain climbing) was not a "necessity" such as employment or medical care, was a factor bearing on the question of procedural unconscionability but was not dispositive. Plaintiffs (decedent's survivors) made a showing of at least a minimal level of oppression to establish that the agreement was procedurally unconscionable. 181 CA4th at 821-824.

Likewise, the recreation company's arbitration provision was substantively unconscionable for numerous reasons (limits on damages, an indemnity provision calling for payment of the company's legal fees in certain

circumstances, absence of agreement as to the sharing of arbitration costs, and lack of mutuality). *Id.* at 824-826.

SUBCONTRACTOR LIABILITY TO OWNERS WITHOUT PRIVACY AND GENERAL CONTRACTOR

- *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.

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.

## INTENDED THIRD PARTY BENEFICIARY OF CONTRACT CAN RECOVER ATTORNEYS' FEES

➤ *Loduca v. Polyzos* (2007) 153 Cal.App.4th 334.

Plaintiff property owner sued as a third party beneficiary to enforce a construction contract between a subcontractor and the general contractor. The owner paid the subcontractor directly. And the subcontractor in all likelihood understood that the party most likely to sue on the contract was the owner.

Furthermore, the text of the contract expressly referred to the owner and stated that the subcontractor's work (cabinetry) was to be built according to plans developed for the owner's residence. The contract contained the following clause:

"If a court action is brought, prevailing party to be awarded attorneys fees and collection costs..."

The Court of Appeal found that the owner was an intended third party beneficiary of the contract and affirmed a trial court award of attorneys' fees.

## 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.

The 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 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. 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.”
- Damages in strict liability for recovery of “physical damage to the truck itself” was denied because plaintiff was unable to prove causation. Had causation been shown, Seely could have recovered for damage to the product 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.” *Id.*, at 19.
- Finally, in *dicta*, *Seely* stated that “even in actions for negligence a manufacturer’s liability is limited to damages for physical injuries and there

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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.

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.

#### RECOVERY FOR DAMAGES TO THE PRODUCT ITSELF

➤ *Sabella v. Wisler*, (1963) 59 Cal.2d 21, 29-30.

Here, the California Supreme Court rejects argument that there must be damage to something other than the home. Wisler, an experienced homebuilder, built a speculation house on property that superficially seemed to be natural ground but was actually partly uncompacted fill at a 1953 quarry site where a substantial pit was excavated. When rains filled the pit with water, it was used as a swimming pond, and also as a dumping place.

The fill was placed but not compacted or consolidated. Wisler did nothing to investigate the quality of the fill and built the home without a soils inspection. He excavated through 24 inches of “bad fill” to install the foundation footings. Wisler should have, but did not, discover the existence of the fill during the digging for footings. Sabella purchased the house in 1955. Sabella’s National Union all risk policy was issued in 1957, with the following exclusion:

This endorsement does not insure against loss ... by termites or other insects; wear and tear; deterioration; smog; smoke from agricultural smudging or industrial operations; rust; wet or dry rot; mould; mechanical breakdown; settling, cracking, shrinkage, or expansion of pavements, foundations, walls, floors, or ceilings; unless loss by ... collapse of buildings ensues. (Emphasis added.)

At the end of 1958 or early 1959, the sewer pipe started leaking and infiltrating unstable earth beneath the foundation. The foundations and walls cracked, doors and windows froze, and one part of the house dropped over seven inches. The market value of the house also dropped, from \$18,200 to \$10,000.

The Supreme Court indicated while coverage for “settlement” of the house was excluded, coverage nevertheless existed because the rupture of the sewer line was due to Wisler’s “third party” negligence and this, rather than “settling” was the efficient proximate cause of the loss. The broken sewer line set in motion the forces leading to settlement. Consequently, the Supreme Court reversed the judgment for defendant National Union.

#### 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.” (Also see depublished case of *Mesa Vista v. Calif. Portland Cement* (2004) 118 Cal.App. 4th 308, which held that Damage was not visible with optical microscopes but observed with scanning electron microscope, constituted actual physical harm under *Aas*.)

- ❖ Also 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 furnace manufacturer was Consolidated Industries Corp.

Consolidated installed stainless steel NOx rods above the burners to meet California requirements for limiting nitrous oxides emitted by residential furnaces. The U.S. Consumer Product Safety Commission issued a safety alert warning that the furnaces “presented a substantial risk of fire.”

KB Home began inspection of the forced air heaters in its 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/or 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 legal issue 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: “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” is 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 “component 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?” *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 identical furnaces in other markets **without** 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.)

#### INCORPORATION DOCTRINE TO ESTABLISH RESULTING DAMAGE

- *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.

#### INCORPORATION OF DEFECTIVE SIDING

- *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 mismilled. 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.

#### INCORPORATION OF DEFECTIVE PLASTER

➤ *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

## INCORPORATION OF DEFECTIVE HONEY NUT CLUSTERS

*Shade Foods, Inc. v. Innovative Products Sales & Marketing, Inc.*, (2000) 78 Cal.App.4th 847

Insurance coverage was triggered by “physical damage” from incorporation of wood splinters that contaminated honey nut clusters in breakfast cereal. The court of appeal discussed the incorporation doctrine;

“While the distinction may sometimes be a fine one to draw, we see no difficulty in finding property damage where a potentially injurious material in a product causes loss to other products with which it is incorporated.

The appellate court held that their decision in *Armstrong World Industries, Inc. v. Aetna Casualty & Surety Co.* (1996) 45 Cal. App. 4th 1 was closely in point.

“There, the insured was sued repeatedly for the manufacture of asbestos-containing building material, such as floor tile and insulation. In general, the plaintiffs sought damages for the cost of removing the material or for the diminished value of the building resulting from its presence. Relying on *Eljer Mfg., Inc. v. Liberty Mut. Ins. Co.*, *supra*, 972 F.2d 805, we noted that the presence of asbestos causes injury to a building “because the potentially hazardous material is **physically touching and linked with the building** . . . .” (*Armstrong World Industries, Inc. v. Aetna Casualty & Surety Co.*, *supra*, at p. 92.) We concluded “that the alleged injury from installation of [asbestos-containing building material] **qualifies** as ‘**physical injury** to . . . tangible property’ ” under the terms of the standard-form policy. (*Id.* at p. 94.)

Following its decision in *Armstrong*, the appellate court held that the presence of wood splinters in the diced roasted almonds **caused property damage** to the nut clusters and cereal products in which the almonds were incorporated.

*Also see: 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, as property damage).

*But see; F&H Construction v. ITT Hartford Ins. Co.*, (2004) 118 Cal.App.4th 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);

#### RECOVERY IN TORT - DUAL CONTRACT – TORT CLAIMS, 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 shipped the boric acid in sealed *felcon* bags but 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 the claims and sued 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.

#### SB 800 CIVIL CODE §896 CASES

#### BUILDER CANNOT ENFORCE PRE-LITIGATION PROCEDURE IF FOUND UNCONSCIONABLE

➤ *Anders v. Superior Court*, (Cal.App. 5 Dist., 2011) WL 360044.

Fifty-four homeowners brought an action against a builder for construction defects. Of the 54 homeowners, 28 owners purchased directly from the builder and 24 were successors-in-interest, and each owner had received the builder's election to use its own non-adversarial procedures in lieu of the statutory provisions.

Builder petitioned to compel contractual pre-litigation procedures and owners challenged the builder's "own pre-litigation procedures" as unconscionable. The trial court held the builder's pre-litigation procedures unconscionable, but ordered homeowners to comply with statutory pre-litigation procedures. The homeowners argued that they should be permitted to go directly into Superior Court.

The court of appeal held that the homeowners did not have to comply with the statutory pre-litigation procedures because the builder's contractual pre-litigation procedures were unconscionable.

§914(a) “. . . A builder may attempt to commence nonadversarial contractual provisions **other than** the nonadversarial procedures and remedies set forth in this chapter, but may not, in addition to its own nonadversarial contractual provisions, require adherence to the nonadversarial procedures and remedies set forth in this chapter, regardless of whether the builder’s own alternative nonadversarial contractual provisions are successful in resolving the dispute or ultimately deemed enforceable.

“. . . If the builder elects to use alternative nonadversarial contractual provisions in lieu of this chapter, the election is binding, regardless of whether the builder’s alternative nonadversarial contractual provisions are successful in resolving the ultimate dispute or are ultimately deemed enforceable.”  
§914, subd. (a).

Interpreting *Civil Code* §914(a), the *Anders* court stated that once the builder makes this election, that election is "binding, regardless of whether the builder's alternative non-adversarial contractual provisions ... are ultimately deemed enforceable." The *Anders* court also relied on *Civil Code* §915, which provides that if the alternate proceeding ceases because the procedures are found to be unenforceable, the homeowner is released from the requirements of the statutory procedure and may file suit.

#### SB 800 ABROGATED THE ECONOMIC LOSS RULE FOR CONTRACTORS AND MANUFACTURERS

➤ *Greystone Homes, Inc. v. Midtec, Inc.*, (2008) 168 Cal.App.4th 1194.

This is an action by the builder against a product manufacturer of pipe fittings. The builder had incurred the cost of replacing the defective pipe fittings because of multiple failures of the Midtec fittings causing leaks in the homes. The builder sued on theories of negligence, negligence per se, and equitable indemnity. Midtec brought a motion for summary judgment or summary adjudication on the ground that the builder could not recover for purely economic losses.

The court of appeal held that the Right to Repair Act had abrogated the economic loss rule in construction defect litigation.

“The Act makes clear that upon a showing of violation of an applicable standard, a homeowner **may recover economic losses** from a builder without having to show that the violation caused property damage or personal injury.” (§§896, 942, *id.* at 1202)

Midtec argued that the Builder is not authorized to bring an action under the Act and the Act did not apply to the claim between the builder and a component part manufacturer. The trial court granted summary judgment on the ground that the

Act did not apply to the builder.

After discussing doctrine of equitable indemnity and the economic loss rule, the court of appeal noted that *Civil Code* § 936 expressly applied to product manufacturers and that under *Civil Code* § 945.5, the builder had the right to allege the affirmative defenses set out in section 945.5. *Id.* at p. 1211-1212.

Midtec also argued that the Act preserved the economic loss rule for claims against product manufacturers that allege a violation of the Act's standards, because the Act refers to a "homeowner's construction defect claim against a *builder*." Since there was no tort, the builder did not have its equitable indemnity claim. Held:the Act abrogated the economic loss rule **against product manufacturers** as well as builders. *Id.* at p. 1217.

The Court of Appeal also held that the builder could bring a **derivative equitable indemnity action** against a product manufacturer under the Act. There was nothing in the Act that precluded indemnity claims, either express or equitable, under the Act. *Id.* at p. 1219.

Midtec argued that the plumbing standards referred only to installation of plumbing products, not **manufacturing**. However, the Court of Appeal cited Civil Code §§ 896(a)(14), (a)(15), and 896(e), and held the provisions are **not limited** to the installation of plumbing products. *Id.* at p. 1220.

Midtec next argued that section 896(g)(3)(E) of the Act excluded product liability claims based solely on defective product claims and that Greystone was making such a claim. The Court of Appeal rejected this contention stating that the plain meaning of the Act defeats the contention (if the defect violates one of the standards in §896, it is actionable). *Id.* at pp.1221-1223.

Finally, the Court of Appeal held that Midtec's motion for summary adjudication on the negligence per se cause of action should have been granted. The builder may not pursue a **negligence per se** claim against Midtec. The Act does not permit the builder to bring a direct action. *Id.* at p. 1228. The builder also may not pursue a claim for negligence based upon the "special relationship" theory of liability. *Id.* at p. 1231. However, Greystone was allowed to recover on its derivative equitable indemnity action.

"Thus, the fact that Greystone could not prevail on a direct cause of action against Midtec does not defeat Greystone's equitable indemnity claim."  
*Id.* at p. 1219.

### 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.

### DEVIATIONS FROM PLANS AND SPECIFICATIONS - BASIS FOR COST OF RECONSTRUCTION

➤ *Shell v. Schmidt* [Breach of Contract Claim] (1958) 164 Cal.App.2d 350.

Plaintiffs sued as third party beneficiaries for breach of contract. All parties agreed that defendant breached the contract and the issue was whether plaintiffs were entitled to cost of repair or the difference of the homes' values as specified and their value as built.

When the court finds that the contractor has:

1. breached the contract by “intentionally” deviating from the plans and specifications, and
2. those deviations substantially affect the building's usefulness for the purpose for which it was intended,
3. then there can be no finding of substantial performance, and
4. the measure of damages is the cost of correcting the deviations.

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

When there is a material and intentional major deviation from the plans and specifications, the contractor cannot invoke the difference in value rule. In *Shell*, the contractor installed stucco rather than wood sheathing on exterior walls, one 35,000 BTU floor furnace rather than two 30,000 BTU wall furnaces, and drywall rather than lath and plaster on interior walls.

The contractor offered evidence that these deviations from the plans and specifications were necessary because what was called for in the plans and specifications was unavailable, and expert testimony showed that what was furnished was equal to or better than what was specified; therefore the value of the house had not been affected by the deviations. "The fundamental principle which underlies the decisions regarding the measure of damages for defects or omissions in the performance of a building or construction contract is that a party is entitled to have what he contracts for or its equivalent." 164 Cal.App.2d at 359-360, quoting American Jurisprudence, volume 9, *Building and Construction Contracts*, section 152, page 89.

The owner has a right to a structure in all essential particulars such as he has contracted for. "The court cannot say that any thing is immaterial which the parties have made material by their contract. One has the right to determine for himself what he deems a good foundation or what materials he desires to be used, and if he contracts for them neither the contractor nor the court has the right to compel him to accept something else which may be shown by the witnesses to be just as good or even better." 164 Cal.App.2d at 359-360, quoting *Perry v. Quackenbush* (1894) 105 Cal. 299, 309-310.

#### DEVIATIONS FROM PLANS AND SPECIFICATIONS AS DEFECTS IN TORT

➤ *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.

#### 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)

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, supra*, at 480.

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.

## PREMISES LIABILITY - DANGEROUS CONDITION

The California Legislature has identified both unreinforced masonry buildings (URM's) and soft story structures as the most dangerous buildings in the state.

Additionally, the state has recognized the dangers of NDRCB buildings (non-ductile reinforced concrete buildings). State building codes do not require owners to retrofit or strengthen known, dangerous, older soft story, URM or NDRCB buildings until they remodel or the building is damaged. However, municipalities are required to inventory these buildings and send out legal notices to owners of these "hazardous buildings."

This leaves thousands of “dangerous buildings” in California used and occupied today by the “unknowing” public. The owners and the public are sitting on a ticking time bomb.

#### BUILDING OWNERS HAVE A DUTY TO RETROFIT DANGEROUS URM BUILDINGS

➤ *Myrick v. Mastagni*, (2010) 185 Cal.App.4th 1082.

The survivors of the two women killed in the San Simeon earthquake brought a lawsuit against the owners of the building that collapsed in negligence for failing to perform seismic retrofitting of the Acorn building. Between 1989 and 1992, the city of Paso Robles had retained a consultant to inventory the unreinforced masonry buildings (URM's). The city identified the Acorn building and gave notice to the owners. The city initially required that the owners had to comply with seismic retrofitting by 1998 and extended the compliance date to 2018. The earthquake occurred in 2003. The owners did not perform seismic retrofitting before the earthquake.

The trial court allowed the jury to consider the ordinance. The jury found that the owners were negligent and awarded substantial damages. On appeal, the owners argued that the city ordinance was a defense to tort as a matter of law, and they had no duty to retrofit until 2018, the deadline established by the ordinance.

The court of appeal pointed out the general rule that property owners must use ordinary care in the management of his or her property to prevent injury to others. The test was whether an owner has acted as a reasonable person in view of the probability of injury.

The court of appeal distinguished the cases that permit the use of statutory compliance as a defense to tort liability. The court of appeal held that the owners presented "no compelling reason for departing from the general rule in this case." *Id.* at p. 1090. The overriding policy behind the seismic retrofit ordinance is not the interests of the building owners but public safety. "To hold that as a matter of law, a building owner has no duty until the compliance date of a code provision would frustrate the very policy that the provision was designed to promote." *Id.*

The court of appeal also upheld the jury's determination that the building's owners were a joint venture, which made each of them jointly and severally liable. The evidence established that each of the defendants had an interest in the operation of the Acorn Building. *Id.* at pp. 1091-1092.

#### DANGEROUS CONDITION ON ADJACENT PROPERTY - FAILURE TO WARN

➤ *Alcaraz v. Vece*, (1997) 14 Cal.4th 1149.

A tenant was injured when he stepped into an uncovered utility meter box owned and maintained by the city. The tenant sued the owners of the rental property and argued that since they had actual notice that the cover was missing or broken, they owed a duty to warn or protect him from a known hazardous

condition on adjacent property they did not own. There was, however, evidence that the property owners maintained the adjacent property and constructed a fence enclosing the adjacent property after the accident, i.e. they treated the adjacent property as an extension of property they owned. The trial court granted summary judgment in favor of the property owners.

The appellate court reversed and held that (1) the duty to warn of or correct a known dangerous condition is “not invariably placed” solely on the person who holds title; (2) evidence that a person knew of a dangerous condition on property he did not own and exercised possession or control over that adjacent property may be sufficient to impose liability.

#### NEGLIGENCE LIABILITY FOR FAILURE TO INSTALL SECURITY GATES - KNOWN RISK

➤ *Tan v. Arnel Management Company*, (2008) 162 Cal.App.4th 621.

Plaintiff was shot in an attempted carjacking in the ungated portion of the common area of his apartment complex. Plaintiff’s family sued the management company and property owner for failure to take proper steps to secure the premises against foreseeable criminal acts of third parties.

The trial court, after an evidentiary hearing, ruled that three prior violent crimes against others on the common areas were not sufficiently similar incidents to that involving plaintiff to impose a duty on defendants to protect tenants of the apartment complex. During the hearing, the trial court asked plaintiffs to articulate what additional security measures were required to prevent harm. Plaintiffs requested that defendants install two security gates, the cost of which was approximately \$13, 050.00.

The appellate court reversed and held that (1) the test for imposing liability was prior similar incidents, not prior *identical* incidents; and plaintiffs had presented substantial evidence similar incidents (sudden attack without warning, late at night) to demonstrate a reasonably foreseeable risk of violent criminal assaults on the property; and (2) the security measures requested by plaintiffs were reasonable and not especially burdensome

#### NEGLIGENCE LIABILITY FOR FAILURE TO REPLACE BROKEN GLASS PANE - KNOWN RISK

➤ *Vasquez v. Residential Investments, Inc.* (2004) 118 Cal.App.4th 269.

Decedent lived in an apartment building. The front door of decedent’s apartment had a diamond-shaped glass pane in the top half. When decedent moved in, the glass pane was missing and a piece of cardboard covered the opening. Decedent’s family on several occasions told the landlord that the absence of the glass pane created a security risk and asked the landlord to replace the glass pane, which the landlord did not do. Decedent’s family replaced the cardboard with a small piece of plywood.

Decedent’s ex-husband obtained entry to her apartment by removing the plywood panel with a “hard knock”, confronted decedent and fatally stabbed her. He was later convicted of murder. No one was aware that the ex-husband was

potentially violent, but the neighborhood and the apartment building had experienced several violent crimes, including a rape.

The appellate court held that the landlord had a duty to make reasonable efforts to replace the missing windowpane and that the burden of doing so would have been minimal: the materials for replacing the missing pane had already been purchase, and the cost of completing the replacement would have been approximately \$15.00.

#### 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 defendants contended the damage the Orndorffs' house has suffered could be remedied by installation of the less expensive reinforced mat.

The Court of Appeal indicated that while there may be cases where repairing damage rather than curing a defect would be appropriate, this is not one of them. The trial court found that further settlement was likely. The Orndorffs presented evidence that **in light of future settlement**, the only way of

preventing future damage was **installation** of the more costly **pier and grade system**. In giving the Orndorffs the amount needed to install such a system, the trial court clearly accepted the Orndorffs' evidence. Thus the record demonstrated the amount needed to repair all the damage caused by the defect is the amount needed to install a pier and grade system.<sup>4</sup>

#### 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: 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

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<sup>4</sup> In contract actions, cost of repair is available for failure to follow plans and specifications. See *Shell v. Schmidt* (1958) 164 Cal.App.2d 350, *infra*.

expectation of the parties are not recoverable. . . . 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.’” *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.

#### EMOTIONAL DISTRESS: PHYSICAL INJURY NOT REQUIRED FOR NEGLIGENCE RECOVERY

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

Independent of *Erlich*, recovery for emotional distress has been permitted. In *Potter*, 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

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>5</sup>

CAUSE OF ACTION DOES NOT ACCRUE UNTIL DAMAGE IS SUFFICIENTLY APPRECIABLE

➤ *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

<sup>5</sup> See SB 800 (*Civil Code* §§895-945.5) setting new statute of limitations for newly constructed residential units completed after 1/1/03.

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.” (Emphasis added.) *Id.* at 1326.

- “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.* 1326.
- “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 that statutes of limitations will not be applied inflexibly where principles of equity and justice favor the application of equitable tolling.

THE STATUTE OF LIMITATIONS BEGINS WHEN THE DAMAGE IS “SUFFICIENTLY APPRECIABLE”

➤ *Mills v. Forestex Co.*, (2003) 108 Cal.App.4th 625.

In 1990, plaintiffs hired Wunder Construction to build a home and garage for them. The siding on the home and garage was a wood product manufactured by Forestex Co. and installed by Wunder. In summer of 1993, the Mills noticed 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. 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.

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.

The Court of Appeal concluded that the defect was a latent defect and explained 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 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. Thus, the siding problem was sufficiently appreciable no later than the summer of 1993 to put them on notice to pursue their remedies, and thus 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. The Court of Appeal held that even with the tolling period, the plaintiffs did not bring the lawsuit until September of 2000 and the lawsuit was **filed too late**.

#### 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

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.)

#### 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 opined 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." 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.

The Court of Appeal reversed. An issue of fact existed as to whether latent construction defects were caused by the contractors' willful misconduct, precluding summary judgment, despite the homeowners' failure to prove that the alleged willful acts had been committed directly by contractors or under their supervision.

Noting that as a matter of law, owners and contractors have a non-delegable duty of supervision over the construction, including the work of the subcontractors, the Court of Appeal held that owners and contractors cannot avoid liability by having an independent contractor assume responsibility for the work. Thus, the general contractor/developer is strictly liable for construction defects regardless of fault. Imputing the subcontractor's willful misconduct is consistent with principles of respondeat superior that hold a principal liable for both the negligent and intentional acts of the agent. When a developer or general contractor receives the economic benefits of the willful misconduct, it 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.

CCP §337.15(F) PROVIDES A WILLFUL MISCONDUCT EXCEPTION TO THE 10 YEAR STATUTE

➤ *Pine Terrace Apartments v. Windscape*, (2009) 170 Cal.App.4th 1.

The buyer of an apartment complex sued the developer and seller after discovering all of the windows in the complex lacked flashing, which led to water and mold damage.

The Court held that there is an exemption from the 10-year statute of limitations for "actions based on willful misconduct" *Code of Civil Procedure* §337.15(f). It applies to cross-complaints for indemnity and the willful misconduct claim may be made by way of a cross-complaint.

The defendant knew the flashing had not been installed and did not disclose the absence of the flashing to the buyer. The buyer presented photographs and the opinion of a licensed California architect and general contractor, who inspected the apartments. The expert stated that flashing has been used by builders for generations and is required by the Uniform Building Code.

In his opinion, the only reason the general contractor and subcontractors would omit the required flashing is to save money, at the expense and harm to the subsequent purchaser. In the expert's opinion, the omission of the flashing was the result of willful misconduct.

The California Supreme Court's use of quotation marks around the word "absolute" in *Lantzy* indicates that the 10-year limitations period cannot be regarded as absolute in all contexts. For example, "[s]ection 337.15 itself provides several clear exemptions from the 10-year limit" (*Lantzy, supra*, 31 Cal.4th at p. 373), and our high court has recognized that a party might be equitably estopped from asserting that the 10-year period has run.

The Court of Appeal in *Pine Terrace* concluded that the 10-year limitations period for latent construction defects does not apply to an indemnification claim based on willful misconduct pursued using a cross-complaint. § 337.15, subd. (f).

## ACCRUAL OF A CAUSE OF ACTION BELONGS TO THE OWNER WHO FIRST DISCOVERED IT

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

Subsequent owners of homes built by defendant, filed defective construction against defendant Anderson Homes, Inc., alleging the homes contained numerous preexisting defects and structural damage which were discovered only after plaintiffs purchased the homes from previous owner. 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, granted the motion and dismissed the complaint.

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).

The Court of Appeal reversed, holding that, without proof the original owners sustained actual economic injuries due to the construction defects, they had no causes of action against Anderson that precluded the subsequent buyers from maintaining their claims. The court also ruled that the cause of action belongs 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 home’s worth, since the owner then must disclose the damage to potential buyers.

In sum, the possibility of discovering the physical defect does not necessarily mean the statute of limitations begins to run in all cases, until discovery of the manifestations of damages from the defect is discovered. The *Siegel* court indicated that “[a] cause of action cannot have accrued before there was someone in a position to actually assert it.”

## STANDING, ASSIGNEE RIGHT TO SUE - NO CURRENT OWNERSHIP RULE

➤ *Jasmine Networks Inc v. Superior Court*, (2009) 180 Cal.App.4th 980.

*Jasmine* sued Marvell, for misappropriating Jasmine’s trade secrets. After filing the action, Jasmine went through bankruptcy and sold its rights in the trade secrets, but reserved its rights in the Marvell lawsuit.

Marvell successfully demurred to Jasmine’s complaint on the ground that the sale had forfeited its “standing” to sue. Marvell advocated a “current ownership rule,” but the Court of Appeal found no support for such a rule. One

whose property has been wrongfully damaged by another does not lose the right to recover for damages merely because he has sold the property at the time of suit.

Such standing was addressed in *Vaughn v. Dame Const. Co.* (1990) 223 Cal.App.3d 144. A builder sued for construction defects, moved for summary judgment because the plaintiff had lost the right to sue by selling the building after filing the suit. The trial court granted the motion, concluding that the plaintiff was no longer the real party in interest. The Court of Appeal reversed, because *Vaughn's* chose of action was not an interest *in the real property*, (analogous to a covenant running with the land), but a distinct form of *personal* property that could be held back by the plaintiff in a sale of the injured property.

*Jasmine* took exception to the approach of the line of cases following in *Vaughn's* wake dealing with questions concerning the right of a subsequent owner to maintain an action for damage done to a building before he acquired it., e.g., *Keru Investments v. Cube Co.*, 63 Cal.App.4th 1412 (the cause of action for “negligent construction . . . was held by the new owner and not the party who transferred the property after the cause of action accrued.”); *Siegel v. Anderson Homes, Inc.*, *supra*, 118 Cal.App.4th 994, 996 (absent proof that the original owners suffered actual economic injuries from construction defects . . . , the original owners possessed no causes of action against the defendant that precluded subsequent owners from suing.). However, none of them cast the slightest doubt on the central premise that a **right of action for damage to property** is **distinct from the title to the property**, and from any right in the property, and that the transfer of the latter does not by itself effect a transfer or diminution of the former. According to the *Jasmine* Court of Appeal, there simply is **no “current ownership rule,”** in this jurisdiction, in trade secret law or – apparently - any other field of property.

#### WATER PROBLEMS IN ONLY ONE OF 61 UNITS INSUFFICIENT TO PUT THE HOA ON NOTICE

- *Creekridge Townhome Owners Ass'n, Inc. v. C. Scott Whitten, Inc.*, (2009) 177 Cal.App.4th 251.

In a construction defects suit concerning a reroofing project at a 61-unit townhome community consisting of 11 buildings, the Court of Appeal reversed a grant of summary judgment in favor of the defendant contractor on statute of limitations grounds. The trial court had erroneously held that because the homeowners association had notice of a water moisture problem inside the window of a single unit as a result of the new roof, the statute of limitations began to run. The court of appeal found that triable issues of material fact remained regarding whether the four-year statute of limitations for patent construction defects or the 10- year statute of limitations for latent construction defects barred the action.

First, the Court of Appeal held that it could not determine, as a matter of law, that the alleged reroofing defects fit within the definition of a patent defect. See *Code Civ. Proc.*, § 337.1. This type of determination is based on an

objective test that asks whether the average consumer, during the course of a reasonable inspection, would discover the defect. Contractor's only evidence supporting the summary judgment motion consisted of a 1997 letter written by a unit owner to the association (concerning a moisture problem and also broken roof tiles), which was discussed during an open meeting. The HOA, on the other hand, provided the declaration from a roofing consultant hired in 2003 after the complex suffered numerous leaks earlier that year. The expert declaration asserted multiple defects from the 1997 re-roofing, and stated that these defects would not be readily apparent to a lay person." Based on this evidence, the court could not say that the re-roofing defects were patent defects as a matter of law. This evidence pales in comparison to other situations where a patent defect has been found as a matter of law (a backyard pond with a one-foot- where a toddler fell in - *Preston*, 42 Cal.3d at 110.)

Next, the court examined whether the statute of limitations for latent construction defects barred the action. See *Code Civ. Proc.*, §§ 337, 338. The court explained that the limitations period for latent defects starts to run upon "discovery," which occurs when the plaintiff suspects or reasonably should suspect that someone has done something wrong to the plaintiff, causing the injury. The court ruled that the moisture problem in one unit was not enough to put a reasonable person on notice.

While the trial court found convincing the case of *Landale-Cameron Court, Inc. v. Ahonen* (2007) 155 Cal.App.4th 1401, review denied, (Jan. 3, 2008), in making its determination that discovery occurred in 1997 when the unit owner sent the letter, the Court of Appeal found the facts of that case distinguishable, since at least half of the units in the Landale complex were leaking, and repair attempts had been observed by the homeowner association board president. The court further reasoned that to hold otherwise would force property owner associations to conduct investigations for possible defects based on any report of a small problem, which would be costly and burdensome.

#### 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.

## 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 non-monetary consideration is included
6. How the parties to the settlement value the non-monetary 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.4th1685.

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.
- "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.

#### SETTLEMENTS BY SUBCONTRACTORS PROPERLY REVISITED, APPORTIONED AND CREDITED

- *El Escorial Owners' Assn. v. DLC Plastering, Inc.*, (2007) 154 Cal.App.4th 1337.

Plaintiff was a condominium association of four three-story buildings housing 261 condominiums built during a six-year period. Plaintiff instituted proceedings under the Calderon Act, *Civil Code* §1375, and demanded that the builder correct numerous construction defects. The parties met over the next two years in an attempt to resolve the dispute. The parties signed an agreement to toll the statute of limitations retroactively two years and prospectively until the end of the negotiations, which were unsuccessful. Plaintiff filed a construction defect lawsuit. Prior to trial, most of the defendants settled. Plaintiff proceeded to trial against the non-settling subcontractors.

#### Revisiting 877.6 Settlement Allocations

Prior to trial, the court approved the offsets for the various defect categories. One defendant requested that the court reserve for all defendants the right to contest the allocations. During trial, the court reallocated the toxic mold allocation. Plaintiff argued on appeal that the court could not reallocate the toxic mold allocation. The court of appeal disagreed, finding that in complex construction defect cases, a trial court has the right to revisit the allocations. The trial court must have the latitude to adjust off-sets in response to evidence adduced in trial. *Id.* at 1351.

#### Statute of Limitations-Tolling

The Court of Appeal interpreted the tolling provisions of former *Civil Code* § 1375(b)(3)(A) broadly. The appellate court stated that the broad tolling provisions apply to the builder and “all parties who may be responsible for the

damages” whether or not they are named in the notice. The court held that the parties could agree in writing to toll statutes of limitations for a longer period than the 150 day tolling period. *Id.* at 1355.

#### No Nuisance for Defects Sounding in Tort

Where negligence and nuisance causes of action rely on the same facts about lack of due care, the nuisance claim is a negligence claim. If the alleged nuisance is the result of defendant’s alleged negligent conduct, rules of negligence are applied. *Id.* at 1349, citing *City of San Diego v. U.S. Gypsum Co.*, (1995) 30 Cal.App.4th 575, 587. Accordingly, the Court of Appeal found that the trial court reasonably considered Escorial’s nuisance cause of action a mere clone of the first cause of action, with a different label.

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

➤ *Goodman v. Lozano*, (2010) 47 Cal.4th 1327.

Home purchasers brought an action against a construction partnership, its construction and financing partners, architect, and brokers, alleging negligence, fraud, breach of warranties, negligent misrepresentation, and breach of contract. Before trial, the purchasers settled claims against all defendants except for the financing partners.

Following a court trial, the trial court calculated the total damages award against the Lozanos, the financing partners. The Judge applied the settlements of \$230,000, as a credit for the Lozanos. Because the \$230,000, settlement exceeded the \$146,000, the trial judge found that plaintiffs should receive nothing.

Exercising discretion under CCP § 1032(a)(4), the trial judge determined that the Lozanos were the prevailing party because they paid nothing under the judgment. The judge awarded the Lozanos \$132,000 in attorneys’ fees and \$12,000 in costs. Plaintiffs appealed from both the net zero judgment and the order finding the Lozanos to be the prevailing parties and awarding the Lozanos fees and costs.

A plaintiff whose verdict is reduced to zero because of offsetting settlements (CCP § 877(a)) does not obtain a "net monetary recovery" under CCP § 1032(a)(4).

In finding the Lozanos to be the prevailing party, the trial court observed:

“The plaintiffs came to this trial with substantial moneys in hand from prior settlements. Both sides acknowledged that those funds would reduce any damages proven at this trial. Plaintiffs presented evidence regarding their entire list of dozens of alleged deviations and defects. The defendants did not dispute all of these claims and, in fact, acknowledged some errors. Although the defendants suggested lower corrective costs than the plaintiffs demanded, the defendants never suggested that no damages should be found by this court. The defendants’ clear and undisputed trial goal was to get a decision

awarding less damages than the sum of the prior settlements. They fully achieved this objective. It is also noteworthy that the settlements were consummated well before this trial, in ample time for the plaintiffs to **reassess their strategy**. Furthermore, these payments were not contingent or uncollected, but had been received by the plaintiffs before they sought further recovery from the Lozanos” (Emphasis added.)

The Supreme Court found that the trial court carefully assessed the parties' bargaining strengths and litigation objectives going into trial against the results actually achieved in this case. Because both parties recognized that the prior settlements would offset any damage award, **the trial court properly considered** whether plaintiffs had **reasonable prospects of recovering money in excess of the settlement** amount. Implicit in this analysis is an invitation by the Supreme Court for the trial courts to engage in a “**subjective**” **evaluation of the reasonableness** of the parties’ respective litigation strategies and whether the attorneys properly reassessed their objectives after entering settlements. Under *Goodman*, a trial court may consider in exercising its discretion whether or not the plaintiff attorney had **reasonable prospects** of recovering **more money** than already received in prior settlements.

Here, although the plaintiffs sought damages in the amount of \$550,000, the court awarded them \$146,000, well below the \$230,000 received in settlement. The Lozanos, conversely, succeeded in proving damages in an amount less than the settlement proceeds, by which they avoided having to pay plaintiffs anything.

Defendants were the prevailing parties entitled to costs and attorney fees because they achieved their trial strategy of limiting damages in an amount less than the settlements. *Id.* at 1338-1339. The defendants’ clear and undisputed trial goal was to get a decision awarding less damages than the sum of the prior settlements.

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

##### DEVELOPER CANNOT USE ARBITRATION CLAUSE IN CC&R'S TO ENFORCE ARBITRATION BETWEEN THE HOA AND THE DEVELOPER FOR CONSTRUCTION DEFECTS

- *Pinnacle Museum Tower Ass'n v. Pinnacle Market Development (US), LLC* (2010) 187 Cal.App.4th 24, *Review Granted and Opinion Superseded*, 242 P.3d 67, (Cal. Nov 10, 2010).

Homeowners association filed action on its own behalf, and as a representative of its members, against condominium project developer for damages to common areas, property owned by the association, and property owned by individual association members, caused by alleged construction defects. Developer petitioned to compel arbitration, based on arbitration clause contained in recorded covenants, conditions and restrictions (CC&R's). The arbitration clause provided that the provision could not be amended without the written consent of the developer.

The Court of Appeal initially held that the Federal Arbitration Act applied to the arbitration provision in the CC&R's. However, state law governs whether an agreement to arbitrate exists. The Court of Appeal noted that there was no evidence that the Association had agreed to the arbitration provision. Based upon the application of fundamental contract formation principles, the Court of Appeal could not see how the Association could have agreed to waive its constitutional right to a jury trial, because the developer was the only party to the "agreement" and there was no independent homeowners association when the developer recorded the CC&R's. *Id.* at p. 35. In addition, the Court of Appeal noted that the CC&R's were a bilateral contract with mutual promises, the builder was not a third party beneficiary of the contract, there are numerous statutes that the Association must follow before it can file an action, a waiver requires an actual "agreement" and *Civil Code* § 945 did not affect the enforceability of any contractual arbitration or judicial reference provision. *Id.* at pp. 35-36. The Court of Appeal found that the arbitration provision was both procedurally and substantively unconscionable. See also, *Thompson v. Toll Dublin, LLC* (2008) 165 Cal.App.4th 1360.

#### ALTERNATIVE DISPUTE RESOLUTION

- *Villa Vicenza Homeowners Assn. v. Nobel Court Development, LLC*, (2011) 191 Cal.App.4th 963.

In 2005, the California Supreme Court held that a person had a constitutional right to a jury trial and a provision that effectively waives a party's constitutional right to a jury trial was unenforceable. *Grafton Partners L.P. v. Superior Court*, (2005) 36 Cal.4th 944, 950-952.

In 2008, the Court of Appeal for the Fourth Appellate District addressed whether a provision for alternative resolution of disputes in recorded CC&R's was enforceable in a dispute between the homeowner's association and a developer concerning construction defects. The Court of Appeal held that no agreement to judicial reference under *Code of Civil Procedure* § 638 could be found absent actual intent to be bound and actual reflection. *Treo @ Kettner Homeowners Ass'n v. Superior Court* (2008) 166 Cal.App.4th 1055, 1066-1067.

In *Villa Vicenza Homeowners Ass'n v. Nobel Court Development, LLC*, the Court of Appeal returned to a related issue, again involving a construction defect dispute between the developer and association. Focusing again on the lack of agreement between the Association and the non-owner developer, on rehearing, the court of appeal again concluded that such a provision was not enforceable.

Recognizing that both federal and state law favor the enforcement of arbitration agreements, the court of appeal, however, the recorded CC&R's were a binding agreement between the Association and the homeowners, but that standing alone, they are not a contract between the developer and the homeowners association, which only came into existence after the CC&R's were recorded. Thus there has been no showing the association entered into a binding arbitration.

In rendering its decision, the court of appeal acknowledged, in a footnote, that the enforceability of an arbitration provision in CC&Rs in a construction defects dispute between a developer and the association is currently pending before the California Supreme Court in *Pinnacle Museum Town Ass'n v. Pinnacle Market Dev. (US), LLC*.

The court of appeal acknowledged that the Federal Arbitration Act applied as the transaction involved interstate commerce. Accordingly, because of federal preemption, the court could not rely on provisions in the *Code of Civil Procedure* §§ 1298 et seq restricting the use of arbitration in construction defect cases to reach its holding or the jury waiver provisions in the California Constitution to invalidate an arbitration agreement.

As in *Pinnacle*, the Court of Appeal explained that state law governs the question of whether an agreement to arbitrate exists. Again, the court concluded that no such agreement was reached in the CC&Rs.

#### JUDICIAL REFERENCE

➤ *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.4th 723.

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.

#### ABSENT CLEAR ARBITRATION AGREEMENT, ARBITRATION CANNOT BE COMPELLED

➤ *Adajar V. RWR Homes, Inc.*, (2008) 160 Cal.App.4th 563.

Homeowners signed applications for new home warranties acknowledging, among other things, that they had read a sample copy of the warranty book and consented to a binding arbitration provision. The builders moved to compel arbitration, but did not produce a copy of the sample warranty booklet given to homeowners. However, the builders did provide a copy of a subsequently issued warranty booklet not originally given to homeowners.

Both the trial court and reviewing court concluded that the applications signed by the plaintiffs did not incorporate by reference the terms of arbitration clauses included in the subsequently issued warranty booklets. The court was not obliged to infer that the subsequently issued warranty booklets were identical to the warranty booklet included in homeowners' applications. Arbitration could not be compelled under both the Federal Arbitration Act and the California Arbitration Act absent proof of an arbitration agreement. The liberal policy of the courts to encourage arbitration as a cost-effective alternative dispute resolution procedure does not override the requirement that the parties clearly and unequivocally agree to arbitration.

#### ARBITRATION AGREEMENT NOT CLEARLY INFORMING HOMEOWNERS - UNCONSCIONABLE

➤ *Baker V. Osborne Development Corporation*, (2008) 159 Cal.App.4th 885.

Builder's application for new home warranty program was presented to homeowners at or shortly before close of escrow. The application contained the following arbitration provision: "Any and all claims, disputes and controversies by or between the Homeowner, the Builder...arising from or related to this Warranty, to the subject Home, to any defect in or to the subject Home or the real property on which the subject Home is situated, or the sale of the subject home by the Builder, including without limitation, any claim of breach of contract, negligent or intentional misrepresentation or nondisclosure in the inducement, execution or performance of any contract, including this arbitration agreement, and breach of any alleged duty of good faith and fair dealing, shall be submitted to arbitration..."

The homeowners' purchase and sale agreement, however, contained an arbitration clause which was limited to the deposit of funds in escrow.

The homeowner filed a construction defect action against the builder, which then moved to compel arbitration. Both the trial court and reviewing court held that the arbitration agreement was unenforceable because:

- It did not clearly and unmistakably reserve to the arbitrator the issue of enforceability of the arbitration clause;
- It was not provided to the buyers at the time they signed the purchase and sale agreement;
- The terms of the arbitration agreement were not contained in the warranty application,
- It was not provided to the buyers until closing of escrow;
- “A reasonable buyer would believe that the arbitration agreement to which the application referred would govern any disputes with [the warranty company] regarding the terms of the warranty, not disputes between the builder and the buyer” (*Id.* at 891); and
- It was one-sided, i.e. for the builder’s benefit only, since the builder “would have no conceivable reason to institute legal proceedings against a homeowner after escrow closed” (*Id.* at 896).

#### FAA PREEMPTS CALIFORNIA LAW WHERE BUILDING MATERIALS FROM OUTSIDE CALIFORNIA

➤ *Shepard v. McKay Enterprises, Inc.*, (2007) 148 Cal.App.4th 1092.

Plaintiff homebuyer sued a contractor and a developer because a leak from an underground plumbing pipe caused extensive damage to the home and to personal property. Defendants moved to compel arbitration and argued that the Federal Arbitration Act preempted California law. The trial court denied the motion to compel.

Evidence that building materials (carpet and vinyl flooring, doors and hardware, trusses, windows and kitchen appliances) used to construct the home were manufactured or produced outside California was sufficient to invoke the phrase “involving commerce” and thus allow preemption of federal law, even though the actual construction dispute did not involve these materials. *Id.* at 1101.

#### FAA DOES NOT PREEMPT CALIFORNIA LAW WHERE AGREEMENT USES CALIFORNIA LAW

➤ *Best Interiors, Inc. v. Millie & Severson Inc.*, (2008) 161 Cal.App.4th 1320.

A subcontractor sued a general contractor, the owner and two building inspectors, alleging that a portion of the contract price remained unpaid and that improper inspections had resulted in increased building costs. The prime

contract contained an arbitration clause, which specified that the contract was to be governed by the law of the place where the project was located, i.e. California. The subcontract did not contain a choice-of-law provision.

However, the subcontract stated that any dispute resolution procedure in the prime contract was incorporated in the subcontract and would apply to any disputes arising under the subcontract. Since the parties agreed that California law would apply to any disputes arising under the subcontract, the Federal Arbitration Act did not preempt the application of California arbitration procedure. The Federal Arbitration Act does not prevent the enforcement of agreements to arbitrate under different rules other than those set forth in the Federal Arbitration Act itself. Under California law, however, the arbitration agreement could not be enforced against the building inspectors because they were not a party to the arbitration agreement and separating arbitrable from non-arbitrable claims by litigating in two different forums could lead to inconsistent results. Both the trial court and the appellate court agreed that denial of the general contractor's petition to compel arbitration was proper.

#### MANUFACTURER'S DEFAMATION ACTION AGAINST LAWYER PROPERLY DISMISSED UNDER ANTI-SLAPP LAW

➤ *Simpson Strong-Tie Company, Inc. v. Gore*, (2008) 162 Cal.App.4th 737.

On December 31, 2003, the treated wood industry abandoned the preservatives formerly used in favor of "chemicals that are considered safer for humans, but unfortunately were more corrosive to galvanized steel products such as those manufactured by Simpson. An attorney published a newspaper advertisement stating that users of certain brand-name galvanized screws "may" have legal rights against the manufacturers. One of the manufacturers sued the attorney for defamation and other relief. The attorney responded with a SLAPP motion. The trial court and appellate court both agreed that the lawsuit should be dismissed.

The lawsuit was subject to a SLAPP motion because the advertisement was not about the goods and services of the attorney or a competitor but rather was about the manufacturer's products. Simpson has conceded time and again that many of its galvanized screws are wholly unsuitable for use in pressure treated wood decks.

- G90 products are recommended only for "dry" untreated wood.
- In other words, Simpson does not consider them suitable for use in any exterior pressure-treated wood application.
- ZMAX/HDG products are recommended for exterior pressure-treated woods only when the wood contains no ammonia.
- In all other exterior applications, Simpson recommended stainless steel connectors and fasteners.

The court held that the manufacturer was not the attorney's competitor. Further an advertisement in anticipation of class action litigation was not

“services.” The manufacturer did not establish a probability of prevailing in its lawsuit and in fact conceded that many of its galvanized screws were unsuitable for exterior pressure-treated wood application. The advertisement did not therefore contain a provably false assertion of fact to establish an actionable claim for defamation.

## IX. CONTRACTOR LICENSING

### SUBCONTRACTOR NOT PROPERLY LICENSED AT ALL TIMES CANNOT RECOVER

- *Great West Contractors v. WSS Indust. Const. Inc.* (2008) 162 Cal.App.4th 581.

A corporate steel subcontractor sued a general contractor to recover for work performed under a construction services contract. The subcontractor's president held a valid individual contractor's license at all times. However, the subcontractor did not have a corporate contractor's license when it submitted its bid proposal and performed some preliminary tasks. The subcontractor obtained its corporate license shortly after the subcontract was signed. The subcontractor obtained a jury verdict and the general contractor appealed.

The court of appeal reversed the judgment. The subcontractor was not entitled to recover any compensation for any act or contract for which a license was required if the subcontractor was not properly licensed *at all times* during the performance of the work, including the submission of a bid for the project, the preparation of shop drawings, the ordering of materials and the submission of two initial invoices. The licensing requirement applies whether or not a contractor is operating under an executed contract while performing tasks which require licensing. All of these tasks were done in furtherance of the scope of work included in the subcontract and cannot be segregated or severed from the parties' integrated agreement to avoid the statutory bar to recovery. The licensing statute represents a legislative determination that the importance of deterring unlicensed persons from engaging in the contracting business outweighs any harshness between the parties, regardless of the equities. The doctrine of substantial compliance is inapplicable where (1) the only valid license in place at all times was an individual license and (2) the corporation was never licensed as a contractor at any time prior to commencement of work under the contract.

## X. INSURANCE

### ARE CALDERON OR SB 800 PRE-LITIGATION PROCEDURES A "SUIT" TRIGGERING INSURANCE COVERAGE?

The California Supreme Court, in *Foster-Gardner, Inc. v. National Union Fire Ins. Co.*, (1998) 18 Cal.4th 857, 887, held that an environmental agency's pollution remediation order was not within the definition of "suit" for purposes of triggering coverage under a comprehensive general liability ("CGL") insurance policy. Taking a "literal approach" to the meaning of the undefined term "suit" in a standard form CGL policy, *Foster-Gardner* adopted a "bright line" rule, restricting a liability insurer's duty to defend to civil actions in court.

In *Ameron Intern. Corp. v. Insurance Co. of State of Pennsylvania* (2010) 50 Cal.4th 1370, as modified Jan. 19, 2011, the Supreme Court held that an insurer must defend construction defect claims in adjudicative administrative proceedings. The Supreme Court in *Ameron* superceded its "bright line"

approach in *Foster Gardner* with a new inquiry in which insurers must analyze administrative actions to determine whether they are sufficiently "adjudicative" to qualify as a "suit" the insurer has a duty to defend. Before *Ameron*, insureds ran the risk that such administrative proceedings would not trigger their insurers' duty to defend.

On November 18, 2010, the California Supreme Court granted the insurer's petition for review in *Clarendon America Ins. Co. v. StarNet Ins. Co.* (2010) 186 Cal.App.4th 1397, which held that the Calderone claim process for construction defects qualified as a "suit." The Court of Appeal in *Clarendon* held that the term "suit" requires an insurer to defend against the *Calderon* pre-litigation dispute resolution process in condominium construction defect litigation. *Civil Code* § 1375 et seq. However, following the *Ameron* decision, the Supreme Court dismissed its review of *Clarendon*.

Parties should continue to assert that both the Calderon and SB 800 pre-litigation procedures are legislatively modified "suits" and that coverage is triggered. A simple practice tip is to concurrently file a civil action to trigger insurance coverage, then have the civil action stayed during the pre-litigation process.

#### A. QUASI-ADJUDICATIVE PROCEEDING WAS A "SUIT" THAT TRIGGERED THE DUTY TO DEFEND

- *Ameron Intern. Corp. v. Insurance Co. of State of Pennsylvania* (2010) 50 Cal.4th 1370.

Following the discovery by the United States Department of the Interior's Bureau of Reclamation (the Bureau) of defects in siphons at an aqueduct in Arizona, the Bureau's contracting officer issued two final decisions holding one of the insureds in this case responsible for the defects. The insured was the contractor and Ameron the subcontractor for the construction of the siphons. The insured and Ameron appealed the decisions before the United States Department of Interior Board of Contract Appeals (IBCA).

Although two of Ameron's insurers were willing to contribute, the remainder of the insurers refused to pay for the costs of defending or indemnifying the insureds in the litigation before the IBCA. This failure to defend or indemnify led to the action with the insurers, and the California Supreme Court held that this quasi-judicial adjudicative proceeding was a "suit" as a reasonable insured would understand that term, despite the CGL policies' definition of "suit" as "a court proceeding initiated by the filing of a complaint."

The Court concluded that the word "suit," when used in a CGL policy with no definition of that word, is sufficiently ambiguous that it should be construed to protect the insured's reasonable expectation of coverage. Critically, this holding may be an implied rejection of *Foster-Gardner's* logic that "suit" unambiguously refers only to court proceedings.

It was clear to the Court that the IBCA pleading requirements met the standards for a complaint under the *Code of Civil Procedure*. Pleadings for the

IBCA are required to "set [ ] forth simple, concise, and direct statements of each claim, alleging the basis with appropriate reference to contract provisions for each claim...." The Court found that this degree of specificity gives as much, if not more, notice to insurers making coverage decisions regarding claims as does the specificity required by the *Code of Civil Procedure*. Additionally, the Code of Federal Regulations provides that such pleadings "shall fulfill the generally recognized requirements of a complaint." 43 C.F.R. § 4.107(a) (2009).

The Court refused to "exalt form over substance" just because the IBCA was not a court of law. Additionally, a reasonable insured would expect coverage under such circumstances. The IBCA hearing lasted 22-days, with witness testimony and cross-examination. Therefore, the *Foster-Gardner* rule was inapplicable, and coverage under the primary, excess, and umbrella policies was triggered. *Foster-Gardner's* "bright-line rule" was thereby limited by *Ameron's* holding that it does not apply to administrative agency adjudicative proceedings.

#### 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. *NAICC* 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 *NAICC'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 *NAICC's* policy periods. *NAICC* 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.”

#### ENDORSEMENT AUTHORIZING ADDITIONAL PAYMENT FOR REBUILDING HOUSE DID NOT INCREASE THE “POLICY LIMIT” PAYABLE IMMEDIATELY.

- *Minich v. Allstate Ins. Co.*, (2011) WL 834071.

Allstate issued the Minichs a homeowner's insurance policy that provided that Allstate would pay the Minichs the “actual cash value” of their house, in an amount not to exceed the “limit of liability shown on the Policy Declarations,” if the house were damaged or destroyed. The “Building Structure Reimbursement” provision of the Policy provided that Allstate would pay the Minichs an amount in excess of the actual cash value if the Minichs were to “repair, rebuild or replace” their house. An endorsement to the Policy modified the “Building Structure Reimbursement” provision to state that this additional payment would not exceed “150% of the limit of liability.”

After the Minichs' house was destroyed by a fire, Allstate paid the Minichs \$129,590-the limit of liability as shown on the Policy's declarations, minus a \$250 deductible. Allstate paid the Minichs the additional \$64,920 approximately 15 months after the fire, once the Minichs demonstrated to Allstate that they were

rebuilding their house.

The Minichs filed this action against Allstate, claiming that Allstate should have paid them the \$64,920 immediately after the fire. Allstate filed a motion for summary judgment in which it argued that it had timely paid the Minichs the full “policy limit” under section 2051, subdivision (b)(1), and that the additional \$64,920 represented an amount above the policy limit. Allstate maintained that it was not required to pay the additional \$64,920 until and unless the Minichs rebuilt their house. The Court of Appeal affirmed the judgment in favor of Allstate.

The insurer did not breach the “Building Structure Reimbursement Extended Limits” endorsement in the open fire insurance policy by delaying payment under the endorsement, where payment under the endorsement was conditioned on rebuilding. The insurer paid the insureds the full amount provided for in the endorsement just one month after the insureds' representative indicated that insurer could inspect the foundation of the new house, and insurer paid the insureds 100 percent of the amount provided for in the endorsement more than three months before the insureds' new house was even 50 percent complete. The endorsement authorizing an additional payment for rebuilding did not increase the “policy limit” payable immediately.

#### XI. CONSTRUCTION ADMINISTRATION

##### CHANGE ORDERS TO PUBLIC CONTRACT CANNOT BE MODIFIED ORALLY OR BY CONDUCT

➤ *P & D Consultants, Inc. v. City of Carlsbad*, (2010) 190 Cal.App.4th 1332.

A civil engineering firm brought an action against the city for breach of contract, breach of implied contract, quantum meruit, and violation of prompt payment statutes, seeking to recover for services pertaining to redesign of municipal golf course. The city filed a cross-complaint for breach of contract, alleging deficient and incomplete work. The trial court granted nonsuit on the quantum meruit and implied contract claims, granted a directed verdict in part, and thereafter entered judgment on jury verdict for the engineering firm on the breach of contract complaint and for the city on the cross-complaint. City appealed.

The Court of Appeal reversed the jury's award of \$109,000 in favor of the contractor. The contract, which contained an integration clause, provided that there **could be no amendments** or waivers of contract terms absent a written agreement between the parties. Nevertheless, for five prior amendments, the city's project manager had authorized the contractor to start the extra work before receipt of the signed amendment. The contractor had introduced evidence showing an oral authorization by the project manager to continue working.

Unlike private contracts, explained the Court of Appeal, public contracts requiring written change orders cannot be modified orally or through the parties' conduct. Accordingly, the trial court erred in submitting the matter to the jury.

Instead, the city's motion for nonsuit should have been granted.

Additionally, since the contractor failed to raise equitable estoppel, waiver, or ratification as viable theories, they were waived. The court also noted that since this was a public contract, a private party cannot sue a public entity under implied contract and quantum meruit. See *Janis v. California State Lottery Com.*, (1998) 68 Cal.App.4th 824, 830.

SUBCONTRACTOR NOT REQUIRED TO STOP WORK OR PERFORM THE MODIFIED SCOPE FOR THE ORIGINAL PRICE IF NEGOTIATIONS FOR MORE MONEY ARE UNSUCCESSFUL

- *Ted Jacob Engineering Group, Inc. v. The Ratcliff Architects*, (2010) 187 Cal.App.4th 945.

An engineering subcontractor on a county hospital renovation and expansion project brought an action against the architect contractor, seeking payment of additional fees based on an increased basic scope of work and for additional services it alleged it was directed to perform. The trial court entered judgment on a jury trial for the subcontractor and awarded prejudgment interest, attorney's fees, and costs. The contractor appealed. The Court of Appeal affirmed, holding that the subcontractor could recover for work which it was directed to perform after unsuccessful negotiations regarding payment for that work.

A contractor faced with a substantial change in its originally contracted scope of work, who is unable to successfully negotiate a price for that additional work, may elect to continue to work and reserve its right to subsequently obtain a judicial determination as to the value of the changes, so long as the other contracting party continues to demand performance of the increased scope of work, and in the absence of any conflicting provision of the contract.

According to the Court of Appeal, where the changes are of great magnitude in relation to the entire contract, the contractor must negotiate in good faith to resolve the price. Where he has done so, he is not required to continue performance in the absence of an agreement as to the price. But, he may **elect to continue to work** and reserve his right to subsequently obtain a judicial determination as to the value of the changes, as long as the other party continues to demand performance of the increased scope of work, and in the absence of a conflicting provision in the parties' contract.