

IMPORTANT DEVELOPMENTS IN CALIFORNIA

CONSTRUCTION DEFECT LAW

(2001)

by Gregory R. Shaughnessy

The potential for liability for construction defects is an issue of extreme importance for every California contractor. In the year 2000 several decisions by the California courts were issued that affect this potential liability, and these decisions must be taken into consideration by contractors in managing the risks arising out of defective construction.

Aas v. Superior Court – Contractor not subject to tort liability for construction defects not causing property damage.

In Aas v. Superior Court (2000) 00 C.D.O.S. 9607 the California Supreme Court ruled that homeowners could not recover damages in negligence from the developer, contractor and subcontractors who built their dwellings for construction defects that have not caused property damage.

The plaintiffs in Aas alleged a variety of construction defects affecting virtually all components and aspects of construction of their single family homes. Some of the defects were alleged to violate provisions of the applicable building codes intended to prevent harm to life, health and property. However, plaintiffs acknowledged that many of the defects had not actually caused property damage. The Supreme Court affirmed the trial court's order granting defendants' motions in limine excluding evidence of those alleged construction defects that had not actually caused property damage, as relates to the plaintiffs' tort claims only.

The court issued a lengthy opinion in which it discussed and distinguished many other decisions by the California Supreme Court and

District Courts of Appeal. The court found that the economic loss rule announced in Seely v. White Motor Co. (1965) 63 Cal.2d 9, under which tort law "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," barred plaintiffs' tort claims. Id., 00 C.D.O.S. 9610.

The court's decision also addressed, in dicta, the issue of what constitutes recoverable "property damage," stating: "Over time, the concept of recoverable physical injury or property damage expanded to include damage to one part of a product caused by another, defective part." Id. In support of this statement, the court cited the recent decision in Stearman v. Centex Homes (2000) 78 Cal.App.4th 611, where the Court of Appeal held that a plaintiff could recover under strict liability against a developer when a defect in one component part of a house causes injury to other component parts of the house, but not to persons or property apart from the structure. The developer in Stearman had unsuccessfully argued that the economic loss rule barred plaintiffs from recovering under strict liability when the only damages claimed were damages to the product itself.

The heart of the Aas decision focused on the application of the six-factor "balancing test" articulated by the court in Biakanja v. Irving (1958) 49 Cal.2d 647 and J'Aire Corp. v. Gregory (1979) 24 Cal.3d 799. The court applied the third factor, which looks to "the degree of certainty that the plaintiff suffered injury," and essentially found that the failure to fulfill this factor, by itself, was sufficient to

prevent a finding of a duty of care necessary to support a tort cause of action in a construction defect case where no property damage was alleged, stating: “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. ... The breach of a duty causing only speculative harm or the threat of future harm does not normally suffice to create a cause of action.” The court concluded its balancing analysis by stating: “In conclusion, applying the J’Aire factors, we do not find that they justify a broad rule permitting recovery of repair costs unaccompanied by property damage or personal injury.”

The Aas decision is an important one for contractors and subcontractors in California, as it should reduce the scope of their potential construction defect liability to defects that have actually caused property damage, at least in some circumstances.

It must be stressed that the rule stated in Aas only applies to tort claims, such as strict liability in tort, negligence and negligence per se. The rule of non-liability for construction defects not causing property damage does not apply to contractual claims, such as breach of warranty or breach of contract. For example, a home buyer could still bring an action for breach of contract based on the failure of the builder to construct the home in accordance with the plans and specifications provided to the buyer, even though the variations had not caused property damage.

The Aas decision may change the way real estate is bought and sold in California. Typically contracts for the sale of improved real property provide that the sale is “as is” with no representations or warranties. There is some authority under prior California law allowing the subsequent purchaser to successfully bring a lawsuit against the contractor and subcontractors who built the project, even though the

subsequent purchaser could not sue the entity from whom the property was bought “as is.” In light of the Aas decision, the subsequent purchaser in this situation will only be able to sue the original contractors and subcontractors for construction defects causing property damage. In order to avoid this result, prudent purchasers of real property will insist that the seller assign to the purchaser all rights the seller has under any contracts the seller had with the original contractors and subcontractors. Sellers may see no reason not to do so, as such a provision does not enlarge the seller’s potential liability. On the other hand, prudent contractors will cause to be inserted in all of their general contracts a provision that states that the general contract may NOT be assigned to a third party and that the general contract is not intended to benefit any third parties.

It is certain that counsel for plaintiffs in construction defect cases will come up with many imaginative theories to attempt to circumvent the rule stated in Aas. There are already rumblings in the plaintiffs bar of introducing legislation that will reverse the rule stated in Aas.

Jiminez v. Superior Court – Are suppliers of construction materials subject to strict liability in tort for construction defects?

In Jiminez v. Superior Court (2000) 82 Cal.App. 4th 856, the 4th District Court of Appeal held that manufacturers of defective windows installed in mass-produced homes may be subject to strict products liability. On November 15, 2000 the California Supreme Court granted a petition for review of Jiminez, and the decision of the Court of Appeal can no longer be cited. Nonetheless, if the decision in Jiminez is affirmed, it could dramatically increase the potential liability of contractors and subcontractors for construction defects.

In Jiminez the windows in the plaintiffs’ single family home leaked and caused damage to the

home. The plaintiffs filed a lawsuit against the developer, the subcontractor who furnished and installed the windows and the window manufacturer and supplier alleging causes of action for strict products liability and negligence. The Court of Appeal reversed the trial court's order granting the window manufacturers' motion for summary judgment on the strict products liability cause of action.

The Jiminez court based its decision on general principals underlying the doctrine of strict liability. However, in reaching its decision, the Jiminez court had to distinguish the decisions in La Jolla Village Homeowner's Ass'n. v. Superior Court (1989) 212 Cal.App.3d 1131 and Casey v. Overhead Door Corp. (1999) 74 Cal.App.4th 112, both decisions by the same 4th District Court of Appeal.

In La Jolla Village the Court of Appeal struck from a homeowners association's complaint a cause of action for strict products liability against all subcontractors "involved in construction and manufacturing" a new condominium building. The cause of action for strict products liability against the developer was permitted. It bears noting that the subcontractors were actually in the position of prime contractors, in that they had a direct contractual relationship with the developer, who also functioned as the general contractor.

The La Jolla Village court stated: "[A] subcontractor who does not have any ownership or control over the project being built should not be held strictly liable for defective or dangerous conditions of the mass-produced homes." Id. at 1145. The court concluded: "We decline to extend the doctrine [of strict products liability] to persons who have no control over or financial interest in, other than for their own payment for services, the project or product being manufactured." Id. at 1146. Based on this language, the logic of La Jolla Village would also indicate that general contractors, who are

not also functioning as developers, should also not be subject to strict liability.

The Jiminez court ultimately distinguished the La Jolla Village decision on the grounds that the subcontractors in that case furnished only services, not materials. Because the defendants in Jiminez manufactured and distributed windows, which are products, not services, the Jiminez court concluded that they were subject to strict liability. Jiminez, supra, 82 Cal.App.4th at 877.

Casey involved a subcontractor who manufactured and installed windows in single family homes. The Court of Appeal affirmed the summary judgment in favor of the subcontractor on the strict liability cause of action, relying on La Jolla Village. The Jiminez court disagreed with the Casey decision, and issued the following alarmingly broad language:

Strict products liability attaches to all persons in the chain of distribution of a defective product, including manufacturer's, wholesalers, suppliers and retailers. The imposition of strict products liability on one link in the chain does not absolve other links from strict products liability. We conclude the manufacturer of a defective window and all distributors of that window, including a developer that integrates that defective window into a mass-produced home, are strictly liable for damage to persons or other property caused by that defective window.

Id. at 880.

This sweeping language from Jiminez noted above could arguably support a cause of action for strict liability against every contractor and subcontractor involved in a construction project, with the exception of parties that provide only services and do not furnish or install any materials or equipment. Under the reasoning of Jiminez, arguably only contractors or subcontractors that enter into "labor only" or

“services only” contracts may avoid strict liability. As such contracts are quite rare in the industry, the potential ramifications if Jiminez is affirmed are great.

The significance of a cause of action for strict liability is that the plaintiff does not need to show that the defendant was negligent. The plaintiff merely needs to establish the existence of a defect and resulting damages. Thus, exposing contractors and subcontractors to strict liability will, at a minimum, make it easier for plaintiffs to prove liability and, to this extent, the rationale of the Jiminez decision increases the potential liability of contractors and subcontractors.

It is difficult to predict how the California Supreme Court will rule in Jiminez. One factor to consider is that Jiminez disapproved the decision in Casey, and the California Supreme Court in the Aas decision cited Casey with approval. On the other hand, the Supreme Court may feel constrained to utilize its opinion in Jiminez to impose strict liability on entities other than developers as a way of balancing the impact of the Aas decision limiting recovery in tort to property damage.

Krusi v. Amoroso – Subsequent purchaser of office building lacked standing to sue original contractor for construction defects.

In Krusi v. S.J. Amoroso (2000) 81 Cal.App.4th 995, the First District Court of Appeal held that the fourth owner of an office building lacked standing to sue the architect, contractor and subcontractors for construction defects where the prior owner had knowledge of some of the defects, the plaintiff owner received no assignment of rights against these entities and there had been a prior arbitration alleging construction defects.

During the course of the original construction the original owner claimed that there were leaks in the garage headwall. In an arbitration between

the owner and the architect, the arbitrator ruled in favor of the architect. Prior to the sale of the property to the plaintiff, their seller became aware of several leaks from the building decks into the building, as well as a problem with crumbling of the floor gypcrete underlayment.

After the sale of the property to the plaintiff, the plaintiff hired consultants who concluded that the leaks and deteriorating underlayment were the result of “building wide deficiencies in the original design and construction of the subject building.”

In affirming the summary judgment in favor of the defendants, the court noted that “a cause of action for damage to real property accrues when ‘damage’ or ‘physical injury to property’ occurs.” Id. at 1005. The court went on to state:

Thus, if, as and when an owner of a building suffers harm because of inadequate design of or engineering or construction work performed on a building, a cause of action accrues to that owner. To be sure, it may choose to deliberately transfer that cause of action to another, but without some clear manifestation of such an intention, the cause of action is not transferred.

Id. at 1005.

The court found that the construction defects existed prior to the acquisition of the property by the plaintiffs and that plaintiffs were aware of the problems prior to their purchase of the property. The court also placed emphasis on the fact that the architect had actually litigated a claim for improper design with the original owners. Based on these facts, the court affirmed the finding that the causes of action for construction defects accrued to prior owners of the building and, accordingly, that the plaintiffs had no right to sue the original architect, contractor or subcontractors.

Krusi is an important decision because it provides another layer of defense to contractors sued for construction defects. If the defect existed prior to the sale of the property, and the property was sold “as is” with no assignment of rights, general contractors may be able to escape liability. Of course, the Krusi decision will also cause buyers of real property to demand an assignment of rights from the seller against the original contractors and subcontractors.

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