

Commentary

A FACELIFT FOR CONSTRUCTION DEFECT CLAIMS

by Barry MacNaughton

Construction defect litigation has become a fact of life in California. Anyone involved in the development and sale of residential or commercial real estate may be involved in a construction defect action whether developing apartments, condominiums or single-family homes. The recent entry of mold as a health hazard into the public consciousness will only exacerbate this trend.

The California Legislature has made several attempts to streamline these cases and provide fairness to all parties. These attempts have generally fallen victim to political warfare among developers, insurers, contractors and trial lawyers.

The Legislature has again delved in to this quagmire with a new Bill, SB 800, also known as the Burton Bill, signed into law by Governor Davis on September 20, 2002. While far from perfect, the Burton Bill provides five advances: (1) it defines considered “defects;” (2) it mandates one-year warranties from builders to home buyers; (3) it gives builders an effective repair remedy to avoid most litigation; (4) it forces both sides to provide substantial documentation prior to the expensive “serve-and-volley” phase of litigation; and (5) it shortens the statute of limitations for certain items. Each of these changes should assist those involved in the construction and sale of new residential housing to limit their expense and exposure in construction defect disputes.

What is a “Defect”

One of the most troubling things about construction defect litigation has been the lack of uniform standards about what constitutes a “defect.” It has often been said that a defect is like pornography — you can’t define it exactly, but you know it when you see it. This has left the field open for creative plaintiffs to expand the defects’ universe and for defendants to close their eyes to obvious construction inadequacies.

The Burton Bill defines “defect” for issues of water intrusion, structural integrity, soils, fire protection, plumbing and sewer systems, electrical systems and others. While each area contains specific standards, the overall purpose of the definitions is to limit the term “defects” to those areas that actually cause problems for homebuyers and consumers. Gone are the days when a defect could consist of any subject which an expert witness was willing to testify violated the applicable standard of care.

In return, homebuyers no longer have to wait for property damage, death or bodily injury to actually occur from those defective conditions. A homebuyer or condominium association is entitled to go forward on the defective condition before it actually causes damage. For example, a claim on a defective roof could be pursued before the roof actually collapses or causes significant water damage. This gives both sides a needed incentive — developers have a defined standard to meet and homebuyers can pursue claims for not meeting those standards without having to wait for significant disruption of their lives.

Builders’ Warranties

The Burton Bill also requires builders to provide a minimum one-year express written limited warranty covering the “fit-and-finish” of building components. This minimum warranty includes protection against a failure to meet the standards in the statute and also includes the fit-and-finish of such items as cabinets, countertops, flooring, paint finishes and similar items.

Builders are encouraged to offer a higher level of warranty in an enhanced protection agreement. Such an agreement must provide either greater protection or protection for a longer time period than the minimum imposed by statute. The advantage to a builder is that an enhanced protection agreement allows the builder to set the minimum standards as long as they meet or exceed those set by statute. The consumer benefits from having a minimum one-year express warranty with the possibility for enhanced protection.

The available enhanced protection agreement will allow builders to compete based upon construction standards and service to the ultimate homebuyer. Builders have an incentive to compete on this basis given that the law implies a minimum standard in any event. All parties should benefit from warranties that encourage repair, rather than litigation, as the effective method for dealing with disputes.

KOREK LAND COMPANY, INC.

14545 ERWIN ST. ❖ VAN NUYS, CA 91411 ❖ (818) 787-3077 ❖ FAX (818) 787-9677
www.korekland.com ❖ mail@korekland.com

Builders Now Have The Option To Repair Defects and Forestall Litigation

The benefits of this incentive can be realized in the mandated pre-litigation procedure. Rather than the typical rush to the courthouse, homebuyers and associations must now provide notice to any party alleged to have contributed to a violation of the minimum standards. That notice must describe the claim in “reasonable detail” sufficient to determine the nature and location of the violation; builders and contractors will have notice of what the case is actually about from the very inception.

This pre-litigation procedure also imposes obligations on builders and contractors. Those obligations include providing plans, specifications and warranty documents to the homebuyer at the inception of the action. The builder is also required to notify the homeowner whether it intends to use the non-adversarial dispute resolution procedure provided by statute or a similar procedure set forth in its warranty documents.

The non-adversarial procedure is designed to resolve as many defect claims as possible at an early stage. The builder is given time to inspect the claimed defect, with a chance for a second inspection if necessary. The builder is also required to notify any design professional, subcontractor, insurance carrier, warranty company or material supplier if it intends to hold that party partially responsible for the claimed defect. This will ensure the appearance of the important parties involved in the action while the defect is still being examined and discovered.

The Burton Bill provides builders with a repair remedy. The builder’s repair offer must be in writing and include a detailed, specific, step-by-step statement identifying the repair and a reasonable completion date. The homeowner either authorizes the repair or requests the name of contractors qualified to review the repair. The statute also sets up a mediation procedure and is designed to allow builders and homeowners to agree on the extent and type of necessary repairs and to make those repairs as promptly as possible in the hope of resolving the dispute.

The remedies section of the Burton Bill does contain one serious flaw — it does not prevent the homeowner from filing a suit even when the builder does repair the claimed defect. The Bill specifically provides that a homeowner can still commence an action for violation of the applicable standard or claimed inadequate repair. After repairs are offered or made, the expectation is that such actions will be limited where builders undertake good faith efforts to repair and remediate construction defect problems. The builder is also entitled to mediation should the homeowner be unsatisfied with the repairs.

The Burton Bill Also Shortens Limitations Periods and Limits Damages

The Burton Bill contains damage limits, imposes duties on homeowners and shortens certain limitations periods. Under the Bill, a homeowner’s damages consist of the reasonable cost of repairing the violation of the standards set by law, the reasonable costs of repairing damages caused by those repair efforts, the cost of repairing and rectifying damages caused by the violation, investigation costs, and lost income or business losses where the home was used as a principal place of business licensed to be operated from the home. A homeowner’s recovery can be reduced due to an unreasonable failure to minimize or prevent damages and failure to perform commonly accepted maintenance.

This new statutory scheme can and should encourage repair and mediation.

The new statutory scheme applies only to escrows closing after January 1, 2003. The potential benefits of this Bill may not be realized for a few years, especially given the one-year statute of limitations for construction defect actions. There may be some ancillary benefits in the short term through decreased insurance premiums and a greater willingness on the part of all parties in these cases to resolve their disputes through repairs and restitution, rather than expensive litigation.

Written by Barry MacNaughton, a partner at the Beverly Hills law firm of Ervin, Cohen & Jessup LLP and a member of the firm’s Litigation Department. Mr. MacNaughton focuses on business and commercial litigation, emphasizing real estate matters, including construction cases, purchase and sale disputes, judicial and non-judicial foreclosures and partnership disputes. He also has significant experience in trade secret and unfair competition litigation, corporate governance matters, and insurance bad faith and coverage litigation.

GUEST COMMENTARIES WELCOME, and may be printed at the sole discretion of **Korek Land Company**.

013003

Previous commentaries available upon request: