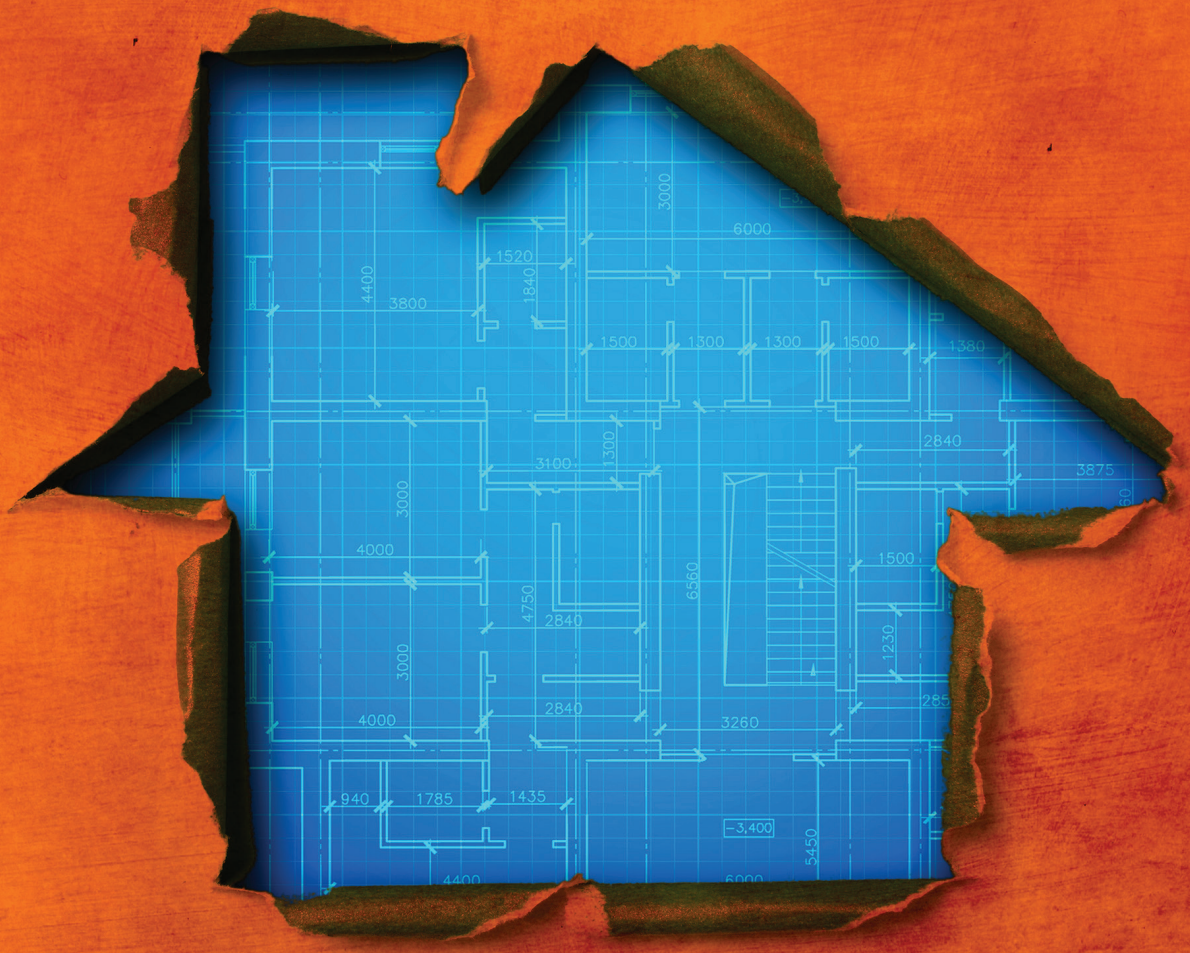
BERDING | WEIL

A Community Manager's Guide to

CONSTRUCTION DEFECT CLAIMS



Published 2014

Berding & Weil LLP
2175 N. California Blvd., Suite 500
Walnut Creek, California 94596

Telephone: (925) 838-2090
Facsimile: (925) 820-5592

www.berding-weil.com

ISBN: 1-4951-2526-3
Printed in the United States of America

A Community Manager's Guide to Construction Defect Claims

Tyler P. Berding, J.D., Ph.D. • Julia Hunting, J.D., P.E., S.E. • Anna P. Fabiano, J.D.

BERDING & WEIL LLP

Contents


concept
maintena
control
warning
repair
Defect list
failure
quality
accuracy

Introduction

For decades, litigation over the defective construction of multi-family projects has been a frequent component of a property manager's portfolio. Low-rise, wood frame condominiums, apartments, and townhouses have long been susceptible to construction mistakes which lead to disputes with contractors and developers. High-rise projects can also exhibit poor construction. Community associations and owners of apartment buildings have found many reasons to sue builders. What leads to construction defects? Often it is a shortage of skilled labor in times of high real estate prices and demand. When there is strong sales potential, builders are eager to supply inventory, but good construction takes time and talent; when time and talent are in short supply, substitutions are made, which can lead to poor quality and subsequent claims.

Construction defects may be noticed almost immediately by new buyers, or they may lurk within a building for years before the damage they cause is detected. These problems can be as obvious as an actively leaking roof, or they can be as subtle as cracking caused by soil problems that develop several years after purchase. They can be easy to fix or potentially catastrophic, and their severity will strongly influence whether or not the builder or contractor will make repairs without the compelling force of litigation.

Here we cover construction defects in new construction. Defective repairs in new and older buildings are a topic covered in our companion book: "A Property Manager's Guide to Reconstruction Projects."[1] Property managers must have a basic understanding of the elements of a construction claim, so they can adequately advise their clients, retain or recommend appropriate professionals, and monitor the claims process. That information follows. We hope this resource will be useful to both you and your clients.

1 Tyler P. Berding. J.D., Ph.D., Paul W. Windust, J.D., and Julia Hunting, J.D., P.E., S.E., *A Property Manager's Guide to Reconstruction* (2013).

CHAPTER ONE

What are Your Client's Objectives?

Ask any owners of multi-family property[2] if litigating construction defects is high on their agenda, and you will be met with blank stares. Unless the damage is serious and visible construction defects are rarely perceived as an immediate crisis by directors or other property owners because construction mistakes which do not cause immediate visible damage do not interfere with their daily lives or raise concerns. Further, builders and contractors will usually respond to the first complaints of a serious problem with attempts to repair it and dispense with the problem. If that effort appears to succeed, everyone is satisfied for the moment. It is when that or subsequent attempts to repair a problem fail that owners seek other answers.

Community association boards of directors and other property owners have varying objectives when faced with a construction error in a building. Many will see such a defect as a limited problem with a short-term solution – if the first leaks have been fixed by whatever means are employed, then the problem is solved, and there is no need for further inquiry. Others who have seen the smoke will want to know if there is a fire and will ask questions that require a more comprehensive investigation to answer: Is the problem *permanently* fixed? Are there similar problems elsewhere?

The approaches taken reflect the personal interests of the individual decision-makers – are those interests short or long term? They can't be both. Individuals with short-term interests, those who do not see these defects as their problem for more than a few more years, will want to keep construction issues to a minimum and assessments low, both of which enhance short-term market value. Those with longer horizons want to be sure that the property's value is preserved for the future, which may mean a more comprehensive investigation or repair and the attendant expenses.

2 By "owner" we mean community associations where the property is a common interest development and investor owners of rental properties. "Multi-family property" includes condominiums, attached planned developments (often referred to as 'townhouses') and apartment buildings.

Managers should understand these competing objectives because they determine what action the client will take to address a construction mistake. If the dominant sentiment favors only short term planning, more in-depth investigations by experts or retention of legal counsel may be resisted. If the client's interest is long-term, then using appropriate experts to assess the damage and retaining counsel to advise on legal options will be more acceptable.

Money always impacts a client's objectives. If the construction issue is small and can be fixed easily, many clients will not see the need to invest in an investigation or take legal action to pursue the builder or contractor. Similarly, a large or pervasive problem that requires an extensive investigation and repair may also be resisted because of the cost of going forward. Borrowing from reserves, special assessments, or bank loans are not popular alternatives even for the most informed and motivated clients.

MANAGER'S HEADS UP

Regardless of the client's interests or conflicts, one thing is inevitable—legal rights can be lost through inaction because there are specific time limits for taking legal action to pursue a designer, developer or contractor. Once those time limits are passed, no amount of later damage can resurrect a claim. Managers should be sure that the owners have all of the information they need to make an informed decision while the choice is still theirs.

Most property managers know that directors of a community association or a real estate corporation have specific fiduciary duties to the corporation and its members. Usually, if there is evidence of a construction defect, those duties include the responsibility to adequately investigate it.[3] If that investigation uncovers problems that require repair, it will then be up to the owners or the board of directors to determine how to raise the funds to accomplish that. It is prudent to arrive at that decision by obtaining the advice of counsel concerning what legal avenues can be pursued and what time limits there are for taking legal action.[4]

3 *California Corporations Code* Section 309(a).
4 See Chapter Three.

CHAPTER TWO

What are Construction Defects?

According to one of several dictionary definitions, a "defect" is a "physical problem that causes something to be less valuable, effective, healthy, or causes weakness or failure."[5] In buildings, the defect usually can be traced to something that the builder – developer, contractor, or both – did wrong during construction that left the building with a functional problem.

The California Building Code, which incorporates the International Building Code[6] and several other codes[7], provides objective construction requirements for certain building components. Experts – architects and engineers – can use "standards" of the construction industry and the drawings and specifications for that specific project to help define a construction defect. "Defects" in construction can be a failure to design something properly, a failure to properly build it according to that design, a failure to adhere to accepted codes or standards, or all of these.

Since a precise definition of a construction defect is difficult to articulate, especially in a courtroom, the California legislature included "performance" standards for community associations in Senate Bill 800 enacted in 2002.[8] Found at Title 7, Part 2, Division 2 of the California *Civil Code* (commonly referred to as "Title 7",) the statute sets numerous standards for performance of most building components found in a residential building.[9] As one example, the performance standard for "Doors" is that a door *"Shall not allow unintended water to pass beyond, around or through the door or its moisture barriers."*[10] There are many other performance standards in Section 896 of Title 7.

MANAGER'S HEADS UP

Title 7 does not apply to rental apartments or condominium conversions but only to new construction intended to be sold as a dwelling unit, such as single family residences and common interest developments, including mixed use common interest developments with a residential component.

Defects can cause catastrophic failures, like a building collapse in an earthquake or a balcony failure from the weight of its occupants, each due to a failed structural design or flawed execution. Defects can also cause less sudden problems, like long-term dry rot or decay resulting from water or moisture leaking into hidden spaces in walls or ceilings and remaining trapped there for a long period of time. When the construction fails to deliver protection against damage and instead allows mold to grow, roofs to leak, walls to crack, or plumbing to break, the construction can also be considered "defective."

MANAGER'S HEADS UP

It is also helpful to know what is *not* a construction "defect." A building not properly maintained by its owner, so it fails for that reason alone, would likely not be found defective by a court. A component damaged by an unforeseen outside force, like a tornado or flood, would not be defective, assuming all building codes and construction standards had been met. However, even in the face of a natural disaster, if a deficiency in the construction or a building product makes the damage worse, then there may still be a claim against the builder or product manufacturer.

5 In *Merriam-Webster.com.* Retrieved March 4, 2014, from http://www.merriam-webster.com/dictionary/defect

6 International Code Council, Inc. *International Building Code*. Illinois: International Code Council (ICC), various years.

7 The *International Building Code* incorporates several codes and standards, including *Minimum Design Loads for Buildings and Other Structures* (ASCE), Steel *Construction Manual* (AISC), *Building Code Requirements for Structural Concrete* (ACI), *Building Code Requirements for Masonry Structures* (MSJC), and the *National Design Specification for Wood Construction* (AF&PA).

8 Title 7, Part 2, Division 2, of the California *Civil Code* commencing at Section 895, *et seq*.

9 California *Civil Code* Section 896.

10 California *Civil Code* Section 896(a)(1).

CHAPTER THREE

What are a Property Owner's Legal Rights?

The owners of multi-family property – apartments, condominiums, or planned developments – and their representatives, such as community associations, have the legal right to maintain an action (suit) against anyone responsible for construction defects whether those defects occur in the original design, derive from a building product or happen during construction. These rights arise from statutes, case law, and contracts between the parties. They are listed and explained further below, but the designers and builders of these projects owe a duty to design and build them properly. When that does not happen and the design is wrong, or the construction does not adhere to the design, or building products incorporated in the construction fail and result in defects, the owner has recourse.

WHO CAN SUE FOR CONSTRUCTION DEFECTS?

To sue someone for construction defects, the claimant ("Plaintiff") must have an ownership interest in the property – a building, unit, or lot. The Plaintiff can be an investor-owner of an apartment complex or an individual owner of a condominium unit – but with condos, it is typically the community association charged with managing the property. California *Civil Code* Section 5980 provides that a community association has standing to sue for defects in the common area or in any portion of the individual units (separate interest) that the association must maintain and repair:

> *An association has standing to institute, defend, settle, or intervene in litigation, arbitration, mediation, or administrative proceedings in its own name as the real party in interest and without joining with it the members, in matters pertaining to the following:*
>
> *(a) Enforcement of the governing documents.*
>
> *(b) Damage to the common area.*
>
> *(c) Damage to a separate interest that the association is obligated to maintain or repair.*
>
> *(d) Damage to a separate interest that arises out of, or is integrally related to, damage to the common area or a separate interest that the association is obligated to maintain or repair.*

MANAGER'S HEADS UP

In some newer associations, the CC&Rs or the Bylaws may require a vote of the members to approve suing for construction defects, so have legal counsel check the governing documents for these provisions and other similar provisions designed to protect the developer from construction defect litigation.

In a typical condominium, the "common area"[11] includes all of the building and the grounds except for the airspace within each unit, so the association would have the right ("standing") to sue for defects anywhere except components or items exclusive to a unit. In an attached planned development, the common area may include only the streets and grounds around the buildings, but because the association may also maintain the exteriors of the buildings – such as roofing, stucco, siding and paint – it will have standing to sue for poor waterproofing and other defects in the exterior "skin" of the buildings as well. The association's obligation to insure the buildings against natural or man-made disasters may also provide a basis for standing to sue. A community association may also sue in a "representative" capacity when a defect is common to many individual owners.[12]

TYPICAL DEFENDANTS

In most construction defect cases brought by the owners of newly-constructed buildings, the "Defendants" can be any or all of the participants in the original construction: the developer, general contractor, subcontractors, product manufacturers, material suppliers and/or the design professionals who created the plans and specifications, depending upon the defect. Often these Defendant parties will also sue some other Defendant parties, each claiming that if the building is defective it is the fault of one or more other Defendants.

MANAGER'S HEADS UP

A property owner probably will not know the identities of all Defendant parties involved in the construction who may be liable for the defects. However, it is unnecessary to ascertain the identities of these parties prior to suing; the property owner can sue the developer and/or builder, since they built the building and placed it on the market.

11 California *Civil Code* Section 4095.

12 *Residents of Beverly Glen, Inc. v. M. Penn Phillips Co.*, 34 Cal.App.3d 117 (1973), *Salton City Area Property Owners Association v. M. Penn Phillips Co.*, 75 Cal.App.3d 184 (1977), *Raven's Cove Townhomes, Inc. v. Knuppe Development Co.*, 114 Cal.App.3d 783 (1981), and *Market Lofts Community Association v. 9th Street Market Lofts, LLC*, 222 Cal.App.4th 924 (2014).

WHAT LEGAL THEORIES ARE AVAILABLE TO COMMUNITY ASSOCIATIONS AND BUILDING OWNERS?

The remedies for construction defects in California are found in three places: Statutes, Case Law, and Contracts.

Title 7 of the California *Civil Code*. The primary statute creating builder liability for construction issues found in projects managed by a community association is Title 7 of the California *Civil Code*. Sometimes known by the name of the Senate bill that created it in 2002, "SB 800," it holds builders liable for failure to meet the 15 specified "Standards for Residential Construction" listed in Section 896 of Title 7. The standards are "performance" standards, not "code" requirements or specifications for construction. The statute states that the Defendant builder "shall be liable for" a breach of those standards.[13] **The Title 7 remedies are only available to individual homeowners and community associations for new construction claims.**[14] Other building owners may use the tort and contract remedies discussed below.

The Title 7 standards speak to how a building component should work in simple terms as follows[15]:

> **Section 896. In any action seeking recovery of damages arising out of, or related to deficiencies in, the residential construction, design, specifications, surveying, planning, supervision, testing, or observation of construction, a builder, and to the extent set forth in Chapter 4 (commencing with Section 910), a general contractor, subcontractor, material supplier, individual product manufacturer, or design professional, shall, except as specifically set forth in this title, be liable for, and the claimant's claims or causes of action shall be limited to violation of, the following standards, except as specifically set forth in this title. This title applies to original construction intended to be sold as an individual dwelling unit. As to condominium conversions, this title does not apply to or does not supersede any other statutory or common law.**
>
> **(a) With respect to water issues:**
>
> **(1) A door shall not allow unintended water to pass beyond, around, or through the door or its designed or actual moisture barriers, if any.**
>
> **(2) Windows, patio doors, deck doors, and their systems shall not allow water to pass beyond, around, or through the window, patio door, or deck door or its designed or actual moisture barriers, including, without limitation, internal barriers within the systems themselves. For purposes of this paragraph, "systems" include, without limitation, windows, window assemblies, framing, substrate, flashings, and trim, if any.**
>
> **(3) Windows, patio doors, deck doors, and their systems shall not allow excessive condensation to enter the structure and cause damage to another component. For purposes of this paragraph, "systems" include, without limitation, windows, window assemblies, framing, substrate, flashings, and trim, if any.**
>
> **(4) Roofs, roofing systems, chimney caps, and ventilation components shall not allow water to enter the structure or to pass beyond, around, or through the designed or**

13 California *Civil Code* Section 896.
14 Condominium Conversions are not covered by Title 7.
15 California *Civil Code* Section 896.

actual moisture barriers, including, without limitation, internal barriers located within the systems themselves. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, and sheathing, if any.

(5) Decks, deck systems, balconies, balcony systems, exterior stairs, and stair systems shall not allow water to pass into the adjacent structure. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashing, and sheathing, if any.

(6) Decks, deck systems, balconies, balcony systems, exterior stairs, and stair systems shall not allow unintended water to pass within the systems themselves and cause damage to the systems. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashing, and sheathing, if any.

(7) Foundation systems and slabs shall not allow water or vapor to enter into the structure so as to cause damage to another building component.

(8) Foundation systems and slabs shall not allow water or vapor to enter into the structure so as to limit the installation of the type of flooring materials typically used for the particular application.

(9) Hardscape, including paths and patios, irrigation systems, landscaping systems, and drainage systems, that are installed as part of the original construction, shall not be installed in such a way as to cause water or soil erosion to enter into or come in contact with the structure so as to cause damage to another building component.

(10) Stucco, exterior siding, exterior walls, including, without limitation, exterior framing, and other exterior wall finishes and fixtures and the systems of those components and fixtures, including, but not limited to, pot shelves, horizontal surfaces, columns, and plant-ons, shall be installed in such a way so as not to allow unintended water to pass into the structure or to pass beyond, around, or through the designed or actual moisture barriers of the system, including any internal barriers located within the system itself. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashings, trim, wall assemblies, and internal wall cavities, if any.

(11) Stucco, exterior siding, and exterior walls shall not allow excessive condensation to enter the structure and cause damage to another component. For purposes of this paragraph, "systems" include, without limitation, framing, substrate, flashings, trim, wall assemblies, and internal wall cavities, if any.

(12) Retaining and site walls and their associated drainage systems shall not allow unintended water to pass beyond, around, or through its designed or actual moisture barriers including, without limitation, any internal barriers, so as to cause damage. This standard does not apply to those portions of any wall or drainage system that are designed to have water flow beyond, around, or through them.

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

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

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

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

(17) Showers, baths, and related waterproofing systems shall not leak water into the interior of walls, flooring systems, or the interior of other components.

(18) The waterproofing system behind or under ceramic tile and tile countertops shall not allow water into the interior of walls, flooring systems, or other components so as to cause damage. Ceramic tile systems shall be designed and installed so as to deflect intended water to the waterproofing system.

(b) With respect to structural issues:

(1) Foundations, load bearing components, and slabs, shall not contain significant cracks or significant vertical displacement.

(2) Foundations, load bearing components, and slabs shall not cause the structure, in whole or in part, to be structurally unsafe.

(3) Foundations, load bearing components, and slabs, and underlying soils shall be constructed so as to materially comply with the design criteria set by applicable government building codes, regulations, and ordinances for chemical deterioration or corrosion resistance in effect at the time of original construction.

(4) A structure shall be constructed so as to materially comply with the design criteria for earthquake and wind load resistance, as set forth in the applicable government building codes, regulations, and ordinances in effect at the time of original construction.

(c) With respect to soil issues:

(1) Soils and engineered retaining walls shall not cause, in whole or in part, damage to the structure built upon the soil or engineered retaining wall.

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

(3) Soils shall not cause, in whole or in part, the land upon which no structure is built to become unusable for the purpose represented at the time of original sale by the builder or for the purpose for which that land is commonly used.

(d) With respect to fire protection issues:

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

(2) Fireplaces, chimneys, chimney structures, and chimney termination caps shall be constructed and installed in such a way so as not to cause an unreasonable risk of fire outside the fireplace enclosure or chimney.

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

(e) With respect to plumbing and sewer issues:

Plumbing and sewer systems shall be installed to operate properly and shall not materially impair the use of the structure by its inhabitants. However, no action may be brought for a violation of this subdivision more than four years after close of escrow.

(f) With respect to electrical system issues:

Electrical systems shall operate properly and shall not materially impair the use of the structure by its inhabitants. However, no action shall be brought pursuant to this subdivision more than four years from close of escrow.

(g) With respect to issues regarding other areas of construction:

(1) Exterior pathways, driveways, hardscape, sidewalls, sidewalks, and patios installed by the original builder shall not contain cracks that display significant vertical displacement or that are excessive. However, no action shall be brought upon a violation of this paragraph more than four years from close of escrow.

(2) Stucco, exterior siding, and other exterior wall finishes and fixtures, including, but not limited to, pot shelves, horizontal surfaces, columns, and plant-ons, shall not contain significant cracks or separations.

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

(B) For purposes of this paragraph, "useful life" means a representation of how long a product is warranted or represented, through its limited warranty or any written representations, to last by its manufacturer, including recommended or required maintenance. If there is no representation by a manufacturer, a builder shall install manufactured products so as not to interfere with the product's utility.

(C) For purposes of this paragraph, "manufactured product" means a product that is completely manufactured offsite.

(D) If no useful life representation is made, or if the representation is less than one year, the period shall be no less than one year. If a manufactured product is damaged as a result of a violation of these standards, damage to the product is a recoverable element of damages. This subparagraph does not limit recovery if there has been damage to another building component caused by a manufactured product during the manufactured product's useful life.

(E) This title does not apply in any action seeking recovery solely for a defect in a manufactured product located within or adjacent to a structure.

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

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

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

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

(8) Untreated wood posts shall not be installed in contact with soil so as to cause unreasonable decay to the wood based upon the finish grade at the time of original construction. However, no action shall be brought pursuant to this paragraph more than two years from close of escrow.

(9) Untreated steel fences and adjacent components shall be installed so as to prevent unreasonable corrosion. However, no action shall be brought pursuant to this paragraph more than four years from close of escrow.

(10) Paint and stains shall be applied in such a manner so as not to cause deterioration of the building surfaces for the length of time specified by the paint or stain manufacturers' representations, if any. However, no action shall be brought pursuant to this paragraph more than five years from close of escrow.

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

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

(13) Ceramic tile and tile backing shall be installed in such a manner that the tile does not detach.

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

(15) Structures shall be constructed in such a manner so as not to impair the occupants' safety because they contain public health hazards as determined by a duly authorized public health official, health agency, or governmental entity having jurisdiction. This paragraph does not limit recovery for any damages caused by a violation of any other paragraph of this section on the grounds that the damages do not constitute a health hazard.[16]

16 Note the provisions in red. These are the statutes of repose that are imbedded in certain of the performance standards. We will discuss these statutes of repose in Chapter Four.

If the standards are found to be breached, the builder is liable for the cost of repairing the failed component and any damage it causes, regardless of fault. The builder also has options under that statute, including a right to repair. The right to repair gives the builder the opportunity to repair and replace damaged building components and avoid a potential lawsuit for construction defects. Title 7 also provides for unique "statutes of repose" (highlighted in red above and discussed in Chapter Four) and provisions for alternative dispute resolution. Title 7 does not apply to construction defect disputes arising with rental apartments, commercial buildings or condominium conversions. For those projects the owner must rely on the common law legal remedies.

Common Law. Construction defect claims can be based on several legal theories that are the domain of "common law." Common law is created by the decisions of appellate courts stretching over decades in California and was and is a separate basis of liability of a builder or contractor being sued by a building owner. When Title 7 was enacted, there was a debate over whether that statute preempted the field—i.e. was Title 7 now the *exclusive* remedy available to community associations and were the common law theories no longer applicable? That matter was recently settled in *Liberty Mutual Insurance Company v. Brookfield Crystal Cove, LLC*, where the California Appellate Court found that common law remedies are still available to homeowners and community associations besides the remedies found in Title 7[17]. Common law legal theories have always been available to owners of commercial and residential buildings. These theories generally address two categories of claims: "tort" claims and "contract" claims.

"Tort" claims in a construction defect case are usually claims for Negligence and Strict Liability. To prove Negligence, a claimant must show that the Defendant builder fell below the standard of care for similar builders when constructing the building and that the defect caused damage to the claimant.[18] Strict Liability is liability without proof of fault. The mere fact that the building is defective and that the Defendant builder/developer built it and put it on the market, is sufficient under the theory of Strict Liability to hold the builder liable.[19] Strict Liability can also extend to product manufacturers that manufacture and supply materials and components incorporated into the construction.

"Contract" claims in a construction defect case are usually claims for breach of implied warranty, breach of express warranty, and breach of contract. These theories are based on the premise that the parties to a dispute have a contractual relationship with one another. This can be an "express" contract (a written purchase and sale agreement, construction contract or subcontract) or an "implied" contract (an oral understanding or the behavior of the parties that would lead a court to find they intended to contract with one another). An owner can sue the builder for breach of contract if the owner contracted directly with the builder. If the contract incorporated the drawings and specifications, as most do, it would be a breach of the contract to not build the project in strict accord with the drawings and specifications regardless of whether the construction was "defective."

17 *Liberty Mutual Insurance Company vs. Brookfield Crystal Cove, LLC*, 219 Cal.App.4th 98 (2013).
18 *Sumitomo Bank v. Taurus Developers, Inc.*, 185 Cal.App.3d 211 (1986), and *Sabella v. Wisler*, 59 Cal.2d 21 (1963).
19 *Kriegler v. Eichler Homes, Inc.*, 269 Cal.App.2d 224 (1969).

ESTABLISHING LIABILITY

In a claim for defects in new construction, the "liability" of a builder or developer is rarely a significant issue. The developer who sold the property is liable for the cost to repair whatever defects are proven to exist except where the time to sue may have expired, as discussed in the next chapter. This is true whether the legal theories are statutory like those found in Title 7, or common law – Strict Liability, Negligence, or Breach of Contract. The same is true of a general contractor who has contracted with the owner to build a building. There may be other parties – subcontractors, material suppliers, or design professionals – also responsible for the defects, and while the developer and/or builder can seek to recover from these other parties, they remain primarily responsible to the Plaintiff.

MANAGER'S HEADS UP

If the owner has a claim for defective construction, look for a written contract. Unlike other common law remedies, a contract will often provide for an award of attorney's fees to the prevailing party.

CHAPTER FOUR

Limitations on the Right to Sue

Time limits on the right to sue (commonly called "statutes of limitation") – initiated either by filing a complaint in a court of law or through a demand for arbitration made by a community association or other building owner – appear in several places in California law and can also appear in private contracts. We will spend some time explaining this important issue because if the limitation date passes without a claim being made, the remedy opportunity is lost.

These restrictions can be divided into two general categories. The first type of restrictions are those imposing time limits triggered by the date of "discovery" of a defect or by the occurrence of an event that leads to damage. Second, there are those constraints that impose outside limits on the right to sue regardless of when the damage occurs or is discovered. The former are true "Statutes of Limitation," loosely termed "discovery" statutes, and the latter are "Statutes of Repose."

STATUTES OF LIMITATION

Notwithstanding the "outside" time limits provided in statutes of repose, a client's claim may also be subject to potentially shorter limitation periods dating from "discovery" of a claim or other events which constitute the commencement of a legal claim. The time to sue allowed by the various statutes depends upon the legal theory or "cause of action" applied to the facts of the claim. Those causes of action traditionally available to a community association for construction problems are: Strict Liability, Negligence, Implied Warranty, Express Warranty, Negligent Misrepresentation, and Intentional acts such as Fraud. Title 7 of the California *Civil Code* (CC), however, provides only for a single, statutory cause of action if a component does not meet the standards in that code.

Other time limits for starting litigation based on construction defect claims are found in the California *Code of Civil Procedure* (CCP). CCP Section 337 governs actions for damage arising from the breach of a written

contract which must be brought within four years from the breach. CCP 339 governs actions for breach of an oral contract which must be brought within two years from the breach.

CCP 338 governs actions for property damage and requires that an action be brought within three years from date of the claimant's "discovery" of the facts supporting the claim. However, determining what constitutes "discovery" of a claim such that it will trigger the start of a limitation period is not a simple matter. Various cases have held that "discovery" occurs when the potential Plaintiff has sufficient knowledge of the damage, its cause, and that cause's relationship to the Defendant's negligence. Ultimately, only a judge can make that determination, but counsel, analyzing the facts of each case, can usually make a reasonable assessment of when a limitation period is triggered.

Often a client's own records can create a defense that the three-year statute of limitations from date of "discovery" has passed as to specific building components. A Defendant can argue that the date of e-mail correspondence or meeting minutes discussing roof leaks is when the three-year statute of limitations was triggered, even though the association may have not understood why the roofs were leaking or the asphalt was deteriorating. The association's attorney might counter that defense by arguing that general knowledge of some roof leaks is not the same as knowing the specific cause. However, the association could incur significant attorneys' fees in fighting a developer on this issue, and settlements may be greatly reduced if the developer can assert a defense based on the early "discovery" of building defects.

If these shorter limitation periods apply, regardless of what the "outside" time limit may be, an action brought by a community association (or any other Plaintiff) must meet these shorter time limits even though the statutes of repose may be longer. The most prudent course is to act to suspend all limitation periods well before their expiration.

STATUTES OF REPOSE

Regardless of when a negligent act or a breach of contract occurred or when damages were discovered, no action may be brought later than the dates established by various statutes of repose. These are "outside" time limits and depend upon when a project was first sold or upon other enumerated events. For many years, it was primarily CCP Section 337.15 which applied a limitation period of ten years starting with the earliest of four definitions of the "substantial completion" of a project. CC's Title 7 provides shorter statutes of repose for actions for damage to certain specific components of a building.[20] Therefore, the first task is to determine which time limit applies and how its provisions govern the right to sue the builder.

Title 7, at CC Section 938, states that its provisions apply "to new residential units where the purchase agreement with the buyer was signed by the seller on or after January 1, 2003." If a home or a building were the subject of a purchase agreement signed prior to that date, the "old" rule of ten years for all components would apply to defects which were not readily apparent and four years for those that were[21].

---

20 Appendix 1 lists the shorter statutes of repose for specific components.

21 California *Civil Code* Sections 337.1 and 337.15. Section 337.1 applies to "patent defects," which are defects that are readily apparent by reasonable inspection. Because these are defects that are obvious, the statute of limitations for bringing an action on them is limited to four years. Section 337.15, on the other hand, applies to "latent defects," which are defects that are *not* readily apparent by reasonable inspection. Because they are not obvious, they may take longer to be discovered and may not even be discovered until other building components begin to fail. For this reason, the statute of limitations for bringing an action on them is ten years.

For projects sold after January 1, 2003 and which qualify under Title 7, an action must be brought no later than a fixed period, depending upon the component, from the date of either "close of escrow" or "substantial completion." For community association claims, "close of escrow" is defined as "…the date of substantial completion, as defined in CCP Section 337.15 (see above), or the date the builder relinquishes control over the association's ability to decide whether to initiate a claim under this title, whichever is later."[22] However, the "close of escrow" trigger date only applies to certain stated components, and the balance of the components, in actions brought under Title 7, fall under CC Section 941, which states: "(a) Except as specifically set forth in this title, no action may be brought to recover under this title more than ten years after substantial completion of the improvement but not later than the date of recordation of a valid notice of completion." We discuss this further below in Chapter Five.

MANAGER'S HEADS UP

Managers should be aware of the various statutes of limitation and repose on construction claims. They should realize that if the client knows the buildings or grounds may be suffering from construction issues or if its records indicate such knowledge, the client has only three years from the date knowledge was obtained to sue the developer or any other contractors or subcontractors who worked on the building or the community. Finally, regardless of when a community association discovers a construction problem, there are statutes of repose that impose an absolute outside limit on a claim. There are several other articles in the Berding & Weil library that cover these various limitation periods in more detail. Understanding these provisions and the manner in which certain documents should be handled will protect valuable claims.

CONTRACTUAL LIMITATIONS ON ACTIONS

The parties can also contractually agree to shorter time limits on the right to sue. Any limitation on the right to sue other than as provided by statute requires the consent of the parties and a knowing waiver of the right to sue on any basis other than just what is covered under the contract. The "contract" can be directly between a property owner and a contractor or between a buyer and a developer. Limitations on civil actions placed into the governing documents of a community association have also been held to be enforceable by the courts.[23]

Parties to a private contract can limit responsibility for construction defects by provisions in the contract notwithstanding longer periods provided by statute. Contracts between property owners and contractors may allow only a year or two for the owner to sue for construction issues even though without such a provision,

22 California *Civil Code* Section 895(e).

23 *Pinnacle Museum Tower Ass'n v. Pinnacle Market Development (US) LLC,* 55 Cal.4th 223 (2012).

the period could be much longer.[24] Private contracts can also require that any dispute be arbitrated instead of litigated in a court action. We discuss more about arbitration options below in Chapter Eight. These contract provisions are a limitation on an owner's ability to bring a civil action against the contractor and shorten the time in which to bring it.

MANAGER'S HEADS UP

Read the Contract carefully for clauses that limit the property owner's right to sue for construction defects. Ask the owner's attorney to review the contract immediately when a dispute arises so as not to lose the opportunity to sue on a valid claim because the owner waited too long.

TOLLING STATUTES OF LIMITATION OR REPOSE

"Tolling" means to stop the clock from running on the time to present a claim. There are several ways do this – agree with the opposing party; file an "action" in a court; or, with a community association, send the developer a notice under Title 7.

Tolling by Agreement. A common way for the disputing parties to toll limitations on actions is by agreement. A tolling agreement is a consensual agreement with the developer (or other participants in constructing the project) to suspend the operation of the statute of limitations, usually for a limited and defined period. A "Tolling Agreement" typically provides that all periods of limitation are tolled for some specified period, usually subject to withdrawal by notice by either party. The purpose of such an agreement is usually to allow the parties time to negotiate a dispute resolution without having to enter litigation by filing a complaint.

Tolling by Notice. An owner of an individual residence or a community association that is a claimant under Title 7 can send a formal notice to the builder (a "Notice of Commencement of a Legal Proceeding" or a "Notice to Builder"). The Notice to Builder must meet several requirements and is described in CC Section 910 as follows:

"The claimant or his or her legal representative shall provide written notice via certified mail, overnight mail, or personal delivery to the builder, in the manner prescribed in this section, of the claimant's claim that the construction of his or her residence violates any of the standards set forth in Chapter 2 (commencing with Section 896). That notice shall provide the claimant's name, address, and preferred method of contact, and shall state that the claimant alleges a violation under this part against the builder, and shall describe the claim in reasonable detail sufficient to determine the nature and location, to the extent known, of the claimed violation. With a group of homeowners or an association, the notice may identify the claimants solely by address or other description sufficient to apprise the builder of the locations of the residences. That document shall have the same force and effect as a notice of commencement of a legal proceeding."[25]

---

24 *Brisbane Lodging, L.P. v. Webcor Builders, Inc.*, Court of Appeals of California, First District (2013). In *Brisbane Lodging*, the court upheld the enforceability of a clause in the construction contract that the applicable statute of limitations would commence to run on the date of substantial completion, rather than when the owner discovered the defect.

25 California *Civil Code* Section 910(a).

A Notice to Builder is not a lawsuit and does not involve the courts. It allows a community association to toll the running of any statutes of limitation for 180 days and may be extended for an additional 180 days by mutual agreement of the parties. There can also be an extension of the period if the builder performs repairs.[26]

In the case of condominium conversions, Title 7 does not apply. However, condominium conversions may utilize CC Section 6000 which provides that a community association with 20 or more units may send a "Notice of Commencement of Legal Proceedings" to the converter, developer or general contractor. Like Title 7's Notice to Builder, the "Notice of Commencement of Legal Proceedings" under CC Section 6000 will suspend the limitations period for 180 days and may be extended for an additional 180 days by mutual agreement of the parties.

MANAGER'S HEADS UP

A notice sent under Title 7 of the California Civil Code applies only to new community associations for common interest developments sold after January 1, 2003, and will not toll limitations on an action brought by the owner of a rental apartment complex or a commercial building, or by associations for condominium conversions. For condominium conversions, a notice sent under California Civil Code 6000 will toll the limitations period. There is no equivalent statute that would accomplish the necessary tolling for apartment or commercial claims, and those claimants would have to accomplish that with either a written agreement or a filing in Superior Court.

Tolling by Filing a Complaint in Superior Court. Filing a complaint in a California Superior Court is the most secure way to toll the period of limitations against any party named as a Defendant and for the claims alleged. Once a complaint is filed, the time limits are suspended or "tolled." But this assumes they have not run out before the complaint is filed, thus the need to pay close attention to the limitation periods discussed above.

MANAGER'S HEADS UP

The impact of limitations on actions, whether statutory or contractual, is complex and should not be determined without the assistance of legal counsel. If you have any questions regarding the applicability of these tolling provisions or their necessity, consult with an attorney specializing in construction defect claims.

26 California *Civil Code* Section 6000(c)

CHAPTER FIVE

Special Issues for Community Associations

Construction defect litigation has been around for decades. It is not surprising, then, that developers and builders have developed methods to protect themselves from liability in such cases. For community association claims, these methods usually take the form of provisions placed in the governing documents by the developer before the project has been built. There are several types: provisions to shorten the statute of limitations, provisions to make it more difficult for an association to sue, and inspection requirements intended to give the developer evidence of early discovery. These provisions can cost a community association a claim or provide a defense to the developer not otherwise available.

MANAGER'S HEADS UP

If the association is investigating a potential construction defect claim against the developer, make sure the attorney reviews the association's governing documents and all construction contracts and defect reports.

TIME LIMIT TRAPS

Statutes of limitation and repose are intended to protect Defendants from stale claims. However, they are also traps for the unwary community association claimant. If the time expires before an appropriate claim is made, legal rights can be permanently lost. Therefore, it is important to know not only what time limits are established for certain claims but also what "triggers" the ticking of the limitations time clock.

Some limitations periods "trigger" on a fixed date: "close of escrow" and certain fence, irrigation and drainage related claims are among that group.[27] But how do limitations triggers apply to a community association with dozens of escrows closing at different times? The California *Civil Code* (CC) provides that for a claim filed by a community association, the phrase "close of escrow" means something very different than it otherwise does.

Regarding claims by a community association, CC Section 895(e) defines "Close of Escrow" as: *"...the date of substantial completion, as defined in Section 337.15 of the Code of Civil Procedure, or the date the builder relinquishes control over the association's ability to decide whether to sue under this title, whichever is later."*[28] Obviously, this definition does not refer to the day an owner went to the title company and signed closing documents.[29]

California *Code of Civil Procedure* (CCP) Section 337.15 lists four possible definitions for "substantial completion." Substantial completion shall not be later than the date of each of the following, *whichever occurs first*:

(1) *The date of final inspection by the applicable public agency.*

(2) *The date of recordation of a valid notice of completion.*

(3) *The date of use or occupation of the improvement.*

(4) *One year after termination or cessation of work on the improvement.*

Among these options, (1) and (2) would most likely be the first occurring event. Whether its date is determined by (1) or (2), the event probably occurred well over a year ago, probably two years ago, when the project was completed. Why is this significant? If the developer still holds three out of five seats on the board of directors, still controls the association, and is not likely to relinquish control until the last units are sold, then one might assume that "close of escrow" hasn't happened yet, and no periods of limitation have run, right? *Wrong.* Below is an excerpt from an association's bylaws that may not be all that unusual. It says:

> *"The sole and exclusive authority to initiate claims on behalf of the Association in connection with (Title 7 claims) shall rest with the Board members elected solely by Class A members (those elected by the members other than the developer)...[and] [t]he decision of a majority of the non-declarant board members shall control..."*

This provision surrenders the developer's control over the decision to make a construction defect claim as of the date that the non-developer board members were appointed, and if that event occurred over a year ago, the shorter limitation periods (and perhaps other, longer periods) have already expired. Why? Recall the language of Section 895(e). The period in which to make a claim for certain of the building standards in Title 7 commences on: *"...the date of substantial completion, as defined in Section 337.15 of the Code of Civil Procedure,* ***or the date the builder relinquishes control over the association's ability to decide whether to sue under this title****, whichever is later."*[30]

---

27 California *Civil Code* Section 896.

28 The statute of limitations for damage to property is three years from the date of "discovery" of the facts constituting a cause of action, according to California *Code of Civil Procedure* (CCP) Section 338. The referral to CCP 337.15 to establish a fixed trigger date makes it clear that the legislature intended for these new periods of limitation to be shortened "statutes of repose" for specific building components. This renders the determination of when the issue was "discovered" irrelevant, at least when dealing with limitation periods as short as 1-2 years.

29 That definition of "close of escrow" still applies, however, to actions against the developer brought by individual owners on their own behalf.

30 California *Civil Code* Section 895(e).

Newer bylaws may contain a provision that states the developer *never* has control over Title 7 decisions. That means the trigger date for statutes of repose could be as early as the date the association was created – and that is the date the first home was sold!

By inserting such provisions into the bylaws of the association, the developer has greatly compressed the time the owners would normally have to discover problems with their building. Doing so eliminates the length of the entire sales period from the time a client would normally have to evaluate a project by starting the clock "ticking" as of the date that the first non-developer board members took office, or worse, the date the first home was sold in the project. For some components, like electrical and plumbing systems, concrete, and paint, longer limitation periods on new claims apply, so this idea of compressed time is not as crucial, but for those components with 1- and 2-year cutoffs, the time to sue could expire before the project is sold out!

MANAGER'S HEADS UP

Any board member/owner on a new development's board of directors should carefully read the association's bylaws and CC&Rs, and if any provision indicates a potential for early surrender of a builder's authority to sue, such as the language above, outside counsel should immediately be consulted. Any delay could sacrifice valuable claims. These provisions are designed to shorten the period in which a new association must evaluate the project and determine whether construction issues exist.

MEMBER VOTE REQUIREMENTS

Next among the newer developer self-protection provisions in the association's bylaws or CC&Rs is the requirement that a member vote be held before an association can "initiate a construction defect claim." While this provision would require a member vote before the association could sue, its intent is far broader. The use of the language "construction defect claim" suggests that the provision could be read as requiring a member vote before the association could give any notice to the builder that defects are present. This would include notice required by either CC Section 6000 or Title 7, which are prerequisites to a defect claim, and would trigger certain time periods during which each side must provide information to the other and the builder can investigate and offer to repair alleged defects.

Statutes of limitation expire quickly; under Title 7, some can run as quickly as one year from the first close of escrow in the project. Serving the statutory notice to the builder stops the statute from running for a period of time. But if the association cannot get the notice out until it holds a member vote and gets a quorum, statutes may run before there are enough votes to make a decision. The association stands to lose its rights because it must wait for member approval in order to "initiate a construction defect claim." This provision could also be read broadly to apply to virtually any communication from the association to the developer regarding construction deficiencies, crippling the board of director's ability to bring such issues to the developer's attention.

This is exactly what the provision is designed to do – impede defect claims. The developer drafted the governing documents and by adding the member vote requirement attempted to insulate itself from many suits for defective construction; however, this effort won't succeed if the association's attorney is creative and savvy enough to help the board get the necessary vote.

Similar provisions requiring member approval are found in the context of fee arrangements with attorneys. Here's one example from a recent set of CC&Rs:

> *"Litigation/Arbitration: The Board has authority to enter into a contingent fee contract with an attorney in a matter involving alleged design or construction defects in the Project, only as to the facilities or improvements the Association is responsible for maintaining as provided herein, and then only after getting the vote at a duly noticed and properly held membership meeting, of a majority of a quorum of the Members other than Declarant [developer]."*

To hire a law firm to represent the association for a contingent fee for defect cases involving facilities the association must maintain, the association in this case must get member approval. New associations typically lack sufficient budgets to pay an attorney's hourly rate, especially for the hours required in pre-litigation discussions or in litigation itself. This leaves a contingency arrangement as the only realistic way in which some associations can obtain competent, experienced counsel to represent their interests. If the Board of Directors cannot secure the appropriate member vote in favor of retaining counsel, the association is left without a remedy for what may be very expensive repairs.

INSPECTION REQUIREMENTS

Another provision that often shows up in developer-drafted CC&Rs is this:

> "*The Association shall cause inspections of all infrastructure to be routinely made in conjunction with the Association's manager. The Board shall engage professionals to conduct inspection of these components of the Project if the Board or the Association's manager deems that such inspection by professionals, such as an architect, a civil engineer, structural engineer, landscape architect or other such professional, is warranted. Inspections shall be made at least yearly and, for appropriate items or events, more often."*

This provision in effect provides the developer a defense to a construction defect claim. Say the association discovers leaks two years after taking control from the developer. If in those intervening two years there were no obvious problems, the hiring of an architect or engineer didn't come up. When the association later sues for defects, the developer points to this failure to act and argues that the defects could have been discovered earlier if the board had engaged the services of a professional. The developer argues it is the association's fault that the defects were not repaired, because the manager and/or board should have hired a professional to investigate the matter. Just like that, the developer has an immediate defense with which to attack the association's claim, one that might succeed even if there were already defects in the project at the time of turnover.

Now, a viable association response may be to assert that this provision has other purposes. Proper maintenance is the obligation of the association, and delineating those requirements–with the option of hiring professionals–creates specificity that benefits both the board and the membership. The provision leaves the

decision on whether to hire a professional to the discretion of the board and manager. All of this may be true. But if you have any doubt about whether the actual goal of this provision is instead to provide a defense to the developer, look at the clause which almost always follows:

> "*For a period of ten (10) years after the date of the last Close of Escrow in the Project, the Board shall also furnish to Declarant [the developer]: (a) the report of each inspection performed for the Board, whenever such inspection is performed and for whatever portion of the Common Area that is inspected, within thirty (30) days after completion of the inspection; and (b) the most recent inspection report for any portion of the Project, within ten (10) days after the Association's receipt of a written request therefore from Declarant.*"

This section obligates the association to send all inspection reports to the developer for ten years after the date of the last close of escrow. If the goal of the previous provision describing the inspections is to spell out the association's obligations for its benefit and that of its members, why would a developer insert this provision to make sure it gets a copy of those reports? Why does the developer even care? And why does the obligation last for ten years as opposed to five or three?

The answer to all these questions is the same: The provision is designed to protect the developer against defect litigation by the association. The developer wants the inspection reports in order to know exactly what maintenance the association is (and is not) doing. The developer wants the reports for ten years because the longest period of limitations on defect claims is ten years. Read together, these provisions require not only that the association maintain the project but also that it provide records of that maintenance to the developer for as long as there is even the potential for the developer to be sued. The developer can even request all of the records, and the association has ten days to provide them. Such a provision gives the developer all the maintenance records to prepare a "lack of maintenance" defense to an association's defect lawsuit.

MANAGER'S HEADS UP

In light of these provisions that may lurk in the association's CC&Rs, the board of directors or the association's manager should document not only the maintenance decisions that the board makes on a regular basis, but also the board's reasoning for any decision to forego more extensive investigation or repairs (i.e., it was too costly to be justified, the problem seemed minor enough that it could be handled by regular ongoing maintenance, there were no indications of systemic problems warranting further inquiry). While these records may not be sufficient to prevent a developer asserting the "lack of maintenance" defense, they may overcome such a defense if they can demonstrate that the board acted reasonably given the limited information and resources at its disposal at the time it made its decision.

BINDING ARBITRATION PROVISIONS

Contractors and design professionals have been inserting binding arbitration clauses in construction contracts for decades. Developers have followed this trend and have inserted similar clauses in the governing documents of community associations. The typical clause applies the rules of one of the arbitration panels like the American Arbitration Association (AAA) or Judicial Arbitration and Mediation Services (JAMS). These clauses were widely ignored by association attorneys for many years as courts had often found such provisions were "unconscionable," since they were placed in the documents without the express consent of either the association or its members.

However, on August 16, 2012, the California Supreme Court determined that arbitration clauses in association CC&Rs – which waive the association's right to jury trial for defect disputes and direct it instead to private arbitrators – are enforceable and not unconscionable. These provisions are drafted by the developer prior to any purchase and before the association exists. Because the CC permits a developer to insert into the CC&Rs "any other matters" that developers consider appropriate, the Court held that developers can place arbitration provisions in CC&Rs.[31]

MANAGER'S HEADS UP

Managers must be on the alert for these provisions. Board members are unlikely to know about these obligations unless a manager informs them. If a manager fails to do so, the consequences can be severe and the client may lose any case it may otherwise have.

31 *Pinnacle*, supra.

CHAPTER SIX

Damages

The Plaintiff is limited to a claim for money "damages" in a construction defect case. There is usually no theory by which the builder can be forced to make repairs – only to pay for them. "Damages" is loosely defined as the money it will take to make the Plaintiff whole. The real question is: What constitutes making the Plaintiff "whole"?

COST OF REPAIR

For the owners of a building, a home, or a community association, the amount of damages is usually the cost of the repair or the loss in market value, whichever is less. Because, as a practical matter, any decline in market value is almost always the equivalent of the cost to repair the defects, the measure of damages used in most construction defect cases is the cost of repair. As stated in Chapter Three, unless the time to make a claim has expired, the liability of a builder or developer is usually not a major issue, and the cost to repair is the primary focus. However, there can be a big dispute over exactly what the "cost to repair" should be, because it raises three debatable issues. The three major questions that arise from cost of repair claims are: What's defective? How can the defects be repaired? What will the repairs cost?

What's defective? The argument here is not so much what constitutes a "defect" but rather where the "defect" exists. There is a large enough body of expert opinion, building codes, and statutory standards as to what constitutes a construction defect to minimize that subject as a point of debate. The real argument often is sample size. The Plaintiff's expert will investigate using both visual and intrusive observations of the construction. Defects which are plainly visible are easy to estimate, but concealed defects, visible only with "destructive testing" methods, are seen only when portions of the outer skin of the building are removed. This uncertainty leads to arguments over what constitutes a "representative" sample of those components. An inadequate sample base is often raised by the defense to counter the defect claim.

How can the defects be repaired? An even more common evidentiary dispute involves the scope of repair. Here expert opinion can vary widely, depending, often, on which party the expert represents. Plaintiffs' experts will propose modes of repair that are conservative, i.e. that carry the least risk to the owner but are often the more expensive method. Defense experts will propose what are often considered more risky but less expensive repair scopes. Scope of repair is by far the most common dispute between the two sides of the case.

What will the repairs cost? Because each side will have its own opinion about how a problem can be fixed, it will also have its own estimate of the cost for that repair. But the opposing parties can also often disagree on what the cost should be for the other party's scope of repair, and thus it is common for bids on the same scope to vary significantly.

CONDOMINIUM CONVERSIONS

A condominium conversion is usually an older apartment building that has been "converted" to for-sale condominiums. A common problem with this type of project is the existence of concealed damage or a large maintenance expense not properly disclosed to the prospective buyers. An improperly disclosed expense usually takes the form of a project management budget prepared for the community association that is insufficient to deal with these concealed problems. While the damages in a condo conversion case are often styled as a failure to provide an adequate budget for the project or the artificially low setting of assessments, they are just the flip side of the cost of repair and are often calculated using the same methods. The argument is that the budget is not adequate for the true cost of maintaining or repairing the project as calculated by the cost of repair.

Most courts have recognized that a condominium conversion is not a product sold to the buyers "as is" but rather is a new type of product produced by creating and funding a community association to maintain and repair the buildings in conjunction with whatever repairs the converter performs. In this regard, damages for a conversion are much like those for new construction with one huge exception: Title 7 does not cover conversions, so condominium conversion claims and damages must be brought under common law remedies.

LITIGATION COSTS AND EXPERT FEES

Litigation "costs" differ from attorneys' fees. These costs are the fees of expert witnesses, court reporters, copy services, and others who provide services needed to advance the litigation. The fees of experts represent the largest costs. Experts bill by the hour whether their fees are paid directly by the client or advanced by the attorneys. The usual components of an expert's expense include the cost of the initial investigation, the cost of any destructive or other type of testing, fees for time spent in depositions, and fees for time to testify in trial or arbitration. Besides the cost of repair, a successful Plaintiff can also recover expert investigation expenses, sometimes referred to as "Stearman" damages.[32] These include the expense of experts to investigate and prepare a repair plan. Other expert expenses associated with preparing for or appearing in the trial are not recoverable unless the parties are suing on a contract that provides for recovery of litigation costs.

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

ATTORNEY'S FEES

The fees of the Plaintiff's attorneys are usually not recoverable unless there is a contract between the parties that provides that the "prevailing party" shall recover its fees. An owner who has contracted directly with a general contractor to construct the building will often have such a provision. Because a community association does not contract directly with the developer, there is usually no contractual basis for an attorney's fee claim. However, recent California Supreme Court cases have held there is a contractual relationship between a developer and a community association which may provide an opportunity to make a claim for fees where the Plaintiff has succeeded. Such a claim would have to be based on interpreting provisions of the association's governing documents since those constitute the only likely basis for an attorney's fee claim. Otherwise there is no statutory basis on which to base an award of fees by a court.

BUSINESS LOSSES

Owners of a defective commercial building, hotel, or apartment complex may also claim damages for business-related losses, such as lost income, loss of goodwill, and lost rents, during the period in which use of the building has been impaired by construction issues.

All of the damages a Plaintiff is entitled to claim are usually combined in a claim document or "demand" that is presented to the defense. Sometimes referred to as a "Statement of Claim," it is the Plaintiff's summary of the claim used primarily for mediation purposes.


$32 026,18
+69%
$72 026,31
+100%
83485

CHAPTER SEVEN

Sources of Recovery

LIABILITY INSURANCE

While an in-depth discussion of insurance coverage is beyond the scope of this book, the following is some general information about construction liability insurance. Insurance policies held by the Defendants are the single most likely source of recovery in construction defect cases. Where there is a policy that "covers" the claim, that policy will likely fund any settlement, at least to the limits of the policy. The most common insurance is a policy that covers the Defendant's liability to third parties – a "comprehensive general liability" or "CGL" policy. Defendant developers, general contractors and subcontractors will usually carry some type of CGL policy. Another type of policy becoming more common is an Owner Controlled Insurance Policy, or "OCIP," that brings under its coverage all of the participants in constructing the project. Either of these primary policy types can also be enhanced by secondary "excess" insurance that provides coverage beyond the limits of the primary CGL or OCIP policy. Design professionals like architects or engineers will carry Errors and Omissions ("E&O") policies that may extend to third party claims.

An insurance carrier's obligation to participate in a loss is usually triggered by the filing of a complaint. This establishes the insurance carrier's duty to defend. Until the complaint is filed, the carrier has no duty to defend and will likely not participate in pre-litigation dispute resolution attempts.

MANAGER'S HEADS UP

Although many owners are averse to litigation and wish to avoid it all costs, sometimes suing is the only or most expedient way to obtain funds from the developer or responsible contractors for the repairs, especially if the matter is complex or the repair is expensive.

SURETY BONDS

A surety bond is not an insurance policy. It is also not a letter of credit. Rather, surety bonds are guarantee agreements, usually issued by corporate sureties. The surety bond "guarantee" is made by the "Obligor," the corporate or other surety, to an "Obligee" that the "Principal" identified in the bond will perform an "obligation" stated in the bond. The Principal is usually a contractor who furnishes the bond to the Obligee, who is usually the building or project owner.

Surety bonds provide financial security by assuring project owners that contractors will perform the work they contracted to perform and will pay their laborers, subcontractors, and material suppliers for the work they perform. There are two types of surety bonds that are commonly obtained by contractors on a construction project – performance bonds and payment bonds. Performance bonds are issued by the surety to guarantee the project owner, as obligee, satisfactory completion of the project. If the contractor fails to build the project according to the specifications or becomes insolvent, the performance bond may compensate the project owner for any loss up to the amount of the performance bond. Payment bonds guarantee the project owner, as obligee, that subcontractors and material suppliers will be paid what they are owed by the contractor. The subcontractors and material suppliers are "Beneficiaries" to the payment bond and they may bring an action against the bond, and the obligee (the project owner).

Both types of bonds operate as a risk transfer mechanism where the surety company guarantees to the project owner that the contractor will perform the work of the contract and its payment obligations to those who perform the work and supply the materials. With a surety bond, the risks of failure of project completion and payment from the contractor to its subcontractors and suppliers are shifted or transferred from the owner to the surety company.

Developers of for-sale residential projects (condos or planned developments) do not secure their performance or the condition of the building with a surety bond issued to the buyers of lots or units. However, the developer might require that the general contractor furnish a bond covering its work and the work of its subcontractors. Also, contractors who build new projects or repair old ones also may provide a bond which secures completing the project for the owner. If a contractor who has furnished such a bond defaults on its performance, under certain circumstances, the bond could be accessed to satisfy a Plaintiff's demand in a construction defect case.

Owners or investors who hire contractors to build or reconstruct buildings also can require the contractor to obtain a performance or payment bond, or both, in their contract. The contractor must qualify with the bonding company to provide the bond, but once the bond is in place, if the contractor fails to perform the contract and cannot meet its obligation to the owners, the owners may make a claim against the bond surety for relief.

PERSONAL OR CORPORATE ASSETS

Sometimes the personal or corporate assets of the developer or contractor may be available to a building owner if the available insurance is inadequate to cover the loss or judgment. Those assets, however, may not be held by the seller of a property in a community association. The seller may be a Limited Liability Company or a Corporation created to develop that specific project, and if its assets have been distributed to members or shareholders, it will require a special proceeding (a "clawback" action) to get them back.

MANAGER'S HEADS UP

Before proceeding with litigation, an owner should work with an experienced construction litigation attorney to properly research what sources of recovery are available. The attorney should analyze whether the expense of suing is merited if it appears likely that a judgment can be satisfied by the defense insurance policies and assets, and will yield a recovery adequate to cover not only litigation expenses but also necessary repairs. While it is impossible to be certain of the outcome of a particular case, an experienced construction attorney can provide a realistic evaluation of its strengths and weaknesses and potential for recovery.

CHAPTER EIGHT

Alternatives to Litigation

In some cases, working with the developer may produce results in correcting a construction issue without the expense of litigation**.** A small problem, like a minor leak, may be something the developer is willing to repair. Title 7 of the California *Civil Code* (CC) usually gives developers the right to pursue that course. Failing to provide them the opportunity to effect repairs can cause a judge to stay the case. It also might void the developer's warranty.

Suing may be a premature option. When you sue, you expect that eventually you will either settle the matter or take it to trial. In either case the Defendants will be released from the claim. But what if the building is new, say just a few years old, and the construction defect issues are small? You might litigate and release the developer of a two-year old building to fix just one or two small leaks, but you shouldn't. Jumping into litigation too quickly can mean releasing a party when the history of the building is not well developed, and facts that may establish future claims have not yet been discovered.

Furthermore, the cost of litigation may outweigh the results. For resolving small problems, litigation will often be inefficient. It does not make sense to chase a dollar with a dollar. It could be less costly in the long run for the owner to repair the problem should the developer fail to properly respond.

Another reason to seek alternatives to litigation is because the target Defendant may not have the resources to satisfy your claim. Even in big cases, where the cost of repair is considerable and the building owner has what we would consider a "righteous" claim against the builder or a contractor, recovery is far from automatic. If the builder is underinsured, is a hollow shell, or is out of business, pursuing litigation may yield a positive judgment but no cash.

An additional "soft cost" of litigation is that litigation may freeze sales and re-financing by owners. Lenders and potential buyers will be leery of a project in litigation. They won't always be sophisticated enough to appreciate that the owner chose that remedy to repair essential components. However, there are some lenders that do finance properties engaged in litigation (see Chapter 10, Part 6), and an experienced construction litigation attorney should be able to provide the owner with a list of prospective lenders.

With these concerns in mind, we discuss the alternatives to litigation below.

INFORMAL NEGOTIATIONS

Nothing prevents the parties to a construction dispute from informally attempting to resolve the issues. Informal negotiations are common in commercial construction projects where building professionals recognize both sides of the issue and understand what is wrong and what it will take to make the owner whole. With community associations, however, boards of directors and some property managers rarely understand the problem, how to fix it, or what the repair should cost. They are not construction professionals. Further, they may not appreciate the finality of a release offered for a "resolution." Experts, both construction and legal, should be consulted before finalizing any negotiation over a construction defect. Owners and managers should also understand that engaging in negotiations does not toll the statute of limitations. Achieving that requires certain specific acts as discussed in Chapter Four above.

TITLE 7 – ALTERNATIVE DISPUTE RESOLUTION AND "RIGHT TO REPAIR"

Title 7 of the CC provides an alternative dispute resolution (ADR) process, which is mandatory before a community association can sue for construction defects. However, ADR rarely works, and it does not apply to owners of apartment projects and conversions.[33] Title 7's lack of effectiveness stems from the way insurance carriers for builders view their obligation to cover claims for defective construction.

A Comprehensive General Liability (CGL) policy must defend a contractor or developer. But that "duty to defend" does not normally arise until there is something to legally defend, i.e. a lawsuit. Title 7 requires the ADR process to be completed *before* any litigation is filed, and therefore before liability insurance coverage is triggered. As a consequence, to resolve a dispute pursuant to the Title 7 ADR process, the builder or contractor must fund any resolution out of its own pocket. Title 7 also gives a builder the "right to repair" in certain instances, i.e. the builder has the right to make repairs to the defective construction. But the same problem exists – the builder must fund those repairs itself without the participation of its insurance carrier.

If the builder waives its rights to ADR or its "right to repair" under Title 7 and waits until the owner sues, the coverage under a CGL policy will trigger, and the carrier will likely defend (and eventually settle) the claim. Thus there is no incentive for a builder to avail itself of ADR or right to repair provisions of the Title 7. Also, the ADR process under Title 7 is time consuming and laden with time traps that are easy for a builder to step in – and if it does, any further rights under Title 7 are waived. Therefore, it is the authors' experience that the Title 7 ADR or "right to repair" provisions rarely lead to resolution of a claim and are often ignored.

FORMAL MEDIATION

Mediation is the process whereby a "Mediator," a neutral intermediary, works between the claimant and the builder or contractors to reach a settlement of a construction dispute. Mediators are usually retired judges or attorneys who specialize in this process and are paid by the parties to the dispute. While perhaps as many as 90% of all construction defect claims are resolved through mediation, almost none are resolved outside of litigation for the reasons cited above – that insurance carriers will not respond to a claim that is not yet in litigation.

33 California *Civil Code* Section 896.

Therefore, Plaintiffs will usually file a formal Complaint, and then the parties will enter into mediation and resolve the claim prior to the date set for trial. Because the majority of construction defect claims are resolved in mediation, we will discuss mediation in greater detail in Chapter Eleven.

ARBITRATION

Arbitration is really not an *alternative* to litigation, but rather litigation by a different set of rules. Instead of filing a Complaint in a court, the parties submit a claim to arbitration. This means that the parties engage a neutral third party (an "Arbitrator"), or a group of neutral third parties (an "Arbitration Panel") to decide which of the parties should prevail in the dispute. Arbitrators, like mediators, are usually retired judges or attorneys who specialize in construction law. Arbitrators sit without a jury and hear the matter employing rules of evidence and procedure issued by a sanctioning body like the American Arbitration Association (AAA) or the Judicial Arbitration and Mediation Service (JAMS). Arbitration cannot be compelled unless the parties agree to it by a contract.

In arbitration, the Arbitrator or Arbitration Panel decides a winner and a loser after a hearing in which evidence is presented. This process is distinct from mediation, where the parties themselves reach a mutually negotiated agreement. Arbitrations were originally conceived as a fast and inexpensive way to resolve disputes. Arbitrations can be binding or non-binding, but the typical arbitration provision in a contract requires a binding award by the Arbitrator or Arbitration Panel. An entire arbitration industry has evolved such that arbitrations are no longer always fast and cheap. The benefits of arbitration are that the parties can have someone decide the case who has a construction background and knowledge of the issues, and they agree on a date that is certain for hearing the case. However, a significant downside is that arbitration does not allow for a jury, and the decision is final and non-appealable.

Preparing a complex construction case to be heard before an Arbitrator or Arbitration Panel can be as time-consuming as preparing to try the case in court. The evidence must be prepared from hundreds or thousands of documents, from investigations by experts, and from the depositions of experts and parties. The preparation is virtually the same for either process, so the time necessary to get a case ready for trial is no faster with arbitration than with judicial litigation. Bear in mind, though, that a court trial, even one that does not involve a jury, may be difficult to schedule, and the time allotted to introduce evidence may be limited. A private Arbitrator has more control of the schedule and, if he or she chooses, can be more or less efficient. In the authors' experience, Arbitrators are more lenient in allowing the introduction of evidence than sitting judges are, which increases the time of the actual hearing.

While arbitration is used to resolve many types of contract disputes, the result always comes down to the decision of a single Arbitrator or, in larger matters, an Arbitration Panel. Most contracts require the Arbitrator to follow the law of a state, but in practice that doesn't always happen. With arbitration, the parties face the risk of a "rogue" Arbitrator failing to follow the law.

All factors considered, the fees of Arbitrators and the lack of a right of appeal may make arbitration of a construction defect case less attractive to either party than a trial before a sitting judge. Regardless of the pros and cons, most construction contracts and many community association CC&Rs contain binding arbitration provisions, and in those cases either party can compel arbitration if it wishes.

MANAGER'S HEADS UP

Read the contract to see if there is an arbitration provision. If there is, try to follow it in good faith before resorting to litigation, otherwise the opposing party may move to compel arbitration and to stay your complaint while arbitration is attempted.

CHAPTER NINE

Commencing Litigation

THE COMPLAINT

If and when the available alternatives to litigation have been exhausted, the parties to a construction defect dispute will turn to judicial litigation—an action filed with a court. In California, that usually means the Superior Court of the county where the project is located. The process starts with filing a "Complaint." A Complaint is a legal document or "Pleading" that sets forth the legal theories, or "causes of action," that the complaining party, the "Plaintiff," asserts against the responding party, the "Defendant."

Typical legal theories that community associations or owners of commercial properties can assert are Negligence, Breach of Contract, Breach of Warranty, Strict Liability, and Misrepresentation. Causes of action available only to community associations and buyers of new homes against builders are the violations of the Title 7 construction standards discussed in Chapter Three. Whether a specific legal theory is sustainable will depend upon the facts that back it up. A Complaint will also specify or "plead" the general or "ultimate" facts which support the Plaintiff's claims, but a Complaint is not a place for great factual detail. The Plaintiff can also use the Complaint to list the relief it is requesting, typically expressed as monetary damages.

THE RESPONSE

The Defendant has several options when responding to a Complaint. It can file an "Answer" which denies the Plaintiff's allegations, or it can challenge the legal theories upon which the Complaint is based in a pleading called a "Demurrer." It is much more common for a Defendant in a construction defect case to answer the Complaint and save its objections to the Plaintiff's legal theories or fact assertions until a trial or a summary proceeding prior to trial.

A typical summary proceeding is a motion for "Summary Judgment" filed by either the Plaintiff or the Defendant. A Motion for Summary Judgment is filed by a moving party if it believes that the facts upon which a claim is based are undisputed and that it is entitled to judgment in its favor because there is no reason for the judge or jury to determine which facts are true. If there are disputes as to the truth of certain facts, a court will typically deny a Motion for Summary Judgment and reserve the issues for trial where the facts will be heard and decided.


DANGER 6932

CHAPTER TEN

Evidence

No claim for construction defects can be won without the Plaintiff and the Defendant introducing sufficient "evidence" to prove their side of the case. The Plaintiff must introduce sufficient facts to demonstrate the problem with the construction, what is necessary to repair it, what the repair will cost, and who is responsible. The Defendant will typically try to offer facts to show any or all of the following: the problem does not exist, it exists at only a few locations, it can be fixed by a method that costs much less than Plaintiff alleges, or the Defendant is not responsible for the problem. Facts such as these must be proven by evidence presented by one side that is more compelling than the evidence offered by the opponent.

Most evidence introduced in a construction defect case comes from the testimony of lay people and experts and through documents. While lay people can testify to what they have seen (e.g. "my roof leaks"), they are usually not qualified to testify why the condition occurred, who is responsible, or what is necessary to repair it. For these matters, the testimony of expert witnesses is required.

EXPERT TESTIMONY

In construction litigation an "expert" will be someone who has both the experience and credentials to convince the court its "opinion" on the issue is admissible in a court proceeding and will assist the judge and jury in reaching a verdict. Owners or property managers can testify to what they have seen, but they are usually not qualified to offer an expert opinion on a construction defect. "Expert" opinions must identify a problem as a "defect," determine what is necessary to repair it, and estimate the cost of that repair. Such testimony is usually not within the province of a layperson and would not usually prevail in court. If the problem has been previously repaired, an owner or a property manager could offer the invoices and testify that payment to repair the problem has been made, but that's the limited extent of such testimony. For all other material that is necessary to convince a judge or jury that your problem is defective construction, you need the services of a true expert.

Experts in construction cases are usually design professionals like architects and engineers, building consultants, or contractors. Design professionals are qualified to offer opinions on both the design itself and how well the contractor followed the design in constructing the building. They can also provide an opinion on what is necessary to repair the defect (the "scope of work.") Building consultants and contractors can provide opinions on how well the contractor followed the plans and met the standards of the building industry. They can also provide a scope of work and estimate the cost of the repair.

So who provides expert opinions for a construction claim? The relevant expert to use will be determined by the specific nature of the problem. If the problem is a failing balcony support beam – something that has rotted from water intrusion or is undersized – just replacing the failed beam may not be enough. You don't want the failure to happen again. Moreover, just because only one balcony failed this time doesn't mean there aren't others in the same condition that could fail in the future.

In the example above, you would retain a waterproofing professional. Would this be a specialty building consultant, a contractor, or an architect? Architects are more expensive, but for a complex waterproofing issue with potentially serious design flaws, you want someone who has the skill and understanding to re-design the system to make it watertight. You would not want to simply replace part of a system that never worked in the first place.

On the other hand, if the basic design is sound, but the materials have failed to do their job, a materials consultant who specializes in waterproof membranes may be the right choice. For this example, we probably would choose an architect or an engineer, because a balcony support beam failure involves a life-safety issue, and re-design and/or strength calculations may be necessary to provide an adequate repair and cost estimate. If the problem does not reside in the original design, such that a re-design of the waterproofing system or a re-calculation of the strength of the system isn't required, and the defect instead requires a proper re-build which adheres to the original design and good building practice, then a general contractor or building consultant could be the right expert.

Because buildings are not single products but rather an assembly of individual parts and components often put together by different contractors, and because the materials used often require periodic upkeep to maintain their projected service lives, and because acts of nature often intervene to test the resistance of building components to leaks and decay, it may not always be exactly clear why a building defect occurs. The average person who one day might sit in judgment cannot easily understand, much less untangle, the complex disputes that arise over these enigmatic, technical and often costly problems.

We see, then, that independent experts play a necessary and valued role in resolving construction defect claims. Experts are professionals whose credentials qualify them to analyze the cause of a construction or design problem, design a solution, and assign responsibility for it. The necessary qualifications are determined by the problem and its components, but in the construction defect arena, the experts are predominantly architects and engineers. Architects are generalists who by education and professional preparation can design almost any component of a building and direct the entire assembly of components.

Engineers are specialists in certain discrete parts of the assembly. There are materials engineers who specialize in the physical composition of components, for example, the wood substances in siding products. Acoustic engineers are trained in noise abatement. Geotechnical engineers study soils for foundation design and for determining the cause and cure of landslides. Mechanical engineers design and analyze plumbing and HVAC systems. Structural engineers investigate the ability of the building framework to resist forces of nature such as earthquakes.

There can be overlap among these disciplines and between architects and engineers, so it is usually up to the attorney to discuss the problem with the proposed experts to be sure he or she has assembled the right team. Once employed, often by counsel for the parties in a construction defect action, the various experts will begin an investigation aimed at answering the three questions we discussed in Chapter Six: What caused the defect, or what's defective? How can the defects be repaired? What will the repairs cost? The owners of the buildings will want to know the experts' findings because ultimately they will have to repair the problem, and if they are bringing a construction claim, they must prove who is responsible for the problem and what the responsible parties' assessed damages will be.

Each of those parties accused of responsibility for the defect will want to know what other theories of causation are available to explain the defect, whether some or all of the liability can be shifted to another party or even to the building owner, and what alternate ways of repairing the problem might be available to lower the cost of resolving the matter.

An example might be a case involving roof leaks. The condominium association's attorney sues the builder, who then turns around and names the roofer and the roof shingle manufacturer. The roofer then sues the sheet metal contractor who installed the weatherproof flashings on the roof and maybe the shingle supplier as well. Experts for each of these parties must investigate the roof and its components to identify the source of the leaks, the components responsible, the contractors who installed or assembled those components, and the most reasonable method of repairing the problem.

Experts are not solely concerned with just what they find in the field. They must also be qualified to testify to their findings in a court of law, first in any depositions taken in preparation for a trial, and second, in the trial itself. Their opinions are also used at mediations or settlement conferences, sometimes in consultation with the experts for other parties, to agree on a mode of repair and cost estimate. To testify, an expert must be qualified by the court, usually after some initial testimony as to the expert's professional education and background.

Without expert witnesses to explain technical issues, complex defect cases could not be prosecuted. The construction expert acts as an interpreter of these issues for the litigants and, ultimately, for the court and jury. Experts provide the evidence necessary to support each party's individual theory of the case where construction methods and materials are beyond the average layman's experience and to assist a court or jury in fixing liability and damages. Finally, and increasingly common today, good expert witnesses can also be called upon to assist in fashioning an early resolution of a case when that opportunity presents itself.

DOCUMENTS

In order to properly identify a construction defect and determine how to fix it, an expert needs several documents. The maintenance history of the project as contained in the client's or manager's records provides evidence of not only what is not working but also where in the project the problem has been found or repaired on previous occasions. Drawings or other construction documents, such as specifications and permits, can either be found at the city building department or obtained from the builder or contractor if the owner does not already have them. These allow an expert to determine if the building was constructed according to the designer's plan and product manufacturer's instructions and whether the design itself was adequate. Questionnaires prepared by legal counsel and directed to individual owners or tenants are other useful tools to provide an expert with data from which to determine how much and what kind of an investigation is needed. Original contracts for the project's construction are also useful in determining which party has responsibility for the problems being litigated.

MANAGER'S HEADS UP

Several types of routine business documents can damage a client's construction defect case. Examples include e-mail correspondence between board members and the manager discussing roof leaks and what could be causing them, letters to the community's developer asking it to fix leaking windows some members have complained about, meeting minutes that include discussion of discolored or crumbling stucco on the client's buildings that persists despite routine maintenance by the association, or reports from a company hired by the association to examine the community's decks and determine why they leak into the units below. Such documents found in the client's records can later turn up in the client's litigation for defects in construction. They can reveal early "discovery" of the problem and create a statute of limitations defense. They can also expose opinions that conflict with the client's experts, and other similar non-privileged information that can be harmful to the client's claim. Care should be taken to avoid unnecessary creation of records such as these, and where they exist, they should be managed carefully and immediately provided to the client's counsel for review.

INVESTIGATION

Once the appropriate experts obtain the historical data found in plans and maintenance records, they can begin a physical investigation of the property. The investigation usually occurs in stages, depending on what is being investigated. Building envelope issues (roofs, siding, windows) typically start with a visual survey of the buildings, followed by intrusive, or "destructive" testing whereby portions of the envelope are removed to allow the consultants to view components (flashing, paper, insulation, framing) hidden beneath the skin. Enough of the envelope is removed to give access to those parts of the assembly that may be causing leaks into the building or excessive condensation within the building. From this access the experts can view not only the possible cause of the problem but also whatever damage within the wall cavity the problem has caused.

Other types of problems require different inspections. Soil or foundation issues may require that a geotechnical engineer observe the results of soil tests or borings to determine conditions such as compaction or composition of the soil beneath the building. Concrete slabs may need to be cored to determine their thickness, or x-rayed to determine the size and spacing of the reinforcing bars. Products such as windows may require spray testing in the field or in a laboratory to determine why they leak. A broad array of possible tests can be done to identify the point and mode of failure and the required repair. The client's experts must be satisfied they have enough information on which to base their opinions, and investigations must be conducted to produce a sample size that is large and random enough so that the judge will permit the results to be "extrapolated" to the entire building or project.

MANAGER'S HEADS UP

A common use of extrapolation evidence in the construction law context is for an expert to opine that damage to a structure is widespread, based on the presence of damage in an isolated part of the structure. Determining the validity of a large-scale construction claim is essentially a statistical exercise, which may require a statistician to perform analyses of the data collected from the inspected and tested areas.

Experts' findings will usually be provided to counsel in a written report. Those reports will often be shared with opposing counsel as a concise way of stating the experts' opinions. Some attorneys do not share their experts' opinions in advance of their depositions. It is the authors' opinion that this approach leads to longer litigation and missed opportunities to reach an early settlement of the case.

INTERROGATORIES, REQUESTS FOR ADMISSION, AND DEPOSITIONS

In addition to the experts' testimony and documents, counsel may obtain information to assist in preparing the case through other means authorized by statute. "Interrogatories," or written questions, are directed to the opposing party to get preliminary information. A "Request for Admissions" is a list of factual assertions which counsel asks the opposing side to admit or deny. "Depositions" are live question and answer sessions before a court reporter who creates a written record of the proceedings. The information gathered by these various methods is subject to objections by opposing counsel and admissible in the eventual trial of the case.

THE ROLE OF THE COURT OR SPECIAL MASTER IN THE DISCOVERY OF EVIDENCE

Gathering necessary evidence or "discovery" is an essential element of every construction case. State statutes usually give attorneys ample authority to seek information they need, and counsel experienced in construction cases routinely make "requests" for records, product information, drawings, specifications, contracts, insurance policies, and other relevant information. Occasionally, however, counsel will balk at providing certain evidence. When this occurs, the attorney requesting the information may file a motion with the court asking for an order that the other side produce the requested material. The court will consider the arguments of both sides and decide whether the requested information meets the requirements for relevance, then ultimately issue the appropriate orders.

This process, however, can be time consuming and expensive. Courts are jammed, and hearings on discovery motions must wait their turn. A more efficient process is for the parties to agree on the appointment by the court of a "Special Master" or "discovery referee" empowered to rule on disputes related to the discovery of evidence. Special Masters are also frequently given the authority to hold status hearings, issue orders intended to expedite preparation of the case, and supervise the pre-trial proceedings. This course of action is arranged through the agreement of the parties and a request to the court to appoint the Special Master.

WORKING WITH OWNERS AND TENANTS

A construction case involving defects in residential properties is not just between the named parties to the lawsuit; it also involves the tenants or owners. The owners of a community association project are involved because their community association is representing them. Both tenants and owners are involved because the investigations and inspections will sometimes disrupt their daily routines. Plaintiff's counsel should provide management with the resources to coordinate inspections, especially when the inspections will occur in the interior of homes or units. Owners who wish to sell or re-finance their individual units or homes will encounter questions from the lender as to exactly what the litigation is about. Prospective buyers will want to know about the defect complaints and the plans for financing and repair.

To answer these questions and provide assistance to managers, a good law firm will prepare frequent updates on the litigation and other disclosures. It will also coordinate the inspection activities, arrange access to units, and periodically provide status information to owners so the manager does not have to deal with these issues. A webpage can be created that makes necessary disclosure information available to owners. Often this page will allow sellers to provide prospective buyers with the status and basic information about the litigation. The disclosure webpage created by the client's counsel is a valuable tool for answering owners' and tenants' questions.

MANAGER'S HEADS UP

The law firm should also provide the property manager with a list of lenders willing to re-finance or lend on properties in litigation. Some lenders don't understand construction defect cases and mistake them for avenues to liability for the building owner. While defect cases identify problems with the building, they are also evidence that the owner, community association, or the investors are serious about dealing with the problems.

CHAPTER ELEVEN

Mediation

Formal mediation is the most common forum for resolution of a construction defect case. After the lawsuit has been filed, the evidence has been collected and exchanged, and the parties have had sufficient opportunity to evaluate their respective positions, experienced construction defect firms will work to bring the opposing parties into formal mediation. This involves appointing a Mediator, exchanging mediation statements, and assembling the parties and their legal counsel in a location where mediation can be conducted.

CHOOSING A MEDIATOR

Mediators are experienced construction attorneys or retired judges selected on the basis of their ability to bring the opposing parties into a position to settle the case. There are few mediators available today who can successfully close out a complex construction case. The skills required include an ability to understand the technical facts of a case, an appreciation for the positions of the parties, and the ability to discuss insurance coverage with counsel and the insurance adjusters who represent the carriers defending the case. A good mediator must have the charisma and esteem to cut through the formal legal positions, negotiate the facts, and resolve coverage arguments between the Defendant and its carriers.

MEDIATION STATEMENTS

Mediation briefs or statements are prepared by the parties for submission to the mediator. These can be confidential statements that only the mediator sees, or they can be shared among the parties. A typical Plaintiff's mediation statement will recite the legal theories upon which the case is based with some supporting authority. It will also contain a fact statement outlining the evidence which it contends supports its claim for relief. The fact statement will be a recitation of the defects in the building as stated by the Plaintiff's experts. This will be followed by the Plaintiff's repair demand, and finally, a list of the damages which the Plaintiff has sustained. Defense mediation statements are similar but will also recite any defenses which counsel believes protect its clients from liability as well as scopes and costs of repair which counter those offered by Plaintiff.

CLIENT AND MANAGER PARTICIPATION

The Mediator will often request the participation in the mediation of the client and the client's manager. This step is important because the Mediator cannot get the agreement of the parties without participation of the party who has the authority to resolve the case. This may be the property manager, but more often it will be the board of directors of a community association or other corporation that owns the project. Attorneys will rarely ask for the authority to make decisions on an owner's behalf because it is important that the owner or the owners' representative be privy to the discussions with the Mediator and listen to the Mediator's views of the strengths and weaknesses of the case.

THE MEDIATION PROCESS

Mediations can be concluded in one day, but more often with a complex case it will take multiple sessions to reach a settlement, perhaps stretching over several months. The format of the mediation is set by the Mediator but will usually start with several "joint" sessions, often including the primary experts for each side. These "joint expert meetings" can, and often do, precede the formal mediation itself. In joint expert meetings the parties' respective experts are encouraged to start a dialogue aimed at bringing their opposing views on the existence and extent of the defects and the mode and cost of repairing them closer together. This is a critical phase since the parties and their counsel rely heavily on their experts to advise them on what is needed to repair the buildings, and if the expert can recommend a resolution also recommended by the opposing experts, then settlement will not be far off.

Joint experts' meetings are followed by meetings between all of the parties, their counsel, insurance carriers, and often, the experts. While there might be an opening session attended by everyone, usually the parties and their retinues are assigned separate rooms, and the mediator will shuttle between them and discuss the case with each party in private. This allows the mediator to get a more candid view of each party's position on settlement and to elicit the true amount the Plaintiff will accept and the Defendants will pay, in order to resolve the case. Truly candid admissions are not likely to be obtained by the Mediator in the presence of the opposing party. The Mediator will offer his or her own opinions on the relative strength and weakness of both parties' position to convince them to bring their positions to a place where an agreement might be reached.

Once the Mediator guides the opposing parties closer to a deal, he or she will direct each party toward a common settlement number. Remember, most construction defect cases settle for a cash payment by the builder or contractors to the Plaintiff, intended for the repair of whatever damage the construction defects have caused. So it will be a specific dollar amount that settles the case, and it is up to the Mediator to get the parties to agree on that amount.

Because insurance policies usually pay the bulk of any settlement, the Mediator may also conduct negotiations with carriers for the Defendants simultaneously with the negotiations with the parties. Often insurance "coverage" issues, i.e. whether or not a policy will pay whatever settlement is agreed upon, drive the settlement discussions, and often the adjusters for each carrier decide whether the case will resolve short of trial.

CONSIDERATIONS IN ASSESSING THE VALUE OF A CASE AND ITS READINESS FOR SETTLEMENT – REVIEWING THE EVIDENCE WITH THE CLIENT AND THE EXPERTS

Everyone believes his or her case is meritorious, and the mediation process is built around that sentiment. However, good construction attorneys know both the strengths and the weaknesses of their particular cases and will give the client a reality check to keep expectations in line with what is likely to come out of a settlement. During discovery and in joint experts' meetings the position of each side will become clearer. The Plaintiff will offer what it considers to be a proper "scope of repair," the method and extent of what it believes is necessary to cure the defect. The defense will do the same. Even if the joint experts' meetings narrow the gap somewhat, there is still likely to be disagreement centering on how to fix the problem and what the fix should cost.

A good construction lawyer will know enough about the technical aspects of the case to be able, along with the experts, to guide his or her client to a solution that will fix the problem. The finding of a sufficient repair compromise requires a willingness to consider alternative modes of repair and the possible adoption of some opinions of the defense experts in order to put together a settlement. It is at this juncture in the proceedings that the greatest degree of attorney expertise is required. It is easy to insist that the total claim be paid and allow the case to drift toward a trial. It is also easy, when representing a Defendant, to deny any validity of the Plaintiff's claim and refuse settlement. To properly assess the value of a case, to know exactly when the maximum amount can be obtained without incurring cost in time and fees for preparing and taking the case to trial, is a fine art.

To miss that moment where the case can be settled with maximum efficiency, i.e., to under value or over value a case, means that the client may be subject to much greater risk than necessary to accomplish its goals. The risk of giving too great a discount (i.e., accepting a payout that is too low) must be weighed against the chance that a jury will reach a higher verdict. Some attorneys who take construction defect cases assert they can settle a case in a short period of time. Any case can be settled quickly, if the client is willing to heavily discount the claim. It is up to the attorney to evaluate the case and base a settlement demand not merely on how fast it can settle but also on whether the client will receive full value on the claim.

Also, the client should expect that the attorney and the experts it retains have taken sufficient time and opportunity to adequately investigate the project. As we discuss below, the settlement of a major construction defect case will often require that the client release the developer and other contractors for all future claims. If the project is young, say less than five years old, it may not be possible to observe the performance of the project over enough time to evaluate all of the conditions that could lead to discovery of a defective component. For example, has there been sufficient rain to test the building for leaks? Too much emphasis on a quick settlement may deprive the client of a thorough investigation and cause the release of claims that the client does not know it may have.

DETERMINING IF AN OFFER IS ACCEPTABLE

Several factors have to be considered in determining if an offer is fair and reasonable. First, what repairs will the client be able to accomplish with the funds it will receive? Even if the client has to phase the construction or prioritize it so the most essential repairs are done first, the offer should be considered acceptable if the repair the client can afford to make with the settlement will put it back in control of the development so the combination of settlement funds, existing reserves, and future cash flow will allow the owner to maintain the building properly. A second question to consider is whether, if the client had obtained a much higher verdict, the amount would be collectible. To know that, the attorney must evaluate the insurance coverage and the other assets that could be reached to collect the judgment. Finally, what are the costs of preparing and trying the case, and what is the risk that the jury or arbitrator might award an amount lower than is being offered? Only once all of these concerns have been carefully factored into the analysis will your client know if the offer is acceptable.

MANAGER'S HEADS UP

Manager's Heads Up: It cannot be overemphasized that a quick settlement may not be a proper settlement. Some law firms advertise the speed by which they say they can settle a case, but what they fail to disclose is that, in their quest for a quick resolution, many dollars may be left on the table, and many claims may remain undiscovered.

CLOSING OUT THE CASE

Once a settlement has been reached, several steps are necessary to close out the case. The settlement must be memorialized in an agreement signed by all parties. This step might take as many as two to three months if the case is complex and if there are multiple parties. The agreement will contain a release of the Defendants from liability for the defects in the claim. If there are many issues, if the investigations have been comprehensive and thorough, and especially if the ten-year statute of limitations has passed, the Defendants will demand a complete release of any known or unknown claims and a waiver of California *Civil Code* Section 1542 which would otherwise preserve unknown claims. A waiver of Section 1542 will often be a condition to any settlement in most construction defect cases, and the client and counsel must carefully consider the ramifications of a complete release. Once the release is signed and the funds are on deposit in the attorney's trust account, a formal dismissal of the case must be filed.

CHAPTER TWELVE

Trial and Appeal

If mediation fails to resolve a case, a jury trial in Superior Court is the opportunity for the parties to present their evidence to a court. The players are the parties, a judge, and a jury. The parties present the case, the judge conducts the trial and makes rulings on evidence, and the jury makes determinations of fact. The judge decides questions of law in response to motions made by the parties.

Only the jury can determine which facts are true and which are not. A judge in a jury trial does not decide facts; rather the judge determines which fact evidence is admissible. The jury hears facts that bear on the Defendant's liability and on what damages should be assessed. The judge "instructs" the jury on the law and what facts it must determine. After the parties have presented their evidence, the judge will instruct the jury on what it must deliberate to reach a verdict. The verdict will become a judgment of the court.

Under certain circumstances, a judge can hear a case without a jury, known also as a "bench" trial. In that situation, the judge determines the law and the facts and issues a judgment. By agreement of the parties, a trial can also be conducted outside of a courtroom by a retired judge or an experienced attorney. Known as a "judicial reference," the trial follows the civil rules of procedure and evidence, and the judge's decision can be appealed unless the parties agree otherwise.

Trials of construction defect cases are actually rare since most construction cases settle without a trial. But when settlement cannot be reached, the trials are fact-intensive and technical; they require experienced trial attorneys to present the case. The attorneys must have a thorough understanding of the construction industry, the role of the various players, and the technical nature of the evidence.

MANAGER'S HEADS UP

An attorney who takes on a construction defect case must have the resources and experience to try it, if and when a trial becomes necessary. Defense attorneys know who has that experience and who does not and will gauge settlement offers on that analysis. If the defense knows that an attorney does not have the capability or experience to try the case, it will extend smaller offers of settlement.

CHAPTER THIRTEEN

Choosing an Attorney

Construction defect litigation is complex and technical. Like so many other areas of legal practice, it requires attorneys who have concentrated their practice litigating and resolving such claims. This is not a field for novice or inexperienced legal counsel or small firms with minimal staff. A property owner who has encountered what may be a claim for defects in the construction of its property should take the time to carefully research the field and find competent legal counsel.

If you are considering retaining counsel for a construction claim, do the following:

CONSULT THE ASSOCIATION'S OR OWNER'S GENERAL COUNSEL

Most building owners and community associations have general counsel that the board or owner consults for a wide variety of issues. This attorney and his or her firm may not handle construction claims, but he or she can recognize the problem and advise the association on how to find legal counsel with the necessary experience. Also, if a community association board of directors is ever concerned about its own responsibility in choosing a qualified construction attorney, general counsel is the best place to seek answers and guidance.

MAKE A WARRANTY CLAIM

For small matters, under the guidance of your general counsel, make a claim to the developer under the builder's warranty. If that fails, or if the problem is pervasive, go to step 3. Remember, however, that making a warranty claim reveals the manager's and client's discovery of the problem, which can commence the running of certain statutes of limitation or repose.[34]

34 See Chapter Four.

SEEK THE ADVICE OF AN INDEPENDENT EXPERT

Management or your general counsel can offer referrals to consultants who can investigate the problems independent of the developer. An independent consultant can be an architect, an engineer, or a contractor whose duty it is to advise the board on the cause of the problem and suggest a means of repair.

MANAGER'S HEADS UP

A project owner should hire an independent expert rather than rely on the developer or builder and its experts to identify the defect and propose a repair, especially where the construction defect appears to be systemic and either difficult or expensive to fix.

INTERVIEW SEVERAL LAW FIRMS

If your consultant advises that the construction problem has not been properly repaired by the developer or contractor, it's time to seek the advice of attorneys specializing in such issues. This might be your general counsel, but if you are interviewing other firms, don't hire the first attorney who walks through the door – interview several firms. Ask them questions. Get recommendations from clients who have worked with them in the past. Compare fee arrangements, understand your choices, and select the attorney that best fits your association and the fee arrangement that best suits your financial circumstances (not what suits the attorney).

Ask the following questions of prospective counsel:

Which attorney will represent the owner or the association? The answer to this may seem obvious, but it's not. Some attorneys who contact clients looking for construction defect cases do not litigate the cases themselves. They are brokers who will sign up a client, arrange with experts, and then broker the package to another law firm. These "brokers" have minimal office facilities, do not actively litigate, and take a percentage of the recovery.

Will the association get a choice of expert consultants? An attorney who will not give the association the opportunity to review the resumes of several expert consultants or who tries to dissuade the board from interviewing alternate consultants probably has a relationship with one consultant, an alliance that will not necessarily benefit the association.

Does the attorney offer a selection of several fee arrangements? We discuss fee agreements further below, but the manager should know that many brokers and other construction defect specialty firms will only offer a contingency fee arrangement, i.e., where the attorney is paid a percentage of the recovery. Such an arrangement may be immediately attractive to a board concerned about expenses, since attorneys' fees for a big case are no small matter. But sometimes other fee plans may be more beneficial to a client. Hourly fee plans can often result in substantially lower attorneys' fees overall. Bank loans or blended arrangements (part contingency, part hourly) can also ease the impact on a client's budget.[35]

35 See Chapter Fourteen.

Resist accepting the only fee arrangement that is offered. Ask to see optional plans. Take the time to review what is being offered. Ask your general counsel to review any agreements or, if general counsel has the experience to handle your case as you would like to see it managed, have an independent attorney review the agreement. Suspect any attorney (or any other vendor for that matter) who suggests directors may be liable if a board does not immediately retain counsel and tries to pressure the board to "sign up" on the spot. You wouldn't buy a car that way or hire a contractor on his first visit, so why hire a law firm that way? Understand your responsibilities; don't be driven by them.

Has the attorney or the firm tried complex construction cases to verdict? While it is true that most construction defect cases will settle with no trial, some go that far. And if they do, legal counsel must have not only the experience but the resources to adequately staff trial preparation. Attorneys or firms which have not had substantial trial experience will often shy away from pushing a case that far and will urge a client to lower its demand so they will not have to try the case or even investigate it thoroughly. A large construction defect case may take five to ten attorneys and other staff members to adequately prepare the case in the weeks prior to a trial. A firm with only two or three attorneys cannot put together a team like that.

With appropriate care and consideration, a building owner or community association can pick the right law firm. Litigation is expensive and time-consuming, but so is dealing with construction defects. Take the time to interview and select among several well-recommended law firms so you are comfortable with your choice.

CHAPTER FOURTEEN

Attorney Fee Agreements

The first big question facing the client in a construction defect case is how the attorney will be compensated. While some firms offer only one fee agreement option, others are more flexible. Before entering into any arrangement, the client should be apprised of all available alternatives so the fee option that best suits the client's needs can be selected. The contents of an attorney fee agreement are governed by rules of professional conduct and state law, which require a full disclosure of key terms and restrict an attorney's ability to share fees with, or pay referral fees to, other attorneys or non-attorneys. California Business and Professions Code Sections 6147 and 6148 require written agreements in cases involving contingency fees or cases expected to result in fees over $1,000. The contract must contain a general description of the services to be provided, specify whether the fee is hourly or contingent, and state how litigation costs will be paid. The fee contract must discuss alternative dispute resolution and disclose whether the attorney will be sharing any portion of the fees.

The single biggest expense in construction defect litigation, outside of the cost of repair, is the fees of legal counsel. Historically, attorneys have been paid by the hour for all types of litigation, and in the corporate world most litigation work is billed at the attorney's hourly rate. Because construction defect litigation often involves individuals, investors, or community associations which have no budget for either repairing the project or paying the expenses of litigation, new types of payment arrangements have been devised, including contingency fee agreements, which originated in personal injury cases. Today, there are several types of fee agreements commonly used in construction defect cases, and we discuss them below.

WHAT ARE THE FEE AGREEMENT OPTIONS FOR LITIGATION?

Historically, both businesses and consumers paid attorneys' hourly rates for all legal services except accident and personal injury litigation, which were usually paid on a contingent basis – that is, in those cases the duty to pay the attorney was "contingent" on receipt of a recovery. More recently, the contingency fee arrangement has become a popular option in construction defect cases. Since there are important differences between hourly and

contingency fee representation, a board of directors must be fully informed of the consequences of choosing one method of payment over another. The most important difference concerns how the payment and recovery risks are divided between the client and its counsel.

Fee agreements allocate some of the financial risk of litigation as between the attorney and the client. There is always the chance the client will receive little or no recovery from the case, and that risk cannot be shifted to the attorney (the lawyer cannot guarantee and underwrite a cash recovery). However, the financial risk of the *expense* of the litigation, i.e., the fees and litigation costs to prosecute it, can be borne by the client, the attorney, or shared between the two. The typical hourly fee agreement requires that the client pay the fees and expenses of the case as they are incurred. With a contingent fee agreement, the lawyer accepts the risk of some portion of the fee and expense until there is a recovery.

An attorney's agreement to accept some portion of the risk is not without cost to the client. The contingent fee in a construction defect matter is a percentage of the recovery; the greater the risk of the claim, the higher the percentage. The percentage compensates the law firm for the possibility that its entire investment will have no return if a recovery cannot be obtained. The contingency fee, when and if it is earned, often represents a premium over what a client might expect to pay for the same case with an hourly fee agreement, where the attorney takes no risk because the fee is paid regardless of whether the client obtains a recovery.

Experience in the resolution of hundreds of construction defect cases shows that the client will likely save money with an hourly fee agreement. The truth of this proposition is substantiated by the fact that the hourly fee remains the arrangement of choice for most for-profit businesses who hire attorneys to litigate on their behalf. When it comes to successful corporations, because cash flow is not as much of an issue, they are in an even better position to pay litigation expenses and avoid any fee premium for "risk insurance."

For many community associations, however, the risk of losing the case or obtaining an inadequate judgment is too great when added to the costs of litigation. They may lack the cash flow to retain lawyers and expert witnesses on an hourly basis. For those clients, contingency fee arrangements are the only viable option. Each situation is different, but for the client, the key is being sure the fee options are identified and explained. The basic arrangements are described below.

HOURLY FEE CONTRACT

Under the standard hourly fee agreement, attorneys are paid for their services for each hour billed. Different attorneys and legal assistants will have different hourly rates. While the rates for the most experienced attorneys will be higher than those for junior associates or legal assistants, it isn't the rate of any individual attorney that is important, but rather the *average* rate of the firm projected over an entire case. This is because more hours are (or should be) invested into a case by those with lower rates. The partners in the firm – those attorneys with the greatest experience (and the highest rates) – will supervise the others and appear at important events like depositions, mediations, and court hearings but will bill fewer hours than other staff members, resulting in an average hourly rate far below that of the partner in charge.

The other major cost component is the fees of experts – architects, engineers, and others – who provide the expert testimony necessary to successfully prosecute a claim. With an hourly fee arrangement, the experts are typically paid by the client on an hourly basis. In a construction case with a potential recovery over a million dollars, attorney and expert fees can easily reach six figures, so the client must have sufficient cash flow or commit other financial resources (such as reserves or loans) to finance the case to conclusion. With this type of

contract, the risk of success or failure resides with the client. The attorney and the experts are paid regardless of the outcome.

CONTINGENT FEE CONTRACT

A contingent fee contract provides that the attorney's fee will be a percentage of any recovery. If there is no recovery, there is no fee. Where cash flow is a big issue with the client, as it often is with community associations, the attorney's willingness to defer fees until and unless there is a recovery is a substantial benefit to the client. The client must remember that with a contingent fee contract, the attorney acts as the bank, and that service is not without cost to the client. If the resulting fee is greater than what the client might have paid with an hourly fee agreement, it is because the client is paying the attorney a premium to accept some or all of the client's risk. If that risk is minimal, the client may be paying for insurance it doesn't need.

Under a contingent fee arrangement, the attorney and client must determine whether the attorney will also advance litigation costs. Litigation costs include all costs necessary to prosecute the case, such as expert fees, court filing fees, copy costs, service fees, etc. In a big case, litigation costs can be substantial. If the attorney is willing to advance costs in a case, it is again of great benefit to the client who has limited cash flow. The lawyer has a right to recover those costs from any resulting settlement or verdict. However, if there is no recovery, the attorney may absorb those costs.

The client should pay particular attention to the fee agreement provisions that dictate the manner in which the litigation costs are reimbursed to the attorney at the time of settlement or judgment. There are typically two alternatives: the costs are deducted from the gross settlement prior to payment of the attorney's fee, or the costs are deducted from the net settlement after the payment of the attorney's fee. If the costs are taken from the gross settlement amount, the attorney is sharing the costs with the client. If the costs are deducted from the net settlement amount, the client is paying for all of the costs.

MANAGER'S HEADS UP

Clients should be wary of law firms that insist upon a contingent fee arrangement and exclude other options. While this option is attractive to and appropriate for some clients, the attorney should always explain the implications of a contingency fee and offer the client an hourly fee option.

HYBRID ARRANGEMENTS

There are also fee arrangements where the client may pay a lower hourly fee coupled with a lower contingent fee percentage paid at the end of the case. This type of arrangement allows the attorney and client to share the risk attendant to the prosecution of the action for a lower contingent fee. Similarly, in such an arrangement, the client may assume some or all of the costs. Another form of hybrid arrangement permits a shift from an hourly fee contract to a contingent fee agreement during the litigation if and when the cash flow burden becomes too great.

WHICH AGREEMENT IS RIGHT FOR MY CLIENT?

For some community associations, deciding whether to enter into an hourly or contingent fee arrangement is easy. Where there is insufficient cash flow or other funding[36] to sustain construction defect litigation, the contingent fee is really the only option. For clients who can bear the financial burden, however, the board of directors should consider whether the fee premium under a contingent arrangement is warranted by the facts of the case.

At the outset, the attorney should provide a preliminary assessment of the case and its prospects for success. Construction defect law and procedure is fairly clear. Where the case involves new construction by a nationwide developer with good insurance coverage, the risk may not be all that great. The majority of the issues are fact-based: Is a building component defective? If so, what is the cost to repair it? Which Defendant (developer, contractors, etc.) built the defective component? Was the design improper? Did the Association wait too long to sue or otherwise contribute to the defects by improper maintenance? When the issues are fact-based, they are candidates for compromise and resolution through pre-trial mediation.

In cases involving residential or commercial conversions, special developer defenses, or insurance coverage problems, the legal issues are complicated, and the risks are significantly greater. The attorney will spend a higher percentage of time focusing on unique legal or coverage issues that could drastically impact the success of the case. Cases which are legally complicated or those with difficult insurance coverage problems are also the ones that may have to be resolved at or near trial, further increasing the risk and expense of the litigation.

Attorneys have a professional responsibility to make sure that the client understands any fee arrangement. The client should always discuss with its attorney the details of the problem, which fee options are available to the association, and whether one option is best suited to the association's needs. The important point to remember is that any proposed agreement must be read, carefully explained and negotiated. Attorney's fees are not set by law; they are a matter of agreement between the attorney and the client. Like any contract, the client may negotiate the terms, and the attorney may accept or reject them.

36 E.g. a special assessment or bank loan.

CAN OTHER LAWYERS SHARE AN ATTORNEY'S FEE?

The California State Bar has hard and fast rules that govern "fee splitting." Lawyers cannot split fees with other lawyers or law firms without the consent of the client. And a lawyer cannot share a fee with a non-lawyer under any circumstances.[37]

MANAGER'S HEADS UP

An attorney fee agreement is never a "one size fits all" contract. Managers and potential clients must consider the association's financial condition, the specific facts of the case and the risk involved in prosecuting the matter. Before a client accepts a fee agreement, the attorney and client should review each of the terms, and the attorney should provide a detailed explanation of why the agreement is best suited to the client's needs.

Complex construction defect litigation is expensive to prosecute, but the cost to repair the damages sustained by building owners and community associations is often extraordinary. In many cases, litigation is a necessary evil, and must be pursued to achieve some measure of justice and the benefit of the consumer's bargain. When that happens, clients can and should be assured that the lawyers they hire will give them their best effort and represent them under fee arrangements which comply with the rules of fairness and professional responsibility.

37 The California Rules of Professional Conduct are clear regarding who can be paid from or share in the attorney's fee. Rule 2-200 states: "A member [attorney] shall not divide a fee for legal services with a lawyer who is not ... [in the same firm] unless the client has consented in writing thereto … [A]fter a full disclosure has been made in writing a division of fees will be made and the terms of such division; and the total fee charged by all lawyers is not increased solely by [the division of fees.]" All such arrangements must be fair to the client, disclosed in advance, and be approved by the client in writing.

That rule further states that unless disclosed to, and approved by, the client, "a member shall not compensate, give, or promise anything of value to any lawyer for the purpose of recommending or securing employment of the member or the member's firm by a client, or as a reward for having made a recommendation…"

Rule 1-320 states: "Neither a member nor a law firm shall directly or indirectly share legal fees with a person who is not a lawyer…" It also states: "A member shall not compensate, give, or promise anything of value to any person or entity for the purpose of recommending or securing employment of the member or the member's law firm ..." There are many players involved in construction defect litigation. Besides attorneys, there are design experts, construction companies, property managers, vendors and directors. Any may find themselves in a position to recommend work to one attorney. These referrals are proper if they are not done in anticipation of monetary payment, gifts or a share of the fees paid to the attorney.

Conclusion

Resolving construction defect claims will be stressful for everyone involved. Owners, investors, board members, property managers, and legal counsel will all be impacted by the time and expense consumed. The alternative – paying for the damage out of pocket – is also difficult. Because any process that potentially involves litigation will tax the patience and pocketbooks of all involved, we adhere to the following philosophy:

1. **Bring in experts who can make a proper evaluation of the extent of any damage or defect so the owner can evaluate its options – including the option of doing nothing.**
2. **Notify the developer and/or builder and give them an opportunity to offer to make repairs. If they make a legitimate offer and the repairs can be overseen by the owner's experts, that may be the quickest and most efficient solution.**
3. **Investigate the resources of potential Defendants before investing our clients' funds in pursuing a claim.**
4. **Protect the client from statutes of limitation or other loss of legal rights while the defects and the resources of the Defendants are being investigated. If necessary, have the attorney explain how he or she is going to achieve this.**
5. **Consider all other options before starting litigation.**
6. **Release only those claims that the settlement demands.**
7. **Do not sacrifice a client's long-term interests to make a quick settlement.**
8. **Have clients consider different attorney fee arrangements, and explain the pros and cons of each one. Do not pressure clients to succumb to accept one type of agreement. A client should never be asked to accept any fee arrangement at the first meeting.**
9. **Explain legal methods to the owners and frequently provide updates on the status of the case.**
10. **Guide clients to retain litigation firms that will be there *after* the litigation to use the knowledge gained in the litigation to assist the client in choosing the right scope of repairs, the proper repair contractors, and the right experts to oversee them.**


BERDING | WEIL

Authors

TYLER P. BERDING, J.D., PH.D.

Tyler Berding is a founding partner of Berding & Weil LLP, and has been legal counsel to the commercial and residential real estate industry since 1974. Mr. Berding is a trial lawyer who has litigated hundreds of building construction failures. His special expertise is water intrusion, foundation and soil problems, failed building systems, and building-product failures. In addition to his law degree from the University of California, Davis Mr. Berding holds a Ph.D. in Government from Claremont Graduate University. He authors the blog "Condo Issues" appearing at www.condoissues.com and is also the author of numerous articles on a wide range of community association and building construction subjects that can be found at www.berding-weil.com.

JULIA HUNTING, J.D., P.E., S.E.

Julia Hunting is a member of the construction law department of Berding & Weil LLP. Her practice concentrates on all facets of construction law, from construction contracts and dispute resolution to complex construction defect litigation. She represents commercial and residential property owners in a variety of construction issues including construction contracts, mechanics liens, release bonds, dispute resolution, settlement agreements, and construction defect litigation. Prior to joining Berding & Weil LLP, Ms. Hunting worked for 12 years as a structural engineer at a large civil-structural engineering firm in San Francisco, with projects ranging from multistory office, residential and hospital buildings to retail rollouts and tenant improvements. She is a California licensed Professional Engineer (PE) and Structural Engineer (SE).

ANNA P. FABIANO, J.D.

Anna Fabiano is a member of the litigation department of Berding & Weil LLP. Ms. Fabiano represents commercial real estate clients, common interest developments, single family owners, and owners associations in complex construction defect actions. Ms. Fabiano moved to San Francisco after receiving her B.A. in Psychology from Colgate University. She received her Juris Doctor from the University of San Francisco School of Law in 2009.

BERDING | WEIL

2175 N. CALIFORNIA BLVD., SUITE 500 WALNUT CREEK CALIFORNIA 94596 925.838.2090 WWW.BERDING-WEIL.COM

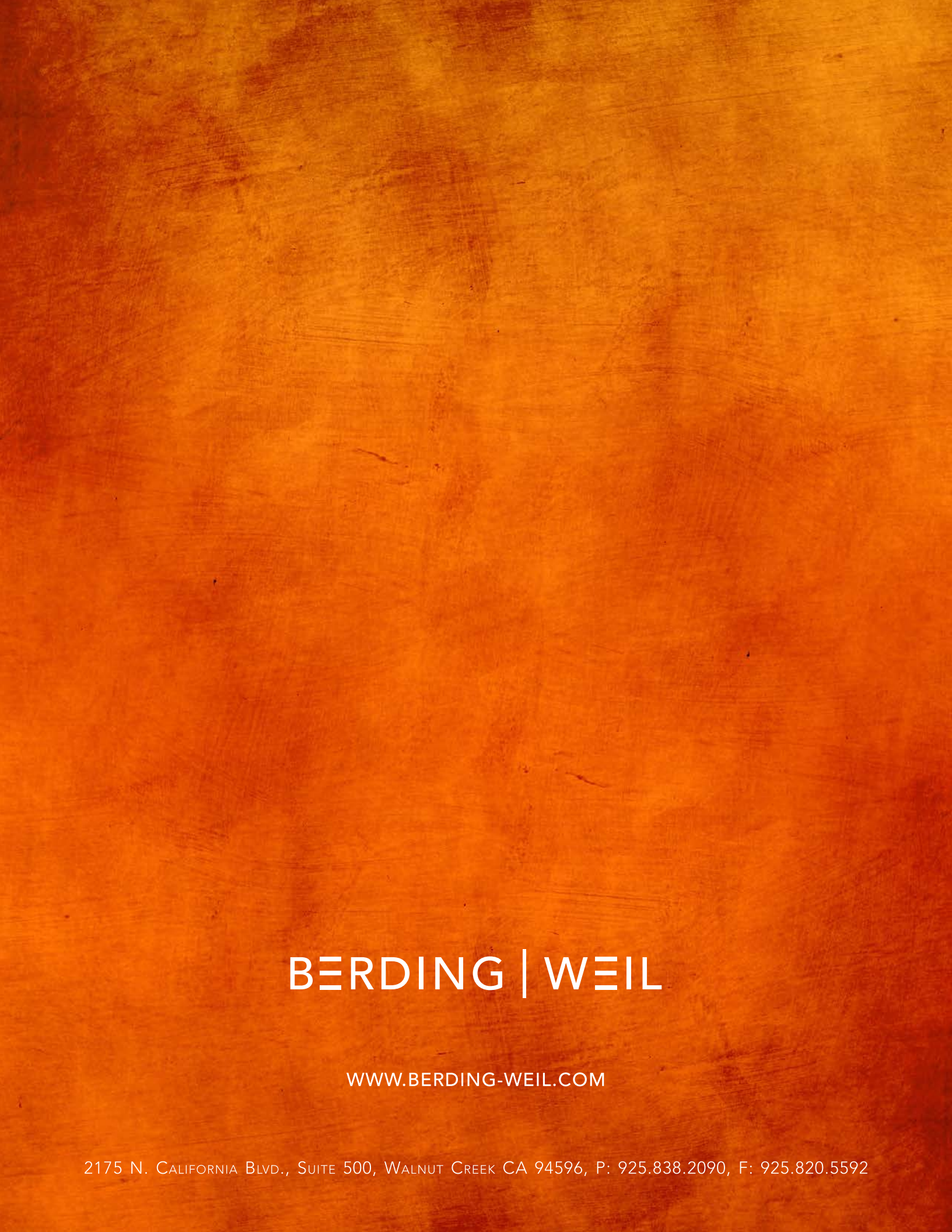
Standards for Residential Construction and Outside Time Limits

on Claims For Construction Defects in Community Associations under Title 7 of the Civil Code

Statute applies to original construction of residential housing where the purchase agreements were signed after January 1, 2003. Notwithstanding the outside limits shown here, each of these claims is also subject to potentially shorter periods, depending upon the nature of the claim. The most commonly applied shorter period is 3 years from the date of "discovery" of the problem, defined as when the claimant knew or should have known that he will suffer damage due to the negligence or other fault of the defendants. Appearing below are the time limits for filing an action and the construction standards that apply to each component:

Building Component/System	Standard
1 YEAR from "close of escrow," defined as either substantial completion or when Developer relinquishes control of Board.	
Irrigation Systems and Drainage	Shall operate properly so as not to damage landscaping or other external improvements.
1 YEAR, unless manufacturer has specified longer warranty period.	
Manufactured Products	Shall be installed so as not to interfere with the product's useful life or utility.
1 YEAR from occupancy of adjacent unit.	
Noise Transmission	Shall comply with applicable government codes, ordinances and regulations.
2 YEARS from "close of escrow," defined as either substantial completion or when Developer relinquishes control of Board.	
Dryer Ducts	Shall be installed and terminated pursuant to manufacturer installation requirements.
Landscaping Systems	Shall be installed in such a manner so as to survive for not less than one year.
Wood Posts (untreated)	Shall not be installed in contact with soil so as to cause unreasonable decay to wood.
4 YEARS from "close of escrow," defined as either substantial completion or when Developer relinquishes control of Board.	
Electrical	Shall operate properly and shall not materially impair the use of the structure by its inhabitants.
Exterior Pathways, Driveways, Hardscape, Sidewalks and Patios	Shall not contain cracks that display significant vertical displacement or that are excessive.
Plumbing and Sewer	Shall be installed to operate properly and shall not materially impair the use of the structure by its inhabitants.
Steel Fences (untreated)	Shall be installed so as to prevent unreasonable corrosion.
5 YEARS from "close of escrow," defined as either substantial completion or when Developer relinquishes control of Board.	
Paint and Stains	Shall be applied in such a manner so as not to cause deterioration of building surfaces for the length of time specified by the manufacturer.

Building Component/System	Standard
10 YEARS from substantial completion, or recording of a Notice of Completion, which ever is later.	
Air Conditioning in Living Spaces	Shall be consistent with the size and efficiency design criteria specified in Title 24 of California Code of Regulations.
Ceramic Tile and Tile Backing	Shall be installed in such a manner that the tile does not detach.
Ceramic Tile and Tile Countertops	Shall not allow water into the interior of walls, flooring systems or other components so as to cause damage.
Decks, Deck Systems, Balconies, Balcony Systems, Exterior Stairs and Stair Systems	Shall not allow unintended water to pass within the systems themselves and cause damage. Shall not allow water to pass into adjacent structures.
Doors	Shall not allow unintended water to pass beyond, around or through the door or its moisture barriers.
Exterior Stucco, Siding, Walls, Framing, Finishes and Fixtures	Shall not allow unintended water to pass into the structure or to pass beyond, around, or through the moisture barriers. Shall not allow excessive condensation to enter the structure and cause damage to another component. Shall not contain significant cracks or separations.
Fire Protection	Structure shall be constructed to comply with design criteria of applicable government building codes, regulations and ordinances. Fireplaces and chimneys shall not cause unreasonable risk of fire. Electrical and mechanical systems shall not cause unreasonable risk of fire.
Foundation Systems and Slabs	Shall not allow water or vapor to enter into the structure so as to cause damage to another component. Shall not allow water or vapor to enter the structure so as to limit the installation of flooring material.
Foundations, Load Bearing Components and Slabs	Shall not contain significant cracks or significant vertical displacement. Shall not cause the structure to be structurally unsafe.
Foundations, Load Bearing Components, Slabs and Underlying Soils	Shall be constructed so as to materially comply with design criteria set by government building codes, regulations and ordinances for chemical deterioration or corrosion resistance.
Hardscape, Paths, Patios, Irrigation Systems, Landscape Systems and Drainage Systems	Shall not be installed in such a way as to cause water or soil erosion to enter into or come in contact with the structure so as to cause damage to another component.
Heating	Shall be installed so as to be capable of maintaining a room temperature of 70 degrees Fahrenheit at a point three feet above the floor in any living space.
Plumbing Lines, Sewer Lines and Utility Lines	Shall not leak. Shall not corrode so as to impede useful life. Shall be installed in such a way as to allow the designated amount of sewage to flow through system.
Retaining and Site Walls, Associated Drainage Systems	Shall not allow unintended water to pass beyond, around, or through its moisture barriers. Shall only allow intended water to pass beyond, around or through the areas designated by design.
Roofing Materials	Shall be installed so as to avoid materials falling from the roof.
Roofs, Roofing Systems, Chimney Caps and Ventilation	Shall not allow water to enter the structure or pass beyond, around or through its moisture barriers.
Shower and Bath Enclosures	Shall not leak water into the interior of walls, flooring systems, or interior of other components.
Soils	Shall not cause the land upon which no structure is built to become unusable for the purpose represented or for the purpose for which that land is commonly used.
Soils and Engineered Retaining Walls	Shall not cause damage to the structure built upon it. Shall not cause the structure to be structurally unsafe.
Structure	Shall be constructed so as to materially comply with the design criteria for earthquake and wind load resistance set forth in the applicable government building codes, regulations and ordinances. Shall be constructed in such a manner so as not to impair the occupants' safety because they contain public health hazards.
Windows, Patio Doors, Deck Doors and Related Systems	Shall not allow water to pass beyond, around or through the component or its moisture barrier. Shall not allow excessive condensation to enter the structure and cause damage.



WWW.BERDING-WEIL.COM

2175 N. California Blvd., Suite 500, Walnut Creek CA 94596, P: 925.838.2090, F: 925.820.5592