CALIFORNIA

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SUCCESSOR HOMEOWNERS HAVE CAUSES OF ACTION AGAINST HOME BUILDER FOR LATENT DEFECTS UNLESS ORIGINAL OWNERS SUFFERED ACTUAL ECONOMIC INJURIES AS A RESULT OF THOSE DEFECTS

Siegel v. Anderson Homes, Inc., 04 C.D.O.S. 4350 (5/20/04)

The Court of Appeal reversed the superior court's grant of defendant home builder's motion *in limine* to exclude evidence of construction defects and dismissal of complaint.

Two homeowners, Siegel and Sanchez (collectively "Siegel"), sued the home builder, Anderson Homes, for strict liability and negligence, alleging latent construction defects in their homes (poor chimney, roof, window and stucco siding installation leading to leaks). Anderson moved *in limine* to exclude evidence of the defects on the ground that, absent an assignment of rights by the original owners to them, Siegel lacked standing to sue for such defects. The trial court agreed and dismissed the complaint. Siegel appealed.

The issue on appeal was "whether a cause of action for latent construction defects accrues when some significant structural damage occurs, or when the owner discovers (or should discover) the damage." After analyzing cases all over the map, including *Krusi v. S.J. Amoroso Constr. Co.*, 81 Cal. App. 4th 995 (2000) – relied upon by Anderson and the trial court, the Court of Appeal reversed, concluding that, "absent proof the original owners suffered actual economic injuries as a result of the construction defects . . ., they possessed no causes of action against Anderson that precluded Siegel and Sanchez from maintaining their present claims." Put another way, the court held that "the cause of action belongs to the owner who first discovered, or ought to have discovered, the property damage."

Where lion's share of damages award to second-tier subcontractor against prime contractor could only have been proper under negligence theory, awards of prejudgment interest and attorneys' fees based on contract were improper

Superior Gunite v. Ralph Mitzel, Inc., 117 Cal. App. 4th 301 (2004)

The Court of Appeal affirmed the trial court's award of compensatory damages but reversed and remanded prejudgment interest and attorneys' fees awards.

Ralph Mitzel Inc., a general contractor, contracted with the Pomona School District to perform foundation work and grading at a high school. Mitzel subcontracted the structural concrete work to Pinnacle Concrete Construction. After Pinnacle filed for bankruptcy, it subcontracted essentially all of its work to Superior Gunite.

After Mitzel caused Superior to incur delays and additional costs (primarily labor cost overruns), Superior sued Mitzel, Pinnacle and Pomona, but only pursued its claim against Mitzel. Superior and Pinnacle entered an agreement assigning all Pinnacle claims against Mitzel to Superior.

At trial, the court found Superior failed to prove its claim for "pass-through damage," but found Mitzel liable to Superior on its own behalf for negligence and as an assignee of Pinnacle for breach of contract. The trial court awarded Superior $7,015 in damages incurred by Pinnacle for delayed commencement of the project ("false start damages"); $406,163 in labor cost overruns (under both contract and negligence theories); and prejudgment interest and attorneys' fees (based on breach of contract). Mitzel appealed.

The Court of Appeal held that the $406,163 judgment for breach of contract could not be justified. First, the only claim held by Pinnacle and assigned to Superior was the $7,015 false start claim. The trial court's damage award excluded delay damages (per the no damages for delay clauses in the contracts), and Superior could not have recovered as assignee of any indemnity claim by Pinnacle because Superior did not pursue or recover any amount from Pinnacle.

Second, Superior did not recover and could not have recovered under a pass-through claim, since the trial court dismissed any pass-through claim Superior might have asserted for lack of proof. As a result, the Court of Appeal did not need to consider that theory. (At footnote 8, the court states that there may be an issue as to "whether a pass-through claim normally applied to government entities can be applied to a nongovernmental entity in California even though a tort remedy for economic loss is available between parties not in privity with each other.")

The court's decision did not affect the $406,163 damage award, which was also based on negligence, but it did require reduction of the trial court's prejudgment interest and attorneys' fees awards. Superior was entitled to both as to its $7,015 award. On remand, Superior would also get the opportunity to recover interest (but not attorneys' fees) on its negligence damages to the extent it can prove those damages were "certain or capable of being made certain by calculation" per Civil Code § 3287(a).

Construction defects claims brought by original purchasers of homes must be determined by judicial referee pursuant to sales agreement

Greenbriar Homes Communities, Inc. v. Superior Court, 117 Cal. App. 4th 337 (2004)

The Court of Appeal reversed in part the trial court's denial of defendant homebuilder's motion to compel reference of plaintiff homeowners' construction defects claims to a referee.

Greenbriar Homes built and sold homes in Stockton, California. The owners of 69 of those homes sued Greenbriar in separate actions for construction defects. The actions were consolidated. Of the 69 homes, 43 were owned by the original buyers, who were in privity

of contract with Greenbriar. The remaining 26 homes were not owned by the original buyers.

The purchase and sales agreements between Greenbriar and the original buyers required that all disputes arising out of the agreements be determined by a judicial referee pursuant to C.C.P. § 638-645.1.

Greenbriar moved to compel the court to order the consolidated action be heard by a referee. The home owners opposed the motion, arguing that the general reference clause was unconscionable and that granting the motion would result in a multiplicity of actions because only the original home buyers could be bound by the clause. The trial court denied the motion on the second ground without ruling on the first. Greenbriar appealed.

Since the parties' consent is required for a general reference, the trial court could not require the non-original buyers to refer their claims, and so, as to those buyers, the trial court's denial of Greenbriar's motion was affirmed.

The original buyers, on the other hand, were bound by the general reference in their home purchase and sales agreements, and, as a result, the Court of Appeal reversed as to those buyers. The court held: the clause was neither procedurally nor substantively unconscionable; the trial court abused its discretion by refusing to enforce the clause due to the possibility of multiple lawsuits; and C.C.P. § 1281.2, which grants discretion not to enforce arbitration agreements in similar circumstances, does not apply to general reference agreements.

Subcontractor that was properly licensed for part of the work is entitled to compensation for the work performed while licensed

MW Erectors, Inc. v. Niederhauser Ornamental & Metal Works Co., Inc., 115 Cal. App. 4th 512 (2004), review granted, 2004 D.J.D.A.R. 5719, 2004 Cal. App. LEXIS 4026 (5/12/04)

Note: This decision is no longer citable due to the California Supreme Court's grant of review

The Court of Appeal reversed the trial court's order granting defendant contractor and sureties motion for summary judgment against plaintiff subcontractor.

Niederhauser Metal Works Company, Inc. ("Niederhauser") was the metal works subcontractor for construction of Disney's Grand Californian Hotel. Niederhauser entered into two subcontracts with MW Erectors, Inc. – one for structural steel work and the other for ornamental metals work. After Niederhauser terminated MW Erectors, MW Erectors sued Niederhauser and its payment bond sureties for amounts allegedly owing on the two contracts.

The defendants moved for summary judgment on the grounds that MW Erectors did not have a Class C-51 structural steel license when the first contract was executed (though it

obtained such a license shortly after performance began) and did not have a Class C-23 ornamental metal contractor license when the second contract was executed or when any of the work under that contract was performed. The trial court granted the motion, and MW Erectors appealed.

The Court of Appeal reversed. With regard to the first contract, the court held that MW Erectors' lack of licensure at contracting did not preclude recovery for the work it performed after it obtained the required license. The court looked at Bus. & Prof. Code § 7031(a), which generally prohibits a contractor from maintaining an action to recover "compensation for any *act or contract* where a license is required . . . without alleging that he or she was a duly licensed contractor at all times during the performance of that *act or contract* . . . ." (Emphasis added.) The court found the section's plain language allows recovery for an act performed while licensed, even if it is performed under a contract that was executed before the contractor was licensed. The court added that its construction of section 7031 was supported by the policy underlying the section, *i.e.*, the public would be protected because contractors could only recover compensation for acts they performed while they were properly licensed.

The court rejected MW Erectors' argument that the defendants were judicially estopped from contending that MW Erectors was unlicensed because Niederhauser had filed a cross-complaint against the general contractor, Turner Construction Company, and a mechanic's lien against the property based on MW Erectors' work. The court reasoned that, even if the cross-complaint qualified as an "inconsistent position" (the first requirement for judicial estoppel), there was no prejudice to MW Erectors (the second requirement) because the trial court had dismissed the cross-complaint.

With regard to the second contract, the court found that the trial court's grant of summary judgment was improper as there were disputed issues of material fact concerning whether the metal work MW Erectors performed was structural, such that its Class C-51 license was sufficient, or purely ornamental, such that a Class C-23 license was required.

Finally, the court rejected the defendants' contention that both contracts were illegal and void *ab initio* because MW Erectors was not properly licensed when it signed them. Relying on the California Supreme Court's holdings in *Gatti v. Highland Park Builders, Inc.*, 27 Cal. 2d 687 (1946), and other cases, the court held that the "void-for-illegality doctrine" is not applied in every instance of technical noncompliance with licensing requirements. Rather, trial courts should examine the contractor's qualifications to determine whether voiding the contract is necessary to protect the public.

Conspicuous written disclaimer in sales and express warranty documents provided to homeowners precluded homeowners' claims against home builder for breach of implied warranty of quality

Hicks v. Superior Court (Kaufman and Broad Home Corp.), 115 Cal. App. 4th 77 (2004), review granted, 2004 D.J.D.A.R. 5706, 2004 Cal. LEXIS 4022 (5/12/04)

Note: This decision is no longer citable due to the California Supreme Court's grant of review

The Court of Appeal denied plaintiff homeowners' petition for writ of mandate on the issue of whether California law precluded the builder of newly constructed homes from excluding from its sales contracts the common law implied warranty of quality.

Plaintiff homeowners purchased new homes from defendant developer Kaufman & Broad Home Corporation ("KB Home"). After discovering alleged design and construction defects in their homes (specifically, the use of allegedly inferior plastic fiber additives to control cracks in concrete rather than welded wire mesh), the homeowners sued KB Home under a number of legal theories, including breach of implied warranty. KB Home moved for summary adjudication on that cause of action on the ground that the buyers had waived any implied warranties under the terms of their sales contracts. The trial court granted the motion, finding that the waiver provisions were sufficiently conspicuous and that they were neither procedurally nor substantially unconscionable.

The homeowners sought a writ of mandate from the Court of Appeal ordering the trial court to reconsider and deny KB Home's summary adjudication motion. The homeowners had argued that the warranty waiver provisions in the sales contract were not sufficiently conspicuous and were unconscionable under the standards imposed by the Song-Beverly Act (Civ. Code §§ 1792, *et seq.*).

The Court of Appeal denied the writ. It held that the Song-Beverly Act applies only to sales of consumer goods and, as such, did not apply to the sale of homes. The court also agreed with the trial court's conclusion that the disclaimer language in the sales contracts was conspicuous in accordance with Commercial Code § 2316 because "a reasonable person against whom [the disclaimer] is to operate ought to have noticed it," and that this conclusion was reinforced by the repetition of the disclaimer in both the disclosure statement and Limited Warranty in the contract. The court further found that the disclaimers were neither procedurally nor substantively unconscionable because there was no adhesion (the evidence showed KB Home would have negotiated the terms and that comparable housing was available), the terms were not overly harsh or one-sided so as to "shock the conscience" (KB Home provided an expanded express warranty in exchange for waiver of the implied warranty), and there was no element of surprise.

A contractual arbitration provision may be unconscionable even if the contract is not an adhesion contract

Harper v. Ultimo, 113 Cal. App. 4th 1402 (2003)

The Court of Appeal affirmed the trial court's denial of contractor's motion to compel arbitration.

Two homeowners, the Harpers, entered into two contracts with a contractor, Ultimo, to stabilize the soil and re-level a pool on their property. The pre-printed contracts provided by Ultimo contained provisions requiring that all disputes be settled in accordance with the Uniform Rules for Better Business Bureau ("BBB") Arbitration, but those rules were not attached.

Ultimo allegedly broke a sewer pipe causing considerable damage to the Harper house's plumbing and backyard drainage systems. At that point, the Harpers learned that the BBB rules precluded their recovery of tort, punitive or any other damages. After they sued Ultimo in superior court, Ultimo moved to compel arbitration. The court denied Ultimo's motion, and Ultimo appealed.

The Court of Appeal easily found the arbitration provisions both procedurally and substantively unconscionable and, therefore, unenforceable. The court held that the appeal was not frivolous, however, due to two issues that it considered somewhat unclear under California law: (1) whether a finding of adhesion is a prerequisite for a finding of unconscionability and (2) whether the trial court should have severed the unconscionable provisions and compelled arbitration on the rest of the Harpers' claims.

On the first issue, the court held that an arbitration provision may be unconscionable even if the contract was not one of adhesion. While a party can show procedural unconscionability by showing adhesion, that is not the only way to do so. In the case before it, the court found the clauses definitely involved procedural unconscionability (because the BBB rules were not attached and, to the Harpers' surprise, provided that no relief would be available for property damage, even if Ultimo committed fraud), regardless of whether the contract was adhesive.

On the second issue, the court held that the trial court's decision not to sever the Harpers' damages claims for jury trial and order the remaining claims to arbitration was not an abuse of discretion, even under the heightened standard of review called for by *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal. 4th 83 (2000). The fact that the Harpers' claims were "all bound up with one another," such that separate adjudications presented a risk of inconsistent rulings, was sufficient to support the trial court's decision.

Privette and its progeny apply regardless of whether the subcontractor's employee's injuries were caused by the subcontractor or whether the elements of premises liability are met

Sheeler v. Greystone Homes, Inc., 113 Cal. App. 4th 908 (2003)

The Court of Appeal affirmed the trial court's grant of summary judgment in favor of the defendant general contractor against an employee of its tiling subcontractor.

Jimmy Sheeler was a tile and masonry worker for Roy Gerbitz Tile, a subcontractor for Greystone Industries, Inc. Greystone was the prime contractor at a home construction

site in Stephenson Ranch. Sheeler was injured at the site when he tripped over debris left on the stairs in one of the homes under construction. He received worker's compensation benefits from his employer's carrier.

Sheeler sued Greystone for negligence. Greystone successfully moved for summary judgment on the ground that it was not liable under any theory permitted under *Privette* and its progeny. Sheeler appealed, and the Court of Appeal for the Second Appellate District affirmed.

Sheeler first contended that *Privette* did not apply because Sheeler's injuries were not traceable to any negligence of his employer. The court rejected this contention both factually – the evidence showed that Sheeler's supervisor acted negligently – and legally – relying on *Smith v. ACandS, Inc*., 31 Cal. App. 4th 77, 82-5 (1994), and holding that *Privette* still governs regardless of whether the injured worker's employer was negligent.

Sheeler also contended that there was a disputed material issue as to whether Greystone exercised retained control, precluding summary judgment. The court rejected this contention as well, distinguishing the case at hand, in which there was no evidence that Greystone affirmatively contributed to Sheeler's injuries and cases like *Ray v. Silverado Constructors*, 98 Cal. App. 4th 1120 (2002), in which the owner affirmatively and contractually undertook responsibility for traffic control and its failure to meet this responsibility caused the plaintiff's injuries.

Finally, Sheeler argued that Greystone was liable under a premises liability theory. Under this theory, a contractor generally has a nondelegable duty to prevent injuries from pre-existing conditions that are either non-obvious or are obvious but could foreseeably cause injury. The court found that this theory "is incompatible with the limitations on hirer liability established in *Privette* and subsequent cases" and held that "an employee cannot recover under the theory of premises liability unless the hirer had control of the dangerous condition and affirmatively contributed to the employee's injury."

FEDERAL COURT DECISIONS

Doctrine of sovereign immunity does not protect construction manager for California public agency from liability under the federal False Claims Act

United States ex rel. Ali v. Daniel, Mann, Johnson & Mendenhall, 355 F.3d 1140 (9th Cir. 2004)

The Ninth Circuit reversed and remanded the district court's grant of summary judgment in favor of the defendant, Daniel, Mann, Johnson & Mendenhall ("DMJM"), which allegedly had submitted false claims in its role as construction manager for the California State University at Northridge ("CSUN").

A. Amir Ali, a *qui tam* relator, sued DMJM and the CSUN for their alleged submission of false claims. Ali was an employee of CSUN in January 1994 when the Northridge earthquake occurred. CSUN retained DMJM as its construction manager in

December of 1994 after it had terminated Ali's employment. Ali filed a *qui tam* complaint under the federal False Claims Act, 31 U.S.C. § 3729, *et seq.*, alleging that CSUN submitted false claims to the Federal Emergency Management Agency ("FEMA") for repairs not related to the Northridge earthquake, and he amended the complaint to include allegations against DMJM. CSUN was later dismissed pursuant to the parties' joint stipulation.

DMJM moved for summary judgment. The district court granted the motion, holding DMJM was not subject to liability under the FCA because it was acting as an agent of the State and was therefore protected under the doctrine of sovereign immunity. Ali appealed.

The Ninth Circuit reversed the district court's decision. While acknowledging its prior holding in *Bly-Mage v. California*, 236 F.3d 1014, 1017 (9th Cir. 2001), that "States and State agencies enjoy sovereign immunity from liability under the FCA", the court declined to extend that protection to a State agency's private contractor construction manager, even though the *qui tam* relator's complaint alleged that the manager, DMJM, was an agent of the public owner (CSUN).

The applicable test for sovereign immunity is the "arm-of-the-state test." Under that test, the court examines five factors to determine whether the agent of a public entity is protected: "(1) whether a money judgment would be satisfied out of state funds; (2) whether the entity performs central governmental functions; (3) whether the entity may sue or be sued; (4) whether the entity has the power to take property in its own name or only in the name of the state; and (5) the corporate status of the entity." In this case, the court found that, even assuming that managing the reconstruction of state university buildings is a central government function (test factor no. 2), the four other test factors weighed against granting DMJM immunity.

California regulations establishing minimum wages and benefits for State-registered apprentices are not preempted by ERISA or NLRA

Associated Builders & Contractors of Southern California, Inc. v. Nunn, 356 F.3d 979 (9th Cir. 2004)

The Ninth Circuit affirmed the District Court's denial of contractor association's request for an injunction to prevent California officials from implementing amendments to the California regulations that established minimum wages and benefits on public and private construction projects for State-registered apprentices.

The Associated Builders brought an action in the U.S. District Court for the Central District of California challenging 8 Cal. Regs. §§ 208(b) and (c) on the grounds that these regulations are preempted both by the Employee Retirement Income Security Act ("ERISA"), 29 U.S.C. § 101, *et seq.*, and by the National Labor Relations Act ("NLRA"), 29 U.S.C. § 151, *et seq.* The district court determined Associated Builders had little likelihood success on the merits because the regulations they challenged were part of the same scheme that the United States Supreme Court held not to be preempted by ERISA in *California Div. of Labor Standards v. Dillingham*, 519 U.S. 316 (1997) ("*Dillingham I*"), and that the Ninth

Circuit, on remand, held not to be preempted by the NLRA in *Dillingham v. Sonoma County*, 190 F.3d 1034 (9th Cir. 1999) ("*Dillingham II*").

Under the California scheme, building contractors can hire registered apprentices and pay them at a special rate that is typically lower than the journeyman rate which is otherwise required under prevailing wage law. The California Code of Regulations sets the special apprentice rate at 8 Cal. Code Regs. §§ 208(b) and (c) for public and private projects, respectively. The 2002 amendments to the regulations, challenged by Associated Builders, recalibrated the wage requirements for registered apprentices on private construction jobs to reflect varied market conditions throughout the State. These regulations are entirely voluntary; they do not impose any obligations on contractors who do not employ apprentices from State approved apprenticeship programs.

On appeal, the Ninth Circuit agreed with the district court and affirmed its denial of Associated Builders' request for injunction. The court held that the ERISA preemption analysis was controlled by *Dillingham I*. That case held that the Labor Code section governing apprentice programs did not violate ERISA preemption because it "functions irrespective of . . . the existence of an ERISA plan" and is indifferent "to the funding, and attendant ERISA coverage, of apprenticeship programs." Likewise, the California regulations did not specifically make ERISA plans essential to their operation and did not act immediately or exclusively upon ERISA plans. The court also was persuaded by the fact that Congress did not intend ERISA to preempt regulation in areas of traditional State concern and that regulation of apprentice standards was such an area. Finally, the court found that California regulations do not have a "forbidden connection" because they "do not bind ERISA plans to anything." While the regulations offer incentives, they do not dictate the choices facing ERISA plans.

Unlike its ERISA preemption claim, which concerned both public and private project apprenticeship regulations, Associated Builders' NLRA preemption claim challenged only the private project regulations. In *Dillingham II*, the Ninth Circuit held that California statutory provision regulating apprenticeship standards on public works was not preempted by NLRA. For similar reasons, the court concluded that the NLRA did not preempt similar regulations for private projects. The Ninth Circuit's holding in *Dillingham II* turned on the court's determinations that the statute at issue was a regulatory, rather than proprietary, action, and that California's apprenticeship regulatory scheme "does not affect the right to bargain collectively." Here, the Ninth Circuit held that § 208(c) of the California regulations was not preempted by the NLRA because the establishment of wage and benefit minimums for apprenticeships is not a policy area that Congress intended to leave unregulated, the regulation affects union and non-union employees equally, and it neither encourages nor discourages the collectively bargaining processes subject to the NLRA.