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San Diego Association of Governments

Condominium Construction Defect Litigation and Affordable Housing

The Anatomy of a Problem, with Strategies for a Solution

Introduction: The Housing Crisis

The San Diego region is facing a housing crisis. While the population is steadily growing, construction of new housing is not keeping pace with demand. The shortage of affordable housing is especially acute.

REGION2020 is SANDAG's strategy for accommodating the expected growth in the region in a responsible way. It seeks to ensure a rising standard of living, improve our transportation system, preserve our natural resources and environment, protect local revenues, and provide a variety of homes for all income levels, especially near jobs and transportation.

Multi-family development helps achieve several smart growth goals: providing more housing options for our residents, reducing the need to use vacant undeveloped lands, and improving the prospects for walkability and transit access. Condominium construction is, therefore, a necessary part of SANDAG's REGION2020 smart growth strategy.

Many feel that the surge of condominium¹ construction defect litigation (CDL) in the last 20 years has significantly reduced condominium construction, and therefore reduced the availability of affordable housing. This paper examines this issue and reviews proposed solutions to the problem.

History and Context: The Law of Construction Defects

From “Caveat Emptor” to “Let the Builder Beware”

Prior to the 1960s, in California as well as the rest of the United States, real estate was sold on a *caveat emptor* basis---“let the buyer beware.” The common law rule of *caveat emptor* originated in an environment of repeat transactions between buyers and sellers who knew one another. Modern markets, however, usually involve buyers and sellers who have limited information about one another and little chance of repeat interaction. In response to this change in market conditions, courts gradually overturned the *caveat emptor* rule in a series of decisions in the 1960s.

Now, defects in housing construction are subject to lawsuits on a strict liability basis. Strict liability is the lowest standard for fault. It means that someone suing over damage caused by a construction defect does not need to prove that the builder was negligent (did not act as a reasonably prudent builder should have acted), but only that the house or condominium was defective as built. Patent (readily discoverable or apparent) defects carry a four-year statute of limitations in California;² latent (hidden or not readily discoverable) defects allow ten years for a homeowner to discover the defect and file an action.³ California’s statutes of limitation are on the longer side of the nationwide average, but are not especially extreme.

¹ It is important to distinguish between high-rise, steel frame condominiums and low-rise, condominiums that are typically built of masonry, wood frame, or concrete. Construction of the high-rise variety can be seen in some locations in the San Diego region. Production of the low-rise variety, however, is almost non-existent.

Several key differences account for this dichotomy. The companies that build high-rise, steel frame condominiums use extremely expensive construction materials and techniques. The finished product is exceptionally safe and rarely experiences defects. And high-rise condominiums sell at prices much higher than their smaller counterparts---prices out of reach for most families. Essentially, there are two separate markets: high-rise, steel frame, luxury condominiums, and low-rise, more affordable condominiums. Construction defect litigation almost always involves the low-rise variety.

The availability of low-rise condominiums is intimately tied to the availability of affordable housing. High-rise condominiums serve a different market---a market that is currently strong. The problem this paper examines relates to low-rise condominiums of masonry, wood frame, or concrete construction, and not their steel frame counterparts.

² California Code of Civil Procedure, §337.1.

³ California Code of Civil Procedure, §337.15.

Fiduciary Duty

An important aspect of the law of construction defects is that condominium associations have a fiduciary duty to residents to investigate and correct certain types of construction defects. This means that the associations have a legal duty to exercise the utmost care in representing the interests of the residents---a very strong obligation. Whether or not they investigate reports of a leaky roof and correct the problem is not discretionary---it is a legal duty. On a related note, condominium associations often have the resources to sue a builder, while individual homeowners may not. With both a duty to repair and the resources to sue, it is not surprising that a condominium association, rather than the owner of a single-family home, is the usual plaintiff in a construction defect action. For this reason, from a legal standpoint, condominium construction may involve more risk than other types of construction.

The Calderon Process

In California, construction defect litigation involving common-interest properties with 20 units or more (a description fitting many condominium projects) is subject to Civil Code §1375, commonly known as the Calderon process. The Calderon process, in theory, requires homeowner associations to try to resolve disputes with builders before filing suit. Certain procedures must be followed before a builder may be sued, including a 90-day settlement period and certain meetings between the builder and the board of directors of the condominium association. The process has received mixed reviews. A California Bureau of Research report⁴ found that the Calderon process was not popular with either side of disputes. Parties felt that the process did not avoid or reduce litigation, but merely added to the time needed to resolve the dispute. Also, because the law requires neither insurance companies nor subcontractors to be involved in the Calderon process, it is unlikely that the process will generate a complete and final resolution to a dispute. Under the current system, insurers only become involved when a building company is sued, triggering its insurance coverage; therefore, builders lack the ability or incentive to settle before they are sued.⁵

The Aas Case: Damage and “Economic Damage”

Just last year, the California Supreme Court decided a very important construction defect case. In *Aas v. Superior Court (William Lyon Co.)* (Cal.4th No. S071258, Dec. 4, 2000), 83 individual homeowners and a homeowner’s association sued their respective builders in tort⁶ for the repair of several structural, electrical, plumbing, and other

⁴ Roger Dunstan & Jennifer Swenson, “Construction Defect Litigation and the Condominium Market,” California Research Bureau Note, Vol. 6, No. 7, November 1999.

⁵ In response to these criticisms, a bill has been proposed in the 2001-2002 California legislature that purports to fix many of the problems associated with the Calderon process. See AB 267 (Steinberg and Frommer) in the Pending Legislation Appendix.

⁶ “Tort” refers to a wrong that is not criminal and not a breach of contract. In the building defect context, it usually means negligence or strict liability.

The *Aas* case, as a negligence case, does not affect a homeowner’s remedy for fraud or breach of contract. However, the damages, statutes of limitation, and legal standards available in a tort case

construction defects, many of which violated the Uniform Building Code. Some defects had caused damage; some had not.

“Damage” is an essential element in any tort action---unless damage has occurred, a person is not allowed to sue. In the law of tort, only a condition that causes actual harm to people or property is considered to have caused damage. A leaky roof that causes the wall to get wet and grow mold, or a poorly constructed roof that caves in during an earthquake and harms its occupants, are both examples of damage in this sense.

On the other hand, sometimes a roof is so poorly constructed that it will obviously cave in if an earthquake hits--- but it has not caved in yet, and it is not clear when the next earthquake is coming. Clearly, a problem like this reduces the value of the structure; and clearly, it seems absolutely necessary to repair it. But in the law of tort, something that is merely defective, but has not caused physical harm to people or property, has only caused “economic damage,” which is not true damage in the tort sense.

Many lower California courts found an exception to this “economic damage rule” in construction defect cases. The economic damage rule was developed in the context of mass-produced products like stoves and automobiles, and the plaintiffs argued that it had never been applied in a housing construction setting. However, in *Aas*, the Supreme Court of California found that the economic damage rule did apply in construction defect cases. The *Aas* majority held that a homeowner may not sue a builder in tort for the repair of defects that have not yet caused true damage---physical harm to person or property.

The effect of this rule is now being debated. Homeowners are concerned that builders will become careless with the building code, or that serious defects such as missing firewalls between bedrooms and fireplaces will go unfixed. Builders feel that the rule will reduce frivolous construction defect suits that rely on an extremely speculative notion of damage. The Chief Justice, dissenting, proposed a rule in which defects that seriously threaten life or property, but not cosmetic defects, would be remediable in tort even if they had yet to cause damage to people or property. The *Aas* majority dismissed this rule as unworkable.

A bill in the California legislature, SB 355 (Escutia), would essentially overturn the *Aas* decision.⁷ It includes a variant of the “serious defect” rule proposed by the Chief Justice.

History and Context: The Region

Some aspects of the history of the San Diego region and the history of condominium construction may shed light on the CDL issue. During the 1970s and 1980s, the San Diego area experienced an economic boom, resulting in an explosion of residential construction. The demand for new construction soon tied up the supply of experienced,

are generally more appealing to a construction defect plaintiff than those in a criminal or contract case and come closer to remedying the full extent of the harm the plaintiff has suffered.

⁷ See the Pending Legislation Appendix.

reputable building companies. New companies---from the inexperienced with good intentions to the truly fly-by-night---entered the market and built many condominiums during this boom period.⁸ During the 1980s especially, credit for construction projects was easily obtainable from savings and loan associations, even for less experienced builders.

At the same time, during the past few decades, multi-family dwellings have become more architecturally complex. While new features such as pop-outs and complex window designs make structures more visually appealing, many of the complicated designs are relatively unproven and may be vulnerable to leaks over time.

In addition, residential construction workers are often paid on a “piece rate” basis---by project, rather than by the hour. Most skilled construction trades workers are not willing to work for the wages available in residential construction; as a result, unskilled labor is often used.

Nature and Scope of the Problem

The greatest initial challenge to any dialogue about construction defect litigation is defining the problem. Builders see the litigation itself as the problem, as it either increases their insurance rates or renders insurance impossible to obtain. But for homeowners and consumer advocates, the extent of CDL’s negative impact on affordable housing availability, the defects themselves, and the resolution of the defects are all aspects of the problem.

Another important point of contention is whether frivolous litigation (as builders argue) or shoddy construction (as plaintiffs’ attorneys argue) is the prime driver of the proliferation of construction defect suits. These two views of the nature of the problem will be addressed in the section on solutions.

Insurance

Both sides agree that the most important effect of construction defect litigation is on two aspects of the insurance market:

1. Availability. CDL makes insurance difficult or impossible for interested builders to obtain for condominium construction, substantially reducing the construction of multi-family ownership housing.
2. Cost. CDL makes building and insurance more expensive; therefore, fewer condominiums are built, and those that are built are more expensive.

⁸ Dunstan & Swenson, 1999.

Aspect 1: Availability of Insurance

If insurance is truly unavailable or scarcely available at any price, we can infer that there are institutional barriers to the construction of multi-family housing. These barriers, especially with the involvement of the insurance industry, could possibly be removed.

Evidence exists to suggest that the availability of insurance for condominium projects has decreased or is simply not available in the San Diego market or only available through non-admitted firms (firms not regulated by the California Department of Insurance). A study by the California Research Bureau found that while more than 40 insurers were willing to finance condominiums in the early 1980s, fewer than three are willing to do so today, along with a few more non-admitted firms. Construction industry professionals confirm that insurance is not available for condominium construction.

Aspect 2: Cost of Insurance

The cost of insurance also is significant. The California Research Bureau study found evidence that insurance premiums for condominium construction has increased significantly in the past decade. Construction industry sources report that construction insurance in California is two to five times more expensive than the rest of the nation and often explicitly excludes coverage for condominiums.⁹ Solutions exist that would reduce the need for, and incidence of, construction defect litigation, and hence insurance premiums.

Construction insurance costs appear to be high, as do condominium prices. This offers support to the theory that construction defect litigation contributes to the housing crisis; still, it is not clear how much construction costs, as opposed to land prices, contribute to high housing prices. A commission in British Columbia, Canada studied the CDL/condominium construction problem in June of 1998.¹⁰ The Canadian model for determining the share of increased housing costs attributable to CDL involves charting the relative portions of property values taken up by land and by improvements. In the Canadian study, land prices increased at a much faster rate than improvement prices and took up an increasingly greater share of housing costs over time. The Canadian study concluded that it was primarily land prices, and not construction prices (including insurance), that were driving housing costs up.

It would be valuable to find similar data for the San Diego region. This would be especially enlightening if the data were specific to condominium housing. However,

⁹ Testimony of George Dale, Chairman of the Construction Dispute Resolution Task Force of the California Building Industry Association before the Assembly Select Committee on Jobs-Housing Balance, November 3, 1999, citing a 1996 survey by the insurance brokerage firm of Anderson and Anderson.

¹⁰ Commission of Inquiry into the Quality of Condominium Construction in British Columbia, *The Renewal of Trust in Residential Construction*, June 1998, available as of June 2001 at <http://bbs.qp.gov.bc.ca/condo/index.htm>. Leaky condominiums are a pressing problem in rainy British Columbia, and this commission was formed to investigate the problem.

even if land prices were the primary driver, construction-related costs such as CDL might still have a significant, although secondary, impact on housing availability. In a competitive market, profit margins are small; increased insurance costs because of prevalent litigation might make a borderline project unprofitable. In any case, finding ways to eliminate construction defects would reduce inefficiencies and inequities in the housing market.

Goals

Deciding how to address the CDL issue depends on the conception of the problem. With this in mind, some possible (though not necessarily compatible) goals may include:

- Increasing the availability of affordable housing
- Increasing the construction of condominiums
- Reducing frivolous construction defect litigation
- Improving the quality of construction
- Ensuring that law-abiding, “by-the-book” construction companies are not forced out of the market by cost-cutting, “fly-by-night” operations
- Bringing insurers back into the condominium construction market
- Remediating condominiums that currently are damaged and preventing future damage
- Better understanding the nature of the CDL/affordable housing relationship

Solutions

The solutions that follow address two different aspects of the construction defect litigation problem. First, solutions are listed that would reduce unnecessary litigation. Second, solutions are presented that would improve the quality of construction by focusing on both the system of construction and the workforce involved.

The parties who would be responsible for implementing each proposed solution are listed in parentheses.

A Note on Increased Costs

Many of the potential solutions to address the CDL issue would result in higher building costs. These higher costs need, however, to be weighed against the savings in insurance, litigation, and repair costs and the decrease in inconvenience and damage to homeowners, as well as increases in opportunities to do business that may be brought about by these measures. If parties raise some expenditures now, they may save money in the long run.

Solutions: Reducing Unnecessary Litigation

A. Mandatory or voluntary warranty programs in lieu of CDL causes of action (lawmakers, builders)

Warranties in lieu of CDL causes of action are favored by the construction industry.¹¹ Consumer advocates argue that warranties would not protect the rights of homeowners. Homeowners choose to resolve their problems with an effective warranty program over litigation anyway, and only turn to litigation when the warranty program is not effective. The law (the Calderon process) requires a period of time for builders to correct problems before homeowners may sue. Only unresponsive builders get sued, consumer advocates argue, and removing the cause of action through a warranty program would remove the final check on irresponsible builders. Still, this option would probably reassure insurers and possibly bring them back into the condominium construction market.

B. Mandatory warranty programs in addition to CDL causes of action (lawmakers, builders)

A mandatory warranty that did not replace the CDL cause of action would offer another option for resolution of CDL cases and could even protect homeowners from “mere economic damage” (such as missing firewalls) that are not recoverable in a CDL action after *Aas*. This might result in higher building costs. The administration of a warranty and the repair of defects covered in a warranty are clearly more costly than no warranty. However, these costs must be weighed against the costs of not fixing construction defects. Also, builders may benefit in the form of increased insurance availability and reduced litigation costs if they administer effective warranty programs.

C. Third-party administration of warranties (lawmakers, third-party agency)

In most cases, builders administer their own warranty programs. Many consumers feel they are ignored or treated unfairly in this situation. A neutral administrator of the warranty would guarantee an arms-length transaction when homeowners experience structural problems.

D. Court priority for construction defect cases (lawmakers, courts)

Some attorneys feel that CDL cases should be given a higher priority in civil courts. Homeowners may not be able to afford to repair dangerous conditions until settlement has been reached. Potential harm and costs could be avoided by speeding up the CDL process once it reaches the courts. The California Research Bureau noted that the use of special masters, court officers who assist with case management and discovery in specific matters, help speed up CDL cases.

¹¹ AB 600 (Dutra) would allow licensed contractors to issue warranties and thereby be immune to construction defect tort suits. See AB 600 in the Pending Legislation Appendix.

E. Ability to sue insurance companies that are uncooperative in resolving CDL cases (lawmakers)

The California Research Bureau reported that attorneys for insurance companies perceived that “a few uncooperative insurance companies complicate defense and settlements.” They suggested that the ability to sue these companies for the tort of insurance bad faith would facilitate settlement of construction defect cases.

F. Alternative dispute resolution (ADR) options or requirements (lawmakers, builders, consumers, insurance companies, attorneys, ADR professionals)

Alternative dispute resolution (ADR) is commonly practiced now in construction defect litigation. The Calderon process currently requires a 90-day settlement period, which usually involves some type of alternative dispute resolution, but there are problems with the process.¹² Settlement is common in CDL, while trial is rare. Housing advocates feel that a requirement of more ADR would not increase the incidence of settlement, but would increase the time and cost involved in solving construction problems.

Increasing ADR options for both builders and homeowners would probably benefit both. There are a variety of options available, including neutral evaluation, mediation, and arbitration. Newer ADR methods such as neutral evaluation appear to be especially suited to CDL. A neutral evaluator is a mutually agreed upon party hired to make a disinterested, yet educated, prediction as to the merits, possible costs, and likely result of a construction defect claim. The evaluator provides valuable information for both sides at a fraction of the cost of discovery, and at the same time provides a framework upon which a solution can be built.

G. Clear statutory definition of “construction defect” (lawmakers)

The California Code of Civil Procedure sets out statutes of limitation for actions to recover damages for any “deficiency in the design, specifications, surveying, planning, supervision or observation of construction or construction of an improvement to, or survey of, real property” (as close as California law comes to defining a construction defect).

Some feel that the lack of a precise, carefully limited definition of construction defect allows litigation for merely cosmetic defects as well as more serious problems. This conclusion is called into question by the recent California Supreme Court ruling in *Aas*, which requires that the defect cause damage to people or property before suit may be brought. At any rate, it is unclear exactly what the definition of a construction defect should be. Should economic damage constitute a construction defect? How serious does a defect need to be to qualify as a basis for suit? Obviously, all sides of the issue will have different ideas about the proper definition.

¹² See above, “The Calderon Process,” and AB 267 in the Pending Legislation Appendix.

H. English System (lawmakers, builders, third party performing insurance and inspection function)

The construction system in the United Kingdom is different from that in the United States in both procedural and substantive ways. The UK employs a builder certification system as well as a long-term warranty program, and no CDL cause of action. The builder is responsible for the first few years, and a third party is responsible for the remaining years. The third party conducts inspections during the construction phase, occupying a role that insurers could eventually fill in the United States.

Solutions: Improving the Quality of Construction: The System

I. Better quality control in condominium construction (builders)

Many feel that some members of the construction industry itself need to exercise better quality control, and that many structural problems and construction defect suits could be prevented this way. Builders could develop and implement quality control programs themselves; government could help implement quality control by mandate or incentive. This step would result in increased costs for many construction companies, but would also enable companies that have optimal quality control measures in place to compete with companies that do not practice adequate quality control under the current system.

Some feel that the market naturally provides the optimum level of quality control. But industry professionals¹³ have pointed out that buyers often lack both information and a long-term perspective when choosing a house. A unit built with cheaper construction methods looks like a better buy than a more expensive, better constructed unit at the time of purchase, but may be more expensive in the long run when repair and litigation costs are factored in. To avoid inefficiencies, many feel that forces other than consumers (either the government, insurance companies, or a regulatory association composed of the firms themselves) must intervene and mandate the level of investment in housing construction that results in the least cost in the long run.

J. Better coordination among all phases and aspects of construction (general contractors, professionals involved in all aspects of construction and design)

Industry professionals cite “fractured services” as a leading cause of building problems. Consultants working on different aspects of construction often do not communicate or work together, resulting in incompatibility between different phases or aspects of construction. A process by which developers could coordinate the provision of services has the potential to reduce building errors, but could also result in increased costs and paperwork.

¹³ Thomas K. Butt and John Clinton, “Limiting Construction Failure Losses – A Challenge for the Insurance Industry,” a publication of the firm Interactive Resources, Inc., accessed at <http://www.intres.com/ConstructionFailureArticle.htm>, July 11, 2001.

K. Architect involvement and responsibility in construction phase (builders, architects)

Currently, architect involvement usually ends long before construction begins. Architects are not available to clarify ambiguities or to ensure that plans are interpreted accurately. Some feel that this leads to more mistakes, hence more construction defects. Either working with the building industry to develop procedures for architect involvement or enacting legislation requiring such involvement may reduce mistakes related to misinterpretation of plans, but also would increase the cost of building.

L. Increased awareness and attention to moisture control and increased investment in the study of Building Envelope Science (government, academia)

Building Envelope Science is a very young field. However, some industry professionals feel that failure of the building envelope (leakage) is the most commonly litigated construction defect. Increased investment in understanding building envelopes and why they fail, along with better education of builders, could lead to a reduction in leaks, and hence in the need for CDL. This approach is a very long-term solution, however, and it would take many years before any noticeable benefits appeared.

M. Insurance industry involvement in creating workable standards (insurance industry, all parties)

Insurance companies have abandoned the condominium construction market during the past 20 years. While 40 insurance companies were estimated to be willing to underwrite multi-family housing construction in the early 1980s, fewer than five are willing to do so today. A shortage of insurance translates into a shortage of construction.

But the insurance companies have an incentive structure that is balanced between consumers and builders. While they do not wish to pay large settlements in construction defect cases, they also do not wish to see the market for insurance products dry up, which might happen if the cause of action for construction defect were abolished. Insurers have the ability to study what construction practices are least likely to result in litigation, and to only insure projects implementing those practices. Working with insurers may be an avenue for developing solutions acceptable to all sides. This solution may include better inspection and supervision by insurers as well as other proposed solutions from this list.

N. More detailed inspections by insurance providers (insurance providers)

Some feel that the inspections insurance companies have traditionally made have not been adequate. This inadequacy is puzzling, considering that it seems to be in the insurance company's best interest to ensure that the projects it underwrites are constructed properly. More study is needed into the nature of insurance inspections and ways to better use them as a tool for quality control and risk management.

O. Change in role of government inspectors to include not only fire and safety, but also building quality (lawmakers, government agencies)

The role of government inspectors is currently limited to identifying fire and building code violations. If this role were expanded to include basic quality control and occurred at several phases of the project, potential defects could be remedied before they became severe problems. Inspection costs could be passed on to builders. Expanded inspections also could result in increased bureaucracy, paperwork, and possibly time and cost per project. Consumer advocates also recommend increasing the training and support that building inspectors receive and ensuring their independence from construction companies.

P. Increased penalties for irresponsible builders (lawmakers)

Consumer advocates suggest increasing penalties for builders who repeatedly build defective homes. They feel that builders, who pass on their litigation expenses to insurance companies, lack incentives to build houses well.

While this solution probably would remove some irresponsible builders from the marketplace, it also could discourage many responsible but cautious builders from doing business, exacerbating any effect CDL has on housing availability.

Q. Central, public clearinghouse of construction defects (lawmakers, consumers, government)

When a construction defect case is settled, secrecy is often made a condition of settlement. This condition results in difficulty gathering information for studying the CDL problem and researching builders and defects. Consumer advocates feel that a central, public clearinghouse of construction defects would provide important information to policymakers and parties to litigation.

Mandatory publication of construction defect settlement information, however, would remove a potential bargaining chip from homeowners. And it is unclear whether such a clearinghouse could be implemented legally with respect to privacy and public policies favoring voluntary settlement.

R. Consumer education (consumer advocates, government)

Education of consumers about construction defects in general, and possibly about individual builders, could improve market functioning.

S. Data collection and further study (government, academia)

The information about condominium construction, insurance, and construction defect cases is inadequate. Further study could help clarify the nature and magnitude of the problem.

Solutions: Improving the Quality of Construction: The Workforce

T. Use more skilled workers in residential construction (construction employers, labor)

The wages paid to residential construction workers tend to attract only unskilled workers. Increasing wages and drawing in more highly skilled workers could improve the quality of residential construction. However, this would also increase building costs.

U. Better training for residential construction workers (builders, government)

Improving training for residential construction workers could improve the quality of construction and decrease the likelihood of defects, but would add to the costs of construction. Both the cost of training workers and the higher wages demanded by better-trained workers would probably contribute to higher building costs.

V. Better enforcement of existing certification requirements for regulated trades (builders, government)

Some evidence suggests that existing certification requirements are not strictly enforced. Better enforcement (by mandatory record keeping, for instance) would ensure that workers who build houses have been trained appropriately, but also could add to the cost of construction.

W. Stricter certification requirements for construction trades (lawmakers)

Some construction trades are not certified at all. The complaint has been made that while a person must be certified in order to style hair, it is not necessary to obtain any kind of certification to perform many aspects of home building. Some feel that requiring certification for more trades, and stricter certification for regulated trades, would lead to a more highly skilled workforce, and therefore better quality of construction. Of course, this would increase construction costs and paperwork.

Conclusion

Numerous options could reduce the need for, and incidence of, construction defect litigation. The key objective should be to increase the supply of affordable housing in the region. In addition to construction defect litigation, factors such as high land costs, neighbor opposition, density restrictions, and historical market conditions contribute to the lack of construction of affordable housing.¹⁴ In an environment of scarce resources, it is imperative that we choose the most cost-effective methods of increasing the housing supply. Addressing the CDL issue is one of these.

¹⁴ The California Research Bureau study identified several factors that may contribute to the current affordable housing shortage:

- the overall conditions in the real estate market brought about by overbuilding in the 1980s followed by a severe and prolonged recession in California;
- opposition to new projects by existing neighborhood residents;
- reluctance on the part of lenders, and their regulators, to finance condominiums because of earlier loan losses;
- increased affordability of single-family homes in the 1990s due to falling prices [no longer a factor in the current housing market]; and
- preference of homebuyers for single-family detached homes.

Sources Consulted

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Appendix

California Legislature Construction Defect Litigation Bills

In the 2001-2002 Session

Including Amendments as of July 17, 2001

AB 267

Assembly Members Steinberg and Frommer
Construction defects.

Strengthens and lengthens the Calderon process. Increases the minimum settlement period from 90 days to 180 days and forbids the builder to unilaterally opt-out. Requires notification and participation in the mediations by all potentially culpable subcontractors, design professionals, and their insurers. Requires the exchange of three different defect lists and certain information.

This bill appears to address the key problem with the Calderon process: the lack of involvement by subcontractors and insurers. It also appears to improve the flow of information by requiring the exchange of defect lists, project plans, subcontracts, and other relevant information.

While the authors of the bill maintain that this bill will decrease CDL times by half, the argument could be made that the mandatory nature of the process additions, and increase in number of parties involved, would add to the time required to resolve building disputes.

AB 600

Assembly Member Dutra
Home warranty program.

This bill would allow licensed contractors to issue ten-year construction warranties on new homes, including condominiums. More importantly, it would provide that people buying homes with these warranties would waive any tort claims against the builder. That is, buyers would not have the right to sue the builder for negligence, strict liability, implied warranties, or any other common law remedy except breach of the warranty contract, bodily injury, wrongful death, or fraud.

The bill further removes the prohibition on requiring homeowners to resolve their construction defect claims with arbitration. Builders would be allowed to require homebuyers to use binding arbitration, rather than the court system, to resolve their claims.

The bill defines a construction defect as "a defect in design, materials or workmanship that: results from an act or omission of the builder (or a contractor working for the builder); occurs during the original construction of the improvement, or in connection

with the warranty repair work; renders the improvement or some part of it not reasonably fit for its intended purpose; and materially affects building site work, substructure, building shell, or building services.”

This bill is supported by business associations and by the building industry. However, many housing and consumer advocates feel that the bill is flawed. A great deal of new home construction currently carries a warranty; it is perceived by some consumer advocates that only unresponsive builders get sued. In addition, the Calderon process already requires a 90-day attempt at settlement; it is unclear whether litigation is truly the first choice of homeowners, as the author implies. While it would eliminate construction defect litigation, this bill would also eliminate the last effective option of a frustrated homeowner. Assembly Committee on Judiciary comments reflect this view.

Requiring licensure of contractors who provide the warranties appears to provide some protection to homebuyers. But the bill also provides that “a contractor shall be deemed to be certified if the [California State Licensing Board] fails to act on a contractor's application within 30 days.” While a builder must renew his license annually, the board must automatically renew his license unless he has failed to meet any of the requirements.

Although the findings of this bill note the shortage of multifamily housing, the bill would not be limited in application to multifamily projects.

AB 739
Assembly Member Frommer
Construction defect litigation.

This bill would increase the settlement period provided for in the Calderon process from 90 days to 180 days, but would otherwise leave the Calderon process unchanged.

AB 1010
Assembly Member Dutra
Construction defect litigation.

This bill would make legislative findings only. The nature of the findings is that California faces a statewide housing crisis, that few Californians are able to buy median-priced homes, and that there is a connection between CDL and the housing crisis. The bill would state that California needs an alternative method to resolve legitimate construction disputes that will “reduce the need for litigation while adequately protecting the rights of homeowners.”

The California Research Bureau report on construction defect litigation¹⁵ suggests that any finding on the extent to which CDL contributes to the housing shortage would be

¹⁵ Dunstan, Roger, and Jennifer Swenson. “Construction Defect Litigation and the Condominium Market,” California Research Bureau Note, Vol. 6, No. 7, November 1999.

premature at this point. This bill would set in place findings that support Assembly Member Dutra's AB 600, which proposes a warranty program in place of construction defect tort actions.

AB 1486

Assembly Member Dutra

Building inspections: liability.

This bill would provide that there will be no personal monetary liability on the part of anyone contracted by a building permit applicant to check plans and specifications to determine compliance with requirements, or who is contracted to inspect an improvement to determine compliance with plans and specifications.

SB 160

Senator Torlakson

Construction defect litigation: restriction on time extensions.

Under the current Calderon process, parties in a construction defect litigation action may decide to extend the required 90-day settlement period to any mutually agreeable amount of time. SB 160 would provide that the parties may only extend the settlement period an additional 90 days, so that the maximum settlement period would be 180 days.

According to the author, parties often agree to multiple extensions of the 90-day period for fear of appearing uncooperative. The bill attempts to address concerns that the Calderon process takes too long and does not fulfill its intended purpose of handling construction defect actions quickly and efficiently.

SB 355

Senator Escutia

Liability: construction defects.

This bill would essentially overturn *Aas v. Superior Court (William Lyon Company)*, a 2000 California Supreme Court case holding that construction defects are not actionable if they haven't resulted in physical harm or damage to property (beyond mere diminution of value). The rule proposed by Senator Escutia would allow a person to sue in tort to repair construction defects that meet certain criteria; the person would no longer need to wait until harm to people or property has occurred as a result of the defect.

In the *Aas* case, the justices specifically suggested that the public policy aspects of this issue were better suited to resolution by the legislature, not the judiciary.

For a defect to be actionable under the bill, it must, if left unrepaired, "pose a danger to the life, health, safety, or property of the occupants . . . in the event of fire, earthquake, windstorm, or any other catastrophic event."

Critics of this position, such as the majority in the *Aas* court, allege that almost any defect, if viewed in a certain light, may pose a danger to life, health, safety, or property. Therefore, they feel that the test proposed by Senator Escutia would allow almost any defect to be litigated in tort. They feel that defects that have not resulted in damage should be remedied in the law of contract or fraud.

Others, such as Justice Mosk, concurring and dissenting in *Aas*, feel that a tort remedy for economic damage from construction defects is the most economically efficient method of resolving the defects.