

DEVELOPMENT

Construction-Defect Litigation Gaining Attention

Insurance companies and state legislation provide some relief to builders facing condominium-related lawsuits

By **JULIE LEUPOLD**
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As a third-party construction inspector, Don Neff has seen builders sued for it all. Noisy neighbors leading to a soundproofing claim, subcontractors hammering in the wrong length nail and even an \$8 million settlement for a fallen roof tile that hit a dog in Anaheim.

The slowing housing market is causing an increase in these construction-defect claims as some home buyers dissatisfied with the rate of appreciation of their new homes or inability to flip properties look for another way to make money, according to some attorneys.

“Construction-defect litigation runs counter to the economy,” said Jay Freedman, partner with Newmeyer & Dillion LLP.

Although the enthusiasm for lawsuits started in Southern California several years ago because of the multifamily building boom, construction-defect claims have increased in the past two or three years, according to Jeffrey D. Masters, partner at Cox, Castle & Nicholson LLP. And this trend is not isolated to Southern California because plaintiffs’ attorneys who cut their teeth in this market move elsewhere.

“The plaintiff firms are taking what they learned in Southern California and going to Northern California and other places so they will have an easier time for the first few years before defendants figure it out,” Freedman said. “The building industry has learned a lot in the last 15 years, and that is just being relearned in other areas.”

Examples of construction-defect litigation have been popping up in the western United States where condominiums are being built or converted with varying levels of fervor. Condominiums are a target for this type of lawsuit because so many more avenues for defects are actionable, including noise, odor and water intrusion.

For-sale multifamily development carries its own set of regulations that inexperienced developers might not know. And with more single-family residential builders bailing out of that market in favor of attached homes, Freedman predicts an increase in code lawsuits, in which owners can sue for code violations that don’t necessarily cause any damage to the property, such as the placement of electrical boxes.



PHOTO PHOTO BY JULIE LEUPOLD

Donn Neff, president of La Jolla Pacific, said that builders have stepped up to educate new homeowners’ associations on how to maintain properties and prevent construction-defect lawsuits.

It would take a pretty savvy buyer to know the codes well enough to spot these issues and litigate over them. So plaintiffs’ lawyers often target specific neighborhoods where they have identified potential code violations or construction defects.

Both Neff and Freedman said that more lawsuits emanate from lower-end housing, not because they were constructed poorly but because plaintiffs’ lawyers target them.

“Plaintiffs’ attorneys are going into areas with low-hanging fruit,” said Neff, president of **La Jolla Pacific**.

Calls to The Miller Law Firm, one of California’s most prominent plaintiffs’ firms specializing in construction defects, were not returned.

“The plaintiffs’ lawyers are generally very knowledgeable about construction, very organized, bloodless. There isn’t a lot of social justice in what they are doing; they are all about the buck,” Masters said. “They will tell the HOA board,

‘Look, you have a project with defects. You have to do something about it; otherwise, you will be breaching our own fiduciary responsibility.’”

Masters expects that the high-end condominiums being built throughout Southern California will be a source of this wave of construction-defect litigation. And so far it has proved true. The Miller Law Firm’s largest settlement to date was a \$15.2 million recovery for defects on a 416-unit luxury high-rise condominium in Century City. And in downtown, a group of homeowners at the Toy Warehouse Lofts was awarded \$1.32 million from Decoma Structural Industries LLC in 2004 because they could hear their neighbors snoring — and a host of other things — because of shoddy soundproofing.

“The high-end projects tend to be litigious and have more funding to prosecute,” Masters said. “They are well-heeled buyers, so the HOAs are well-funded. And I’m sure it will be because

the psychology of that buyer profile is a lot of impatience with less than perfection.”

Although developers claim that they have raised the building standards, perfection is hard to come by. The majority of the time, construction defects are grounded in fact, according to Masters. Although not every unit in a massive multifamily project may have the actionable issue, it takes only one occurrence to sue the project.

“Most construction-defect lawsuits have at least a kernel of truth to them that there is some defect that needs to be addressed,” Masters said. “Where the system goes wrong is that the little kernel of truth gets blown out of proportion so you get a defect list that makes you think the project is about to fall down.”

Ways to Minimize Lawsuits

Many times, the initial defect is a fixable problem, but often the first time a builder has notification of a problem is the lawsuit, according to Freedman.

In 2002, the state Legislature passed Senate Bill 800, which gave the builder a “right of repair” for new homes sold after Jan. 1, 2003. This law, which is in existence in some form in 30 states, gives the developer a chance to fix a problem before a lawsuit can be filed. Although it should provide some protection to builders it is not all-inclusive because it doesn’t protect builders who sell their projects to condominium converters and are sued after the converter sells the units. It also allows homeowners to choose other contractors to fix the problem instead of the original builder, so it partially undercuts the right to repair.

“It is really too early to tell [how SB800 affects lawsuits] because it has only been on the books for four years,” Masters said. “Most of the SB800 claims

get resolved at the builder construction level, so net it is a positive.”

Freedman said that plaintiffs’ lawyers tend to stay away from buildings that qualify for SB800 protection because the majority of their profits come from contingency fees. Because construction-defect litigation has a 10-year statute of limitations and SB800 applies to any new homes sold in 2003 or later, a shrinking pool of units is eligible for the kinds of lawsuits popping up today.

However, those owners who bought conversions at the height of the condominium craze in Southern California and found a problem with their new unit can proceed with a lawsuit, even if they are trying to sell it. According to Freedman, the litigation doesn’t stop if a condominium is sold, and the original owner can maintain rights to a settlement if he or she sold the property at a loss.

“We don’t see litigation as an impediment to sales,” he said.

This continued affront of lawsuits has helped the building community, according to Neff, driving it to build a better product.

“The reality is we have this litigation wave. Everyone has bootstrapped their way up the learning curve, and we are building a better product than we have ever seen,” he said.

But the product itself isn’t often the problem; it’s the way homeowners are treated when they bring a complaint to the developer. Those who believe they were treated poorly are more likely to sue, Freedman said.

“There will be one or two homeowners very upset — sometimes it is legitimate, sometimes not — and they rally the neighbors,” he added. “In general, customer service has gotten better over the past 20 years. It used to be a 20-year-old kid in a pickup with

a can of paint and spackle.”

Now, Neff said, builders have stepped up to educate homeowners’ association board members with formal turnover walks and manuals explaining how to maintain the property.

However, the builder isn’t involved in every aspect of the development process, putting a lot of faith in contractors and subcontractors. Freedman recommends hiring a third-party inspector to monitor these entities during the construction project and acquiring wrap insurance, which protects every level of company involved in the construction process under one policy in the case of a lawsuit down the road.

“Here’s the traditional lawsuit: Plaintiffs’ attorney sues builder; builder sues trades; whomever is left standing pays the plaintiffs’ attorneys,” Neff said.

But under wrap insurance, there is only one set of attorneys for the construction companies and one for the homeowners, making the process and the potential settlement much more expedient, he added. Although this insurance is more available today than it was 18 months ago, it doesn’t always solve the problem of the construction defect because settlements aren’t regulated by the insurance companies after lawsuits are finished.

“Anecdotally, a big portion of the payoff doesn’t go to fix the defects,” Masters said.

His firm is working on legislation to require the settlements be used to perform repairs or put into the reserves of the homeowners’ association. That legislation is in the preliminary discussion stage with the California Building Industry Association to create the language and foster support for a ballot initiative.

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