

**SB 800: PRE-LITIGATION ADR
OF CONSTRUCTION DEFECT CLAIMS
AND NEW STANDARDS FOR WHAT
CONSTITUTES A DEFECT**

CIVIL CODE §§ 895, *et seq.* (2003)

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Introduction

The newly chaptered provisions of Civil Code §§ 895-945 set forth the newest construction defect/tort reform in California. Its provisions apply to every newly constructed home and condominium sold in California after January 1, 2003. The new procedure requires specified construction defect claims to be arbitrated prior to suit being filed by an Owner in state court. It promises to have a fairly comprehensive impact on how future construction litigation claims are litigated, especially when it comes to establishing what actually constitutes a “construction defect” and how proper compensation for these problems is to be measured. It also overrules in part the “economic loss rule” stated by the California Supreme Court in its 2000 decision, *Aas v. Superior Court*, in which it was determined that a construction defect claim could not be based on a tort theory of recovery in the absence of proof of injury to persons or property. Indeed, most of the new standards adopted in SB 800 relate only to a violation of a building code provision or a perceived defective condition in a component part of a structure. With very few exceptions, no additional property damage even needs to be demonstrated by the Owner to prove an actionable violation under the new standards [§ 896].

The liberal new standards defining “construction defect” and the revamped statutes of limitations set forth in Section 896 apply to defect claims brought under the new pre-litigation ADR procedure as well as in state court actions [§ 915]. The provisions apply to indemnity claims based upon negligence and breach of contract claims against subcontractors, suppliers, design professional and product manufacturers involved in the construction of the affected property [§ 936]. The existence of the procedure is required to be stated on title documents relating to the affected property and is binding on all original and subsequent purchasers [§§ 912(f), 945]. Also, in an apparent response to the requirement in a typical CGL policy that a suit be filed in order to trigger the policy’s defense obligation, the statute specifically states that Owner’s notice of claim “*shall have the same force and effect as a notice of commencement of legal proceeding.*” [§ 910(a)].

The procedure provides Builder the absolute right to first submit a construction defect complaint to ADR rather than formal suit in state court (*see*, summary at Tab A). A Builder which has timely participated in the process has a “cram-down” right to repair a claimed defect as proposed, or to at least provide the Owner adequate cash to effect necessary repairs [§ 921]. Owners still have a right to sue the Builder for construction defects thereafter, but not until the process either is completed or the Builder fails to timely respond within the various deadlines set by the procedure [§§ 912(i), 916(d), 920]. The pre-litigation ADR process can be most easily analyzed in four parts: (1) recoverable damages; (2) construction defect standards; (3) statutes of limitations; and (4) claim procedures.

1. Recoverable Damages. Section 944 identifies the various species of damages which Owner may recover for any construction defect embraced by the statute. No other damages are recoverable for a negligence or breach of contract claim brought by Owner for the specified defects. Those various types of damages are as follow:

- Cost of repair of the defect which has violated a standard;

- Cost of repair of damage caused by Builder's repair of the defect;
- Cost of repair of damages resulting from the violated standard;
- Cost of removing & replacing improper Builder repairs;
- Relocation and storage expenses made necessary by the repair;
- Lost revenue if subject property is the location of licensed business;
- Investigative costs for each established violation; and
- Costs and fees recoverable by contract or other statute.

2. New Construction Defect Standards. The new law establishes performance standards for most building systems and components typically used in new home construction (*see*, Tab B, the entire text of the statute). Those standards are grouped into the following categories:

Water Intrusion Standards. Windows, doors, roofs, chimney caps, vents, decks, balconies, exterior stairs, foundations, hardscape, irrigation, landscaping, drainage, stucco, siding, exterior walls, retaining walls, site walls, plumbing, sewers, utilities, shower and tub enclosures, tile walls, floors, decks, and countertops:

- May not allow unintended water to pass into the structure or to pass beyond the actual or intended moisture barrier of the system [§ 896(a)(1-2, 4-5, 10, 12-13, 17)];
- May not allow excessive condensation to enter the structure and damage another building component [§ 896(a)(3, 11)];
- Decks, balconies & exterior stairs may not allow water to pass within the system itself and damage the components of the system [§ 896(a)(6)];
- Hardscape may not cause water or soil erosion or damage to another building component [§ 896(a)(9)];
- Foundations may not allow water or vapor to enter the structure and either damage another component, or limit the installation of types of flooring [§ 896(a)(7-8)]
- Plumbing, sewer and utility lines shall not leak and shall not corrode so as to impede the useful life of the system [§ 896(a)(14-15)];
- Sewer systems must allow the designated amount of sewage to flow through the system [§ 896(a)(16)]; and
- Tile walls, decks, floors and countertops shall not allow water intrusion to damage another component [§ 896(a)(18)].

Structural Standards. Foundations, slabs, and shear walls shall not contain significant cracks or significant vertical displacement, shall not cause the structure to be structurally unsafe, and must materially comply with design criteria of applicable building codes, regulations and ordinances for chemical deterioration/corrosion resistance, earthquake, and wind load resistance in effect at time of construction [§ 896(b)].

Soils Standards. Soils shall not cause damage to the structure, the structure to be structurally unsafe, or the land to become unusable for intended purpose [§ 896(c)].

Fire Protection Standards. Fire-rated assemblies, fireplaces, chimneys, chimney caps, electrical & mechanical systems must materially comply with design criteria of applicable

building codes, regulations and ordinances for fire protection in effect at time of construction; may not cause an unreasonable risk of fire [§ 896(d)].

Plumbing, Sewer & Electrical Standards. Plumbing, sewer and electrical systems must operate properly and may not materially impair the structure's intended use [§ 896(e)-(f)].

Miscellaneous Standards.

- Hardscape - no cracks with significant vertical displacement or that are excessive [§ 896(g)(1)];
- Stucco & exterior wall finishes and fixtures - no significant cracks or separations [§ 896(g)(2)];
- Manufactured products - installation may not interfere with useful life [§ 896(g)(3)];
- Heating - maintain room temperature of 70° F at a point 3' above the floor in any living space [§ 896(g)(4)];
- Air Conditioning - must comply with Title 24 [§ 896(g)(5)];
- Sound transmission-attached units - must comply with applicable code, ordinance or regulation in place at time of construction [§ 896(g)(6)];
- Irrigation systems and drainage - may not cause damage to landscaping or other external building components [§ 896(g)(7)];
- Untreated wood posts - not installed in direct contact with soil based upon finish grade causing deterioration [§ 896(g)(8)];
- Steel fences - installed to prevent unreasonable corrosion [§ 896(g)(9)];
- Paint & stains - deterioration of building surfaces may not occur during manufacturer's warranty term [§ 896(g)(10)];
- Roofing materials - avoid materials falling from roof [§ 896(g)(11)];
- Landscaping - must survive for at least one year [§ 896(g)(12)];
- Ceramic tile - may not detach [§ 896(g)(13)];
- Dryer ducts - install in compliance with manufacturer's requirements [§ 896(g)(14)];
- Catch-all Provision - may not impair occupant's safety due to public health hazard (e.g., excessive mold) [§ 896(g)(15)] and may not cause damage [§ 897].

Fit & Finish Warranty. Builder is deemed to provide each Owner with a one-year warranty on "fit & finish" on cabinets, mirrors, flooring, interior & exterior walls, countertops, paint and trim. All manufactured parts are deemed to have a useful life either of 1-year or whatever term identified by the manufacturer, whichever term is longer [§§ 896(g)(3), 900].

Builder's Enhanced Protection Agreement. Builder may provide a written guarantee, the Enhanced Protection Agreement (EPA), in lieu of what is provided in Section 896, but the EPA must meet or exceed those statutory standards. Builder may also have its own ADR procedure, which, if found to be enforceable, would replace the statutory procedure. Within 60 days of filing a response, Builder may seek bifurcated hearing on the enforceability of the EPA procedure. Failure to seek a hearing within that time period operates as a waiver [§§ 901-906].

3. Statutes of Limitations. Shorter terms than the usual 10-year statute of limitations under Code of Civil Procedure § 337.15 have been established for certain types of claimed defects which typically are viewed as “nuisance” type claims. All of the terms are subject various tolling applications, also discussed below. The new statute of limitation terms are as follow:

One (1) year from date of original occupancy of adjacent unit.

- Noise transmission claims in attached structures [§ 896(g)(6)].

One (1) year from close of escrow.

- Irrigation and drainage claims [§ 896(g)(7)].

Two (2) years from close of escrow.

- Untreated wood post at finish grade [§ 896(g)(8)];
- Landscaping [§ 896(g)(12)]; and
- Dryer ducts [§ 896(g)(14)].

Four (4) years from close of escrow.

- Plumbing & sewer systems [§ 896(e)]
(but not water intrusion claims [§ 896(a)(14-15)]);
- Electrical system [§ 896(f)(1)];
- Steel fence [§ 896(g)(9)]; and
- Hardscape [§ 896(g)(1)].

Five (5) years from close of escrow.

- Painting [§ 896(g)(10)].

Ten (10) years from recordation of notice of completion.

- All other claims not mentioned above which are embraced by the statute [§ 941(a)].

Tolling Rules. All of the above statutes of limitations are tolled from the time period of the original claim being made up to the following cutoffs:

- Repairs Completed: 100 days from completion of repairs
- Process Suspended by Builder’s Non-response: 45 days from response due date.
- Mediation Under Builder’s EPA: 100 days after completion or suspension.
- Post-repair Mediation Completed: Later of (1) 100 days from completion of mediation or (2) the first court date following completion of mediation.

4. Construction Defect Claims Procedures.

Owner’s Construction Defect Claim.

- **Owner’s Notice of Claim.** Written notice by Owner must be provided to Builder’s designated agent, stating claimant’s name, preferred method of contact, and description of defect [§ 901(a)].
- **Builder’s Acknowledgment of Receipt of Claim.** Builder must acknowledge receipt of the claim within 14 days from date of receipt [§ 913].
- **Discovery Rules.** Builder must allow Owner to observe and record all inspections, testing, and repairs performed [§§ 916(a), 922]. Builder has 30 days from date of Owner’s request to provide Owner, at Owner’s expense, copies of the following:
 - Maintenance and preventative maintenance instructions that were provided to the Owner at the sale of the home [§ 912(b)];
 - Manufacturer’s maintenance and preventative maintenance instructions and limited warranty [§ 912(c)];
 - Builder’s written warranty [§ 912(d)];
 - If claim relates to structural, fire safety or soils issues, copies of all relevant plans and specifications [§ 912(a)]; and
 - All photos and documents relating to a repair [§ 923].
- **Initial Inspection by Builder.** The initial inspection and testing by Builder must occur within 14 days from the date of Builder’s Acknowledgment. Builder must restore the property to pre-inspection condition within 48 hours of testing completion [§ 916(a)].
- **Second Inspection by Builder.** Builder must request second inspection within 3 days following completion of initial inspection, and must complete the second inspection within 40 days of the initial inspection [§ 916(c)].
- **Builder’s Notice to Responsible Third Parties.** Builder is to put all potentially responsible third parties on notice of the ongoing inspection. Builder’s own liability carrier is not part of this group [§ 916(e)]. **OPEN QUESTION.** Does an Additional Insured carrier need to be included as a potentially responsible third party who Builder must notify?
- **Builder’s Offer to Owner.** Within 30 days of completing the inspection, Builder must provide Owner with an Offer which must include the following [§§ 917- 919, 924, 929(a)]:
 - An offer to address all recoverable Section 944 damages;
 - An all-cash offer to compensate Owner for the identified defect(s) or a repair proposal which includes the specific violation being addressed, detailed description of the proposed repairs, completion date, name(s) of the contractor(s);
 - Notification of Owner’s right to request the names of up to three (3) additional contractors to perform the repairs;
 - An offer to submit the matter to mediation;
 - Identification of any part of the Owner’s claim not being addressed by the

Builder's Offer and the reason(s) for that position being taken; and

- Builder's Offer may not be contingent on Owner providing a release unless it is an all-cash offer.

● **Owner's Response to Offer.** Owner has 30 days from its receipt of Builder's Offer to either: (1) authorize the proposed repair; (2) request up to three alternate contractors to perform the repairs; or (3) submit the matter to Repair Mediation. If Owner requests alternate contractors, an additional inspection is to be held within 20 days of the election to allow access by Builder and alternate trades. Builder has 35 days from receipt of the request to provide the additional name(s). Owner has 20 days from receipt of the name(s) to either authorize the proposed repairs or submit the matter to Repair Mediation [§ 918].

● **Repair Mediation.** Within 15 days of Owner's request, a 4-hour mediation is to be held regarding the Builder's Offer. The non-affiliated mediator is to be selected and paid for by Builder, unless Owner agrees to pay half, in which case both select the mediator [§ 919]. If the Repair Mediation does not resolve the dispute, Owner must allow the repair proposed by Builder to go forward [§ 921].

● **Term of Repair Period.** Repairs must begin within: 14 days of Owner's acceptance of Builder's Offer or Claimant's acceptance of the alternate contractor; 7 days from completion of the Repair Mediation; or 5 days from the issuance of any necessary building permit. [§ 921(a)]. Repairs must be completed within 120 days [§ 921(b)].

● **Post- Repair Mediation.** If there had been no prior Repair Mediation, then Owner must request mediation prior to filing suit in state court. The 4-hour mediation is to be held within 15 days of Owner's request. The non-affiliated mediator is to be selected and paid for by Builder, unless Owner agrees to pay half, in which case both select [§ 928].

● **Extensions of Time.** All cutoff dates may be extended by mutual written agreement including a knowing waiver by Owner [§ 930(a)].

Concurrent Claims in the Calderon Process. To the extent the claim would be duplicative, this pre-litigation procedure supercedes any claims being made in the § 1375 Calderon Process [§ 935].

Owner's Subsequent State Court Action. Once the ADR process either is (1) completed, or (2) Builder fails to timely complete the tasks required by the pre-litigation ADR procedure, Owner may file its claim in a state court action.

- **Admissibility of Builder's Repair.** Evidence of the nature, extent, and reasons for

Builder's repair efforts is allowed [§§ 933, 935]. Owner may offer the pre-repaired condition of the property to show the repair provided was inappropriate, inadequate, or incomplete, and does not have to show further or continued damage being caused [§ 933]. In a claim involving fraud, a limiting instruction is to be given to the effect that the Owner did not voluntarily agree to the repair provided by Builder [§ 931].

● **Affirmative Defenses by Builder.** Section 945.5 limits Builder to the following affirmative defenses in any subsequent state court action based on the defect which was subject of the pre-litigation claim:

- Unforseen Act of God;
- Owner's Unreasonable Failure to Mitigate Damages;
- Owner's Failure to Maintain;
- Ordinary Wear & Tear or Misuse/Abuse;
- Statute of Limitations;
- Release;
- Builder's Repairs Were Successful;

● **Affirmative Defenses by Other Construction Professionals.** All other involved trades, design professionals, vendors and manufacturers may also assert all common law and contractual defenses which otherwise would be available [§ 936].

● **Related Claims Outside Scope of Procedure.** An Owner's fraud-based claims against the Builder and products liability claims against component part manufacturers can proceed concurrently in state court [§§ 896(g)(3), 931, 936].