Whose Claim and Defense Is It Anyway?

A Review of Current Claims Against and Best Defenses for Subcontractors

By Melissa Lin

Evaluating indemnity obligations early will determine the specific discovery needed, while evaluating the statutes of limitations and repose may provide the bases for motions for summary judgment or dismissal.

This article provides an overview of construction defect litigation, the causes of action typically found in construction defect cases against subcontractors, and the affirmative defenses available in such cases. It intends to provide a general understanding of these issues rather than exhaustive analyses.

Construction defect lawsuits take a variety of forms and can involve a variety of parties. Generally, the two most prevalent claims are those brought by individual homeowners (HO), single family condominium or town-home unit owners, or groups of each asserting a class action arising out of damage allegedly caused to their homes by defects. The second type involves claims brought by homeowner associations (HOA) representing the common interests of unit owners for damage allegedly caused to multi-family developments. Commercial construction defect claims are less common, but when they are asserted they are usually pursued by owners or developers of commercial projects that have contractual standing with the builder and design professionals.

Typical defendants in construction defect lawsuits often involve owners, developers, builders, general contractors, and construction managers. Typical third-party defendants often include subcontractors, design professionals, and material suppliers. General contractors (GC) and construction managers (CM) regularly award a portion of an existing construction contract to independent contractors that hold themselves out as having expertise in a particular construction trade. They are referred to as subcontractors or sub-trades. A subcontractor's work is limited to a distinct portion of a project such as grading, framing, plumbing, electrical work, roofing, drywall, and painting. Historically, claimants have brought claims only against the developer and GC who in turn filed third-party complaints against the subcontractors and design professionals. More recently, claimants have started to bring claims directly against subcontractors and design professionals.

General Contractor Versus Subcontractor

Typically, a construction defect lawsuit involves a contract between an HO and

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a GC through which the GC expressly or impliedly warrants its new construction. If a developer has indemnity rights against a GC, a third-party claim, or cross claim may be filed to preserve the developer's rights against the GC. If a developer or a GC has indemnity or other contractual rights against the sub-trades, a third-party complaint can be filed against those entities to similarly preserve rights. Although the relationships between the parties change depending on the case, the motive behind third-party litigation is the same: to shift the risk of loss to those that should bear the loss, either because of contractual obligations, or because equity demands it. The following are claims typically asserted by GCs in the effort to allocate or to shift responsibility for alleged defects.

Claims

A GC or a developer may file suit against subcontractors, engineers, or design professionals for claims including but not limited to indemnity, breach of express warranty, breach of implied warranty, negligence, and negligence per se.

Express Indemnity

Express indemnity occurs when there is a written indemnity provision in a contract or an agreement dictating the scope of the indemnity provided. *Brian Flaherty et al.*, Arizona Construction Law Practice Manual, Vol. 2, §5.9.2.3.1 (2nd ed. 2011). Express indemnity provisions have historically been classified as either general or specific. *Id.*

General Indemnity

Even if a contract contains an express indemnity provision, the GC or developer must still look at the specific language of the provision to determine if it is a general or specific indemnity provision. When an indemnity clause does not specifically address the effect that the indemnitee's negligence will have on the indemnitor's obligation to indemnify, it will be regarded as a "general" indemnity agreement. *See Estes Co. v. Aztec Const., Inc.*, 139 Ariz. 166, 169, 677 P.2d 939, 942 (1983). Under a general indemnity agreement, an indemnitee is entitled to indemnification for a loss resulting in part from an indemnitee's passive negligence, but not due to active negligence. *Id.* As explained elsewhere, "[g]enerally, active negligence is found if an indemnitee has personally participated in an affirmative act of negligence, was connected with negligent acts or omissions by knowledge or acquiescence, or has failed to perform a precise duty which the indemnitee had agreed to perform." *Id.* In contrast, "passive negligence is found in mere nonfeasance, such as the failure to discover a dangerous condition, perform a duty imposed by law, or take adequate precautions against certain hazards inherent in employment." *Id.* If a subcontractor can prove that a GC or a developer was actively negligent, then the GC or developer may not be entitled to indemnification since general indemnity is an all or nothing provision. If a state does not recognize comparative indemnity, a subcontractor may only need to pass a relatively low threshold to prove active negligence, by demonstrating that a GC or a developer is one percent at fault.

Common law indemnity is a general indemnity claim. If a contract does not contain *any* language on indemnification, then a GC or a developer can only bring a common law indemnity claim. In general, in an action for common law indemnity against a subcontractor, a GC or a developer must show that (1) it has discharged a legal obligation owed to a third party; (2) the subcontractor was also liable to the third party; and (3) the obligation should have been discharged by the subcontractor. *See id.*

In Florida, courts use a two-prong test to determine whether a plaintiff can recover on a theory of common law indemnity. A plaintiff must show that he or she was wholly without fault and the party against whom indemnity is sought is guilty of negligence, and (2) the party who seeks indemnity must be obligated to pay another part or entity only because of some vicarious, constructive, derivative, or technical liability. *Gatelands Co. v. Old Ponte Verde Beach Condo.*, 715 So. 2d 1132, 1134 (Fla. Ct. App. 1988); *see also Houdaille Industries, Inc. v. Edwards*, 374 So.2d 490 (Fla. 1979).

Specific Indemnity

A GC or a developer may also bring a specific indemnity claim against a subcontractor. This generally would involve "[a] 'specific' indemnity agreement," which would specify the "effect [that] the indemnitee's negligence has on the indemnitor's obligation to indemnify and specifically imposes upon indemnitor an obligation to indemnify for any type of damage, even though also caused by the negligence of indemnitee." *Grubb & Ellis Management Services, Inc. v. 407417 B.C., L.L.C.*, 213 Ariz. 83, 87, 138 P.3d 1210, 1214 (Ct. App. 2006). In Arizona, an express indemnity provision will not protect an indemnitee against its own negligence unless that intent is evident from the terms of the contract. *See* Washington Elementary School District No. 6 v. Baglino Corp., 169 Ariz. 58, 62 817 P.2d 3, 7 (1991); *see also* Cunningham v. Goettl Air Conditioning, Inc., 194 Ariz. 236, 240, 980 P.2d 489, 493 (1999). In other words, a GC cannot through a contract eradicate its own negligence unless an indemnity provision clearly expresses an intent that the GC is to receive indemnity if it is negligent. When specific indemnification exists, an indemnitee (a GC or a developer) can receive indemnity relief even if it is 99 percent at fault for the liability-causing event; any amount of fault by the indemnitor (the subcontractor) will trigger this full indemnity relief.

However, most states have enacted statutes declaring indemnity agreements void and unenforceable when a GC or a developer seeks indemnification from a subcontractor for the GC or the developer's sole negligence. *See, e.g.*, Colo. Rev. Stat. §13-21-111.5(6) (2015); Ariz. Rev. Stat. §32-1159 (2015); Or. Rev. Stat. §30.140 (2015); S.D. Codified Laws §56-3-18 (2015).

If a contract does not contain *any* language on indemnification, then a GC or a developer can only bring a common law indemnity claim.

Implied Indemnity

When a GC or a developer does not have a contract with a subcontractor, implied indemnification may happen. Arizona Construction Law Practice Manual, *supra*, at §5.9.2.3.1. "Implied indemnification" happens "when two parties have a contract with no indemnification provision, but the relationship between the parties is such that the court imposes one nonetheless." *Id.* Implied indemnity is only permitted when the party seeking indemnity did not participate at all in the alleged liability-creating event. An omission can still be considered active negligence, preluding indemnification. *See* Cella Barr Associates, Inc. v. Cohen, 177 Ariz. 480, 485, 868 P.2d 1063, 1068 (Ct. App. 1994).

Courts in some states, such as California, apply a two-pronged test to determine entitlement to indemnification on a purely equitable basis: "Such indemnification requires an indemnity claimant to prove that (1) the damages sought to be shifted were imposed as a result of a legal obligation owed to the injured party, and (2) the indemnity claimant did not actively or affirmatively participate in the wrongdoing." *Singh v. John Gargas Landslide Repairs*, 588 F. Supp. 1359, 1362 (C.D. Cal. 1984) (citing People ex. rel. Dept. Pub. Wks. v. Daly City Scavenger Co., 19 Cal.App.3d 277, 96 Cal. Rptr. 669 (Ct. App. 1971)). This theory does not support a comparative fault argument.

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Defenses

Subcontractors may assert statutory and common law defenses. They may also assert specific remedies and relief explicitly listed in their contracts with a GC or a developer.

Statute of Limitations and Statute of Repose

Regardless of the claim against them, subcontractors may always assert these defenses as an absolute bar to a lawsuit if not brought within the tolerated time period.

> Statutes of limitations extinguish, after a specified period of time, a person's right to prosecute an action after it has accrued. …statutes of repose cut off the right to bring an action after a specified period of time measured from the completion of the work, regardless of when the cause of action accrues.

Higgins *et al.*, *Overview of Construction Defect Litigation in Colorado*, available at http://www.hhmrlaw.com/publications/CD percent200verview percent20(2013 percent20edition).pdf. As of 1978, 43 states had enacted statutes of repose giving special treatment to suits against builders. *See* Collins, *Limitations of Action Statutes for Architects and Builders—An Examination of Constitutionality*, FIC Quarterly (Fall 1978).

In Arizona, the statute of repose precludes contract and implied warranty claims against developers and builders filed more than eight years after substantial completion of the improvements. Ariz. Rev. Stat. §12-552(A). This statute limits the time for filing any contract-based claims to eight years after the date of substantial completion. However, if damage from a latent defect is discovered during the eighth year after substantial completion, the state of repose will be extended by one year. Contract-based claims that are filed after the expiration of a statute of repose are barred. *See* Arizona Construction Law Practice Manual, *supra*, at §5.9.2.4.1. This conditional extension is only common among a few other states. *See, e.g.*, Ark. Code Ann. §16-56-112 (2015) (one year); Ga. Code Ann. §9-3-51 (2015) (two years); Ind. Code Ann. §32-30-1-6 (2015) (two years); Wis. Stat. §893.89 (three years). In Arizona, the statute of limitations for negligence claims is two years, while the statute of limitations for breach of contract claims is six years. Arizona Construction Law Practice Manual, *supra*, at §5.9.2.4.1; *See* Ariz. Rev. Stat. §12-542 (2015) (held unconstitutional as to accrual for wrongful death actions).

The Colorado legislature adopted a six-year statute of repose that mandates any action be brought within six years from the date of substantial completion, while the statute of limitations for bringing the action is two years from the time that the defect manifests itself. Higgins *et al.*, *supra*, at 10. The statutes of limitations and repose are governed in Col. Rev. Stat. §13-80-104 and §13-80-102. *Id.* In Colorado, generally the statute of limitations for bringing an action is two years from the time that the defect or the problem manifests itself. *Id.* However, because this time span could potentially be indefinite, the legislature included a six-year statute of repose, which mandates that any action must be brought within six years from the date of substantial completion. *Id.* The six-year conditional statute of repose should act as an absolute bar to any claim brought six years after substantial completion of the improvement to the real property. *Id.* However, if a defect arises in the fifth or sixth year, the claimant has two additional years to bring the action. *Id.* This is sometimes referred to as an "eight-year absolute bar." *Id.* Various courts have criticized Colorado's statutes, interpreting them as elusive since the accrual dates are often uncertain, and the two-year window within which a claim must be brought has the effect of watering down the two-year limit in the statute. *Id.*

In Alabama, the statute of repose is seven years. *See* Ala. Code. §6-5-221. A claim can be brought up to two years after a cause of action accrues. In Alabama there is no relief for causes of actions that accrue more than seven years after substantial completion of improvement. *Id.* The statute of repose was originally 13 years, but was subsequently amended.

Missouri has a 10-year statute of repose. For real property, a claimant has 10 years from completion of improvement. However, this only applies to persons whose sole connection with the improvement is performing or furnishing, in whole or in

part, the design, planning, or construction, including architectural, engineering, or construction services. *See* Mo. Rev. Stat. §516.097 (2015).

Many states have different statutory definitions of "substantial completion." Knowing the specific time periods for the statutes of limitations or repose involved in the particular circumstance and the definition of "substantial completion" is crucial to the defense of a subcontractor. A statute of repose or limitations defense can be very effective for subcontractors when a GC or a developer fails to file its third-party complaint within the relevant time periods. This most often occurs when HOs or HOAs file suit just before a statute of repose expires. Because of the time needed to determine which subcontractors are implicated in the claims, a GC or a developer may be unable to file suit within the applicable statute of repose or limitations period.

The Economic Loss Rule

The economic loss rule is a judicially created doctrine that has been adopted by a majority of states that prevents recovery in tort of damages for purely economic loss, as opposed to the damages arising out of personal injury or property damage. Matthiesen, Wickert & Lehrer, S.C., *Economic Loss Doctrine in All 50 States*, available at http://www.mwl-law.com/wp-content/uploads/2013/03/economic-loss-doctrine-in-all-50-states.pdf (last updated Apr. 14, 2015). Economic losses typically refer to those losses stemming from inadequate value, repair costs, and replacement costs of a defective product, or loss of profits. *Id.* The motive behind the economic loss rule is to secure the expectations of parties and prevent tort law from intruding on and potentially enveloping contract law, including the law of warranty. *Evans v. Singer*, 518 F. Supp. 2d 1134, 1138 (D. Ariz. 2007) (citing *East River S.S. Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 866, 106 S. Ct. 2295, 90 L.Ed.2d 865 (1986)).

Since the U.S. Supreme Court issued the decision in *East River S.S. Corp. v. Transamerica Delaval, Inc.,* numerous jurisdictions have adopted the economic loss rule. James Acret *et al.*, *Economic Loss in Negligence Cases*, 1 Construction Law Digest §13:21 (2014). Only a few states reject the economic loss rule and essentially allow plaintiffs to recover in tort for economic loss without limitation. Those states include New Jersey, Arkansas, Colorado, Louisiana, Connecticut, and Virginia. The remaining states follow either the rule strictly or in an intermediate way. The strictly applied rule, which most states adhere to, applies the economic loss rule to prevent a plaintiff from recovering purely economic damages in tort completely. *See Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965)). The "intermediate rule" applies the economic loss rule using various exceptions.

The economic loss rule precludes negligence actions between GCs and subcontractors when a series of interrelated, written contracts exists between them that delineate the contractual duties and the remedies for breach of those duties. *See* Overview of Construction Defect Litigation in Colorado, *supra*, at 12. In such situations, the underlying public policy supports that a claim sound in contract, rather than in tort law. In many cases, the existence of a subcontract with warranty and indemnity provisions will preclude a negligence action under the economic loss rule.

Failure to Mitigate Damages and Comparative Negligence

Because the economic loss rule bars tort claims in most states, the failure to mitigate damages and the comparative negligence defense is seldom successful in reducing damages paid to HOs or HOAs. However, the comparative negligence defense is still commonly asserted and therefore worth mentioning.

Under the doctrine of comparative negligence, negligence is measured in terms of percentage, and any damages awarded to the injured party are reduced in proportion to the amount of negligence attributable to the injured party. *Id.* The Uniform Contribution Among Tortfeasors Act (UCATA) has been adopted by 17 states and has a provision for contribution when two or more persons become jointly and severally liable in tort for the same injury to persons or property "even though judgment has not been recovered against all or any of them." Matthiesen, Wickert & Lehrer, S.C., *Joint and Several Liability and Contribution Laws in All 50 States*, available at http://www.mwl-law.com/wp-content/uploads/2013/03/contribution-actions-in-all-50-states.pdf (last updated October 7, 2014).

States differ on whether and how they have adopted joint and several liability. Some states have adopted pure several liability, including Arizona, Arkansas, Connecticut, Florida, Georgia, Indiana, Kansas, Kentucky, Michigan, Oklahoma, Tennessee, Utah, Vermont, and Wyoming. *Id.* Under the doctrine of pure several liability, there is no right of contribution when a settling defendant's liability is several only. Contribution is only allowed in rare instances. Other states adopt pure joint and several liability. Such states include Delaware, District of Columbia, Maryland, Massachusetts, North Carolina, Rhode Island, and Virginia. *Id.* Under the doctrine of pure joint and several liability, a plaintiff can recover the entire amount of damages from any particular defendant. The remaining states have adopted modified joint and several liability standards. *See, e.g.,* S.C. Code Ann. §15-38-15 (2015); *Nelson v. Concrete Supply Co.,* 303 S.C. 243, 399 S.E.2d 783 (1991). Under these modified joint and several liability standards, a plaintiff may only recover if his or her negligence does not exceed that of the defendant's, and additionally, the amount of the plaintiff's recovery "shall" be reduced in proportion to amount of his or her negligence; if there is more than one defendant, the plaintiff's negligence "shall" be compared to combined negligence of all defendants.

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It is important to note that most state rules of civil procedure impose time requirements for defendants to provide notice to a claimant of any intention to argue that a nonparty is at fault. *See, e.g.,* Arizona Rules of Civ. Proc. R. 26(b)

(5) (2015). To assert a non-party at fault defense, a subcontractor must timely and properly identify the non-parties at fault to the claimant.

Homeowner and Homeowner Association Versus Subcontractor

Homeowners and homeowner associations typically assert three claim types against subcontractors: negligence, breach of implied warranty, and strict product liability claims. Subcontractors have several defenses against these claims.

> **Many states are split** on whether implied warranty claims can be brought against GCs or subcontractors that were not in privity with the original home purchaser.

Claims

Depending on the particular cause of action, an HO or an HOA may assert a claim directly against a subcontractor, despite the absence of a contractual relationship between the HO or HOA and the subcontractor. Depending on whether the HO or HOA had a contract with the subcontractor determines which causes of action can be successfully brought against the subcontractor. There has been little consistency in state court holdings on the circumstances under which an HO or an HOA can sue a subcontractor in tort law. Below are some commonly asserted claims brought by HOs and HOAs against subcontractors.

Negligence and the Economic Loss Rule Revisited

Generally an HO may not recover in tort when subcontractors have no duty in tort to protect the HO from purely economic damage. For example, in Ohio, an owner has no tort cause of action against a subcontractor for purely economic loss. In *Corporex Dev. & Constr. Mgt., Inc. v. Shook, Inc.*, 106 Ohio St. 3d 412,835 N.E.2d 701 (2005), the court held that the owner could not recover in tort when the subcontractor had no duty in tort to protect the owner from purely economic damage.

However, subcontractors—along with all construction professionals—have a paramount duty to avoid negligence, and as a result, many state courts have carved out exceptions to this general rule. *See*, *e.g.*, *Stewart v. Cox*, 55 Cal. 2d 857, 13 Cal. Rptr. 521, 362 P.2d 345 (1961) ("we recognize that liability for negligence can exist without privity even though the risk involved is only damage to the property."); *Tiara Condominium Ass'n, Inc. v. Marsh & McLennan Companies, Inc.* 110 So. 3d 399, 38 Fla. L. Weekly S151 (Fla. 2013) (recognizing other exceptions to the economic loss rule, such as professional malpractice, fraudulent inducement, and negligent misrepresentation).

The Colorado Supreme Court held that a HOA's negligence action against subcontractors was not barred by the economic loss rule because subcontractors owed homeowners a duty of care, independent of contractual obligations, to act without negligence in construction of homes. *A.C. Excavating v. Yacht Club II Homeowners Ass'n, Inc.*, 114 P.3d 862 (Colo. 2005). *See* Jesse H. Witt *et al.*, *Colorado Supreme Court Upholds Homeowner Rights*. In *Yacht Club*, the HOA alleged that various subcontractors were liable for, among other claims, the cost of fixing leaking windows and roofs, and poor drainage. *Id.* The trial court found that the economic loss rule barred the HOA's claims and dismissed the case. *Id.* Upon appeal, the Colorado Supreme Court reinstated the lawsuit and concluded that the economic loss rule did not apply. The court held that subcontractors have an independent duty of care when someone's home is at risk and that the economic loss rule did not protect a subcontractor from liability to the owner for negligent acts. *Id.*

In Arizona, an HO or an HOA may file suit directly against subcontractors for negligence in certain situations. Similar to most states, a plaintiff may generally recover in tort for negligently caused damage to personal property or injury to a person. However, when the property damaged is the subject of a contract or warranty, the question arises whether the plaintiff's claims should sound in contract or tort. The Arizona Court of Appeals has directed Arizona courts to "consider three non-dispositive factors to determine whether tort or contract law should apply to a particular claim: (1) the nature of the defect causing loss, (2) how the loss occurred, and (3) 'the type of loss for which the plaintiff seeks redress.'" *Valley Forge Ins. Co. v. Sam's Plumbing, LLC*, 220 Ariz. 512, 514, 207 P.3d 765, 767 (2009). If the property damage is the subject of a contract or warranty, the economic loss doctrine should apply and bar a plaintiff from seeking recovery in tort for purely economic loss unless the contract states otherwise. *See Flagstaff Affordable Housing Ltd. Partnership v. Design Alliance, Inc.*, 223 Ariz. 320, 223 P.3d 664 (2010).

The Arizona Supreme Court found that the application of the economic loss rule depends on context-specific policy considerations for tort and contract law. The court found that "rather than rely[ing] on the economic loss doctrine to preclude tort claims by non-contracting parties, courts should instead focus on whether the applicable substantive law allows liability in the particular context." *Id.* at 327–28. Plaintiffs may assert tort claims even when they have suffered purely economic loss when they have no contract with the defendants as long as they can legally bring the claims under tort law.

Special Considerations for Subsequent Home Purchasers

Most states do not allow subsequent home purchasers to pursue claims against subcontractors absent contractual privity. However, some states have created certain exceptions in light of public policy considerations.

In Sullivan v. Pulte Home Corp., 232 Ariz. 344, 306 P.3d 1 (2013), the Arizona Supreme Court held that the economic loss rule does not apply to non-contracting parties and that the economic loss rule does not bar HOs' negligence claims for construction. *Id.* However, the Arizona Supreme Court further clarified that its holding did not mean that a negligence claim would be successful; merely that it could be brought. On remand, the trial court ruled that the negligence claim against the developer-

builder was barred absent any property damage or personal injury. Subsequent homeowners are limited to the same causes of action as original purchasers in actions against developer or builders. Subsequent owners cannot bring a negligence claim against a developer after the statute of repose has passed and must now pursue damages under the implied warranty of habitability within eight years of substantial completion of the home. While a startling decision for Arizona, some states seem to have generally agreed with it.

Colorado courts have also tolerated the availability of a negligence claim to extend to subsequent home purchasers. In accordance with its *Yacht Club* decision, the Colorado Court of Appeals held that the availability of a negligence claim is not limited to the first purchaser of a home. *Park Rise Homeowners Ass'n, Inc. v. Resource Const. Co.*, 155 P.3d 427, 430 (Colo. App. 2006). A subsequent home owner asserting a negligence claim against the home builder must demonstrate that the defect was latent at the time of the purchase and must show that the builder caused the defect. *Yacht Club II Homeowners Ass'n, Inc.*, 114 P.3d at 868 (internal citation omitted). The subsequent home purchaser assumes the risk of patent or obvious defects and cannot successfully sue a builder for those defects. *Id.*

However, other states have taken different approaches when handling claims brought by subsequent homeowners. In Nebraska, subcontractors are not liable to subsequent home owners because they are not in privity with the homeowners. *Moglia v. McNeil Co. Inc.*, 270 Neb. 241, 700 N.W. 2d 608 (2005). In *Moglia*, the Nebraska Supreme Court held that neither the contractor nor the subcontractors had a legal duty to subsequent homeowners stemming from a contract between the original homeowners and contractor; the "accepted work doctrine" barred negligence claims against the contractor. *Id.*

Familiarity with the limitations and the application of the economic loss doctrine in each jurisdiction can be an effective sword against negligence claims filed by HOs and HOAs.

Breach of Implied Warranty

HOs and HOAs also typically plead breach of warranty causes of action, a theory intended to protect innocent buyers. *Lempke v. Dagenais*, 130 N.H. 782, 788, 547 A.2d 290, 294 (N.H. 1988). A breach of warranty claim can be based on express warranty provisions in the contract between a HO or an HOA and the GC, builder, or developer, or it can be based on implied law, or both. Construction Law Practice Manual, *supra*, at §5.9.2.2.3. Many states are split on whether implied warranty claims can be brought against GCs or subcontractors that were not in privity with the original home purchaser. Because most HOs and HOAs are not in contractual privity with subcontractors, breach of express warranty claims are omitted from the discussion below.

In some jurisdictions, privity is not necessary to enforce an implied warranty claim; these jurisdictions include Idaho, Arizona, Illinois, New Jersey, Mississippi, Texas, Oklahoma, South Carolina, Indiana, Wyoming, Arkansas, and most recently, New Hampshire. Prosser, *The Assault Upon the Citadel*, 69 Yale L.J. 1099, 1126 (1960) (internal citation omitted)). Privity is necessary in jurisdictions including New York, Georgia, Minnesota, South Dakota, Connecticut, Colorado, Florida, and Missouri. *Id.* However, states differ on the implied warranty causes of actions that they allow. Matthiesen, *supra*, at 5.

In Arizona, common law imposes upon a builder-vendor an implied warranty that the construction be performed in a workmanlike manner. *Columbia Western Corp. v. Vela*, 122 Ariz. 28, 592 P.2d 1294 (Ct. App. 1979). The test for breach of the implied warranty and proper workmanship is "reasonableness, not perfection; the standard being, ordinarily, the quality of work that would be done by a worker of average skill and intelligence." *Nastri v. Wood Bros. Homes, Inc.*, 142 Ariz. 439, 444, 690 P.2d 158 (Ct. App. 1984) (rejected by *Flagstaff Affordable Hous. Ltd. P'ship v. Design Alliance, Inc.*, 223 Ariz. 320, 325, 223 P.3d 664, 669 (2010) on its interpretation of the economic loss rule).The Arizona Supreme Court went one step further in *Richards v. Powercraft Homes, Inc.*, holding that implied warranty of workmanship and habitability claims can be made by subsequent purchasers against builders or developers, and these are particularly favored in circumstances of latent defects. 139 Ariz. 242, 245, 648 P.2d 427, 430 (1984). However, *Richards* failed to address whether implied warranty claims can be brought against contractors and subcontractors that are not in privity with the original home purchasers.

The Arizona Court of Appeals has held that a lack of contractual privity precludes homeowners from asserting claims against subcontractors for breach of implied warranty of workmanship and habitability. *Yanni v. Tucker Plumbing, Inc.*, 233 Ariz. 364, 312 P.3d 1130 (Ct. App. 2013). In *Yanni*, an HO filed suit for breach of implied warranty against subcontractors, asserting that the implied warranty claim "naturally extends to and is properly asserted against [subcontractors] who actually worked on the home." *Id.* at 367, 1133. The court of appeals found that "[t]here is a distinction between the creation of an implied warranty by virtue of construction of a structure and the contractual relationship required to assert its breach as a cause of action." *Id.* at 368, 1134. The court further stated that homeowners may still seek relief from builders for the subcontractors' defective work. *Id.*

However, in Connecticut, homeowners may recover from subcontractors on an implied warranty theory. *See Fava v. Arrigoni*, 35 Conn. Supp. 177, 402 A.2d 356 (Super. Ct. 1979) (holding that subcontractor fell within statutory definition of a "vendor" since they qualify as "any person… creating an improvement to real estate."). *Id.* at 358.

Strict Product Liability

The Restatement (Second) of Torts §402A (1965) states the following:

> One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer or to his property, if (1) the seller is engaged in the business of selling a product, and (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold.

Id.

Most jurisdictions have adopted this Restatement. Strict liability is a "public policy device to spread risk from one to whom

a defective product may be a catastrophe, to those who marketed the product, profit from its sale, and have the know-how to remove its defects before placing it in the chain of distribution." *Tucson Indus., Inc. v. Schwartz*, 108 Ariz. 464, 467-68, 501 P.2d 936, 939–40 (1972). With a claim for strict products liability, the plaintiff does not need to prove fault, but only that the quality of the product was defective and the defect created an unreasonably dangerous product. Arizona Construction Law Practice Manual, *supra*, at §23.5. A product is defective when "the foreseeable risks of harm posed by the product could have been reduced or avoided by the adoption of a reasonable alternative design." Restatement (Third) of Torts: Product Liability §2(b) (1998).

The express terms of a purchase contract or a CCR also may require that the homeowners participate in alternative dispute procedures ranging from individual mediations to formal arbitrations.

Many courts have found that the public policy underlying the Restatement supports that the seller of a product need not be in the "initial" chain of distribution. *See, e.g., Jordan v. Sunnyslope Appliance Propane & Plumbing Supplies Co.*, 135 Ariz. 309, 315, 660 P.2d 1236, 1242 (Ct. App. 1983). However, Arizona courts have also been reluctant to accept Hos' and HOAs' strict liability claims in construction defect cases. Arizona Construction Law Practice Manual, *supra*, at §5.9.2.2.5. Although often pleaded by plaintiffs, Arizona trial courts have consistently held against the viability of such claims in residential construction defect cases. *Id.*

In California, however, strict liability is permitted in an action by an HO or a HOA against the builders of mass-produced housing. *See, e.g., Kriegler v. Eichler Homes, Inc.*, 74 Cal. Rptr. 749 (Ct. App. 1969)). In *Kriegler*, the court held that the contractor was liable to the subsequent home purchaser under strict liability since the radiant heating system installed was defective. *Id.* The court premised this decision on the fact that the builder was a mass producer of housing and, therefore, the doctrine of strict liability should apply. *Id.* California has also applied the doctrine of strict liability to subcontractors since they may be considered " supplier[s] in the stream of commerce" or "chain of distribution" and the purpose is to impose the cost of defective products on all engaged in the overall producing and marketing enterprise. *See A.L. Lease & Company, Inc. v. AMFAC Dist. Corp.*, 46 Cal. App. 4th 1029, 54 Cal.Rptr.2d 259 (Ct. App. 1996).

Missouri has also held subcontractors (and even sub-subcontractors) liable based on theories of strict liability. *See Commercial Dist. Cntr, Inc. v. St. Regis Paper Co.*, 689 S.W.2d 664 (Mo. Ct. App. W.D. 1985).

Other courts have held that the strict liability does not apply to products incorporated into a structure. *See Wells v. Clowers Const. Co.*, 476 So. 2d 105 (Ala. 1985). In *Wells*, the Alabama Supreme Court held that even though a defective fireplace caused a fire, the fireplace became a part of the house once it was installed and therefore was not considered a product for purposes of strict liability. *Id.* Arizona and Utah have adopted a similar approach. Both states have included an unreasonably dangerous element into their strict liability statutes. Many defendants in strict product liability actions have asserted that the construction of a home, including its individual components, is not considered a product and that the unreasonably dangerous element necessary to maintain the strict liability cause of action cannot be met. *See, e.g., Menendez v. Paddock Pool Construction Co.*, 172 Ariz. 258, 261, 836 P.2d 968, 971 (Ct. App. 1991) (holding that structural improvement to realty is not necessarily "a product" subject to strict liability claims); *Maack v. Resource Design & Const. Inc.*, 875 P.2d 570 (Utah Ct. App. 1994), abrogated on other grounds by *Davencourt at Pilgrims Landing Homeowners Ass'n v. Davencourt at Pilgrims Landing, LC*, 221 P.3d 234 (Utah 2009) (holding that doctrine of strict liability only applies to sellers or manufacturers of a product; construction company merely used component parts to construct the residence; dilapidated and crumbling stucco not considered "unreasonably dangerous"). *Id.*

Colorado also has barred strict liability actions by subsequent purchasers of homes against the original builders for damages resulting from latent defects.

See Wright v. Creative Corp., 30 Colo. App. 575, 498 P.2d 1179 (Ct. App. 1972).

Defenses

Many of the defenses that a subcontractor would assert against an HO or HOA are the same as the defenses it would assert against a GC or developer such as the statute of limitations or repose, the economic loss rule, and comparative negligence. Below are some additional defenses that subcontracts may assert against HOs and HOAs.

Standing

Lack of standing is an available affirmative defense for subcontractors. However, there may be specific state statutes that confer standing to a HOA to sue on its own behalf or as a representative of two or more individual HOs for alleged defects to the common elements. *See*, *e.g.*, Ariz. Rev. Stat. §33-1242 (A)(4) (2015), §12-1361(1) (2015) (recently amended in 2015) (conferring standing to HOAs to sue on its own behalf or as a representative of two or more individual homeowners for alleged defects to the common elements). Under these statutes, potential plaintiffs include single family homeowners, single family condominium or town-home unit owners, groups of each asserting a class action, or associations representing the common interests of unit owners. Ariz. Rev. Stat. §12-1361 *et. seq*. In particular, the Arizona Purchaser Dwelling Act confers standing to a person (excluding real estate brokers) or entity including an "association" to pursue a "dwelling action" against a "seller." *Id.*; *see also* Kansas Apartment Ownership Act, K.R.S. §58-3127. The definition of "seller" was recently amended to

> any person, firm, partnership, corporation, association or other organization

that is engaged in the business of designing, constructing or selling dwellings, including construction professionals." *Id.* The definition of "construction professional" was recently added to the statute. "'Construction professional' means an architect, contractor, subcontractor, developer, builder, builder vendor, supplier, engineer or inspector performing or furnishing the design, supervision, inspection, construction or observation of the construction of any improvement to real property.

Very similarly, the Colorado Common Interest Ownership Act allows HOAs to file suit on behalf of two or more HOs for damages with respect to matters affecting their individual units. *Yacht Club II Homeowners Ass'n v. A.C. Excavating*, 94 P.3d 1177 (Colo. App. 2003), *aff'd*, 114 P.3d 862 (Colo. 2005) (conferring standing to a HOA to sue various subcontractors for defective construction even though the HOA did not suffer damages; the individual homeowners did). New Hampshire and California have also held similarly, allowing a HOA to bring suit against subcontractors.

The purchase contract and covenants, conditions, and restrictions (CCR) that govern a HOA often place restrictions on an homeowner's rights to bring a lawsuit. The two most common restrictions are to require homeowner approval and alternative dispute resolution. As for homeowner approval, the express terms of a CCR may require that a certain number of the total homeowners vote to approve the initiation of litigation. Depending on the percentage required, argument can be made that such a condition violates public policy and is not enforceable. The best and safest practice is to obtain the necessary homeowner approval but this is not always practicable. This is particularly challenging in projects that cater to investors or are retirement communities where there are few full time residents. The express terms of a purchase contract or a CCR also may require that the homeowners participate in alternative dispute procedures ranging from individual mediations to formal arbitrations. Arizona public policy favors arbitration, with arbitration clauses construed liberally and any doubts about whether a matter is subject to arbitration being resolved in favor of arbitration. *See City of Cottonwood v. James L. Fann Contracting, Inc.*, 179 Ariz. 185, 189, 877 P.2d 284, 288 (Ct. App. 1994) (*distinguished by WB, The Bldg. Co. LLC v. El Destino, LP*, 227 Ariz. 302, 313, 257 P.3d 1182, 1193 (Ct. App. 2011) on a separate matter).

Patent Defects

Patent defects are those that are open and obvious and can readily be discoverable after reasonable inspection; latent defects, however, are those not readily discoverable by reasonable inspection.

The implied warranty of workmanship claim exists only with respect to latent defects that become manifest after purchase. *Richards v. Powercraft Homes, Inc.*, 139 Ariz. 242, 245, 678 P.2d 427, 430 (1984); *Hershey v. Rich Rosen Construction*, 169 Ariz. 110, 113–114, 817 P.2d 55, 58–59 (Ct. App. 1991). Stated alternatively, this defense precludes recovery for patent defects; *i.e.*, those that could have been discovered upon a reasonable inspection. *Hershey*, 169 Ariz. at 115. An implied warranty does not extend to patent defects. *See Hartley v. Ballou*, 286 N.C. 51, 61, 209 S.E.2d 776, 782 (1974) ("The law of implied warranty will not avail against patent defects, nor against latent defects which are either disclosed or are discoverable by the exercise of caution on the part of the purchaser."); *Keaton v. A.B.C. Drug Co.*, 266 Ga. 385, 386-387, 467 S.E.2d 558, 561 (1996). *See also Kala Investments, Inc. v. Sklar*, 538 So.2d 909, 913 (Fla. Ct. App. 1989) (the owner is "presumed to have made a reasonably careful inspection thereof, and to know of its defects, and if he takes it in the defective condition, he accepts the defects and the negligence that caused them as his own…").

In Florida, public policy supports the proposition that contractors and subcontractors cannot be held responsible for injuries to third parties after the owner accepted the deficient work by undertaking maintenance and repairs. *Slavin v. Kay*, 108 So. 2d 462 (Fla. 1959) (creating the "completed and acceptance rule" also known as the *Slavin* doctrine).

The reasonable inspection requirement is necessary to avoid a windfall to a purchaser who negotiates a reduction in the purchase price based on defects and then subsequently seeks damages from the builder for the same defects. *Hershey*, 169 Ariz. at 114. The essence of the implied warranty is the protection of "innocent purchasers." Neither the characterization of "innocent," nor the underlying logic of protection, applies to purchasers who purchase with full knowledge of a plainly visible condition. Knowledge by a previous owner of defects in the construction of a house is also imputed to the subsequent purchaser and bars the subsequent purchaser's action for implied warranties. *Curry v. Thornsberry*, 98 S.W.3d 477, 482 (Ark.2003) (citing *Briggs v. Riversound Ltd. P'ship*, 942 S.W.2d 529 (Tenn.1996) (collecting cases)).

Differentiating between patent and latent defects may affect the time limit that a plaintiff must abide by to bring a lawsuit.

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Failure to Mitigate Damages

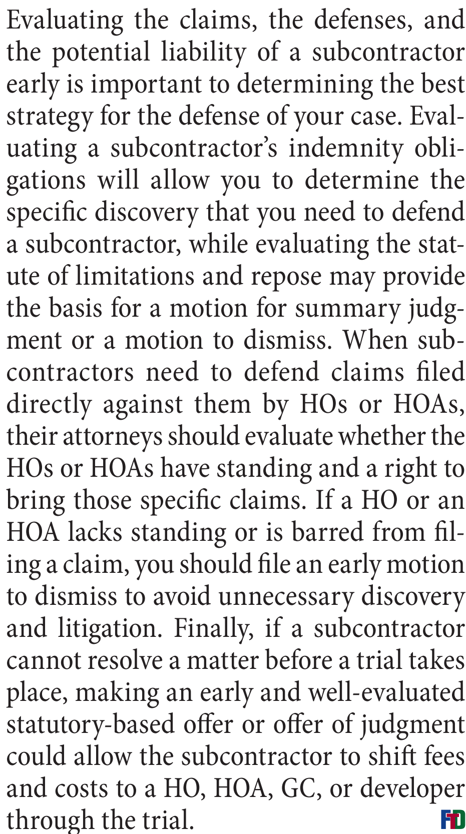
The doctrine of mitigation of damages mandates that an HO or an HOA has a duty to exercise reasonable diligence and ordinary care in attempting to minimize the damage to the home caused by construction defects. Higgins *et al.*, *supra*, at 11. Once a HO or an HOA determines that the common areas and units within a project were experiencing problems, the HO or the HOA is obligated to take reasonable steps to resolve the problems as quickly as possible to minimize any resulting damage. *See Coury Bros. Ranches, Inc. v. Ellsworth*, 103 Ariz. 515, 518; 446 P.2d 458, 461 (1968).

HOs or HOAs cannot recover for loss which occurred as a result of their failure to take reasonable steps to avoid additional or continuing losses. *Continental Townhouse East Unit One Ass'n v. Brockbank*, 152 Ariz. 537; 733 P.2d 1120 (Ct. App. 1986). If a builder can pinpoint some action or omission by a HO that evidences the HO's failure to mitigate the damages to

the defect, the builder can seek to have a damage award reduced in an amount that represents additional damage that could have been avoided by the HO. Higgins *et al.*, *supra*, at 11.

Offers of Judgment and Statutory Offers

If a subcontractor is unable to reach a settlement with an HO, HOA, GC, or developer, a subcontractor can use an offer of judgment or statutory offer to shift costs and fees to the HO, HOA, GC, or developer. The amount of attorneys' fees expended through the date of the offer should be evaluated and specifically included or excluded in the offer of judgment. It is important to note that if attorneys' fees are excluded from an offer of judgment and the offer of judgment is accepted, a HO, HOA, GC, or developer may be able to collect attorneys' fees as the prevailing party.



Conclusion

Evaluating the claims, the defenses, and the potential liability of a subcontractor early is important to determining the best strategy for the defense of your case. Evaluating a subcontractor's indemnity obligations will allow you to determine the specific discovery that you need to defend a subcontractor, while evaluating the statute of limitations and repose may provide the basis for a motion for summary judgment or a motion to dismiss. When subcontractors need to defend claims filed directly against them by HOs or HOAs, their attorneys should evaluate whether the HOs or HOAs have standing and a right to bring those specific claims. If a HO or an HOA lacks standing or is barred from filing a claim, you should file an early motion to dismiss to avoid unnecessary discovery and litigation. Finally, if a subcontractor cannot resolve a matter before a trial takes place, making an early and well-evaluated statutory-based offer or offer of judgment could allow the subcontractor to shift fees and costs to a HO, HOA, GC, or developer through the trial.