State Specific: California

Construction Defect Prelitigation Notice Requirements Called Into Question

BY TODD HARSHMAN AND SALLY NOMA, GROTEFELD HOFFMANN, LLP

On August 28, 2015, California's Fifth Appellate District published a decision regarding prelitigation notice requirements in construction defect cases that could seriously curtail subrogation recovery from homebuilders.

Basing its decision on SB800[1], passed by the California Legislature in 2003, *McMillin Albany, LLC v. Superior Court*[2] would bar any subrogation suit against a builder for a construction defect unless the homeowner complied with statutory notice and opportunity to repair requirements.

Under SB800, a builder must be notified of a defect and given the opportunity to acknowledge receipt of the claim, to inspect the property (twice, if requested), and to respond with an offer to repair.[3] Applying to any home purchased new after January 1, 2003, these notification requirements would mean a delay of at least two weeks but as much as four or five months before repairs could begin.[4] Insurers, however, must respond to their insureds' claims promptly and simply cannot delay repairs for such an extended period merely to protect subrogation recovery.

McMillin creates a split in authority in California concerning whether these prelitigation requirements apply when a construction defect causes property damage, as opposed to merely diminution in the value of the home. California courts have wrestled with this issue for some time.

The History of SB800 and Construction Defect Law in California

The Legislature passed SB800 in response to a California Supreme Court case, *Aas v. Superior Court*[5], which precluded tort remedies against homebuilders for a construction defect when the defect only reduces the value the home but does not actually damage property.[6] Generally referred to as the "economic loss doctrine", plaintiffs have traditionally been restricted to contract or warranty claims when a defective product, like a home, only results in economic damages, such as diminution in value.

Understandably, the California legislature sought to create a mechanism for homeowners to recover damages for construction defects, even where those defects did not actually cause property damage; that mechanism was SB800.[7] The policy behind SB800 was also to create a formal mechanism for builders[8] to be placed on notice of potential claims and have an opportunity to repair the defect prior to a homeowner initiating litigation.[9] The notice requirements are strictly construed and enforced; if not followed; a builder may stay the litigation pending compliance or seek dismissal.[10]

This is a significant problem for homeowners and subrogated insurers alike, neither of which have the luxury of allowing, for example, water to stand in a home for weeks or months while wading through these prelitigation procedures.

State Specific: California *(cont.)*

Subrogation Claims and SB800 – *Liberty Mutual* and *Burch*

Before too long, builders challenged the ability of subrogating carriers to pursue subrogation for property damage resulting from construction defects – such as defective water pipes that fail and flood a home – without complying with the SB800 notice and opportunity to repair requirements.

California's Fourth Appellate District was the first to rule on this issue in 2013. In *Liberty Mutual Insurance Company v. Brookfield Crystal Cove LLC,* Liberty Mutual sued a homebuilder for a sprinkler burst in its insured's home, but the builder raised the defense that the lawsuit was barred by SB800.[11] The *Liberty Mutual* court, however, held that SB800 is not the sole remedy in cases where actual damage results from construction defects; SB800 controls only where the defect causes economic damage and not property damage.[12] The Court also noted as applied to subrogating property insurers, the reporting guidelines of SB800 are unnecessary and nonsensical.[13]

Thus, insurers were free to treat potentially adverse builders in the same manner as any other adverse party without concern for the notice provisions in SB800. A year later, in *Burch v. Superior Court*[14], California's Second Appellate District not only upheld the *Liberty Mutual* decision but also extended the rationale to a non-subrogation context.

Current Split of Authority – *McMillin*

On August 28, 2015, however, the Fifth Appellate District[15] published *McMillin*, which directly conflicts

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State Specific: California *(cont.)*

with both *Liberty Mutual* and *Burch*, holding that SB800 is applicable not only to claims of purely economic loss but also any claim against a builder for property damage.

In *McMillin*, a group of homeowners proceeded directly to litigation for their common law tort claims on the basis of *Liberty Mutual* and *Burch* without the SB800 notice and opportunity to repair process.[16] Analyzing the language of SB800, the *McMillan* court held that whether a plaintiff seeks recovery under SB800 or the common law, in enacting SB800 the Legislature did not limit its application "to actions seeking recovery for deficiencies that have not yet caused property damage."[17] Because the Act applies to "any action seeking recovery of damages arising out of, or related to deficiencies in, the residential construction," the court was unwilling to endorse an exception for cases involving actual property damage and tort claims, as would be allowed under common law principles.[18]

As a result, *McMillin* requires that the prelitigation procedures outlined in SB800 be followed regardless of whether property damage or other causes of action are part of the underlying incident. This is a significant problem for homeowners and subrogated insurers alike, neither of which have the luxury of allowing, for example, water to stand in a home for weeks or months while wading through these prelitigation procedures.

The Future of Notice and Opportunity to Repair Requirements

Unless and until the question is addressed by California's Supreme Court, trial courts are free to adopt the reasoning of either *Liberty Mutual* or *McMillin*. Given the stark contrast between the two interpretations of SB800, it seems likely that the Supreme Court will take up the issue. During this time of limbo, current subrogation cases against builders should expect challenges attempting to dismiss or stay the cases based on the *McMillin*.

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As for new claims involving homebuilders, a conservative approach for subrogation is to abide by the notice requirements for as long as is reasonable to allow the builder an opportunity to inspect the damages prior to remediation and restoration of the premises, while preserving any later claim for damages against the builder.

Endnotes:

1 Cal. Civil Code §§ 895-945.5.

2 *McMillin Albany, LLC v. Super. Ct.* (2015) 239 Cal.App.4th 1132

3 Cal. Civil Code § 910.

4 See Civil Code §§ 913, 915-918, 938.

5 *Aas v. Super. Ct.* (2000) 24 Cal.4th 627

6 *Id.* at 639-640.

7 *Darling v. Super. Ct.* (2012) 211 Cal.App.4th 69, 73.

8 "Builders" is defined in Cal. Civil Code § 911.

9 *Darling v. Super. Ct.* (2012) 211 Cal.App.4th 69, 73.

10 Cal. Civil Code § 930

11 *Liberty Mut. Ins. Co. v. Brookfield Crystal Cove LLC* (2013) 219 Cal.App.4th 98, 101, 106.

12 *Id.* at 109.

13 *Id.* at 106.

14 *Burch v. Super. Ct.* (2014) 223 Cal.App.4th 1411.

15 The Fifth Appellate District includes the Central California counties of Fresno, Kings, Tulare, Madera, Merced, and Mariposa. The Fourth Appellate District (*Liberty Mutual*) includes San Bernardino, Riverside, Orange, San Diego, and Imperial Counties; while the Second Appellate District (*Burch*) includes Los Angeles, Ventura, Santa Barbara, San Luis Obispo, and Kern Counties.

16 *McMillin*, 239 Cal.App.4th at 1139-1140.

17 *Id.* at 1141.

18 *Id.* (citing Cal. Civil Code § 896; emphasis added by McMillan court).