



SUMMER 2009

Does *Greystone* Signal the End of the Economic Loss Rule in New Residential Home Construction in California?

By Maria J. Giardina

In *Greystone Homes, Inc. v. Midtec, Inc.*, 168 Cal.App.4th 1194 (2008), a homebuilder's equitable indemnity claim trumped the "economic loss rule" and paved the way for the builder to recover repair costs against the supplier of a defective product that had not caused property damage.

Greystone represents a departure from traditional construction defect recovery. The "economic loss rule" typically precludes a person or company from recovering money to repair construction defects arising out of another's negligence, unless the person or company can show that it suffered personal injury or property damage as a result of the negligence. It was applied against a group of homeowners in a well-known case titled *Aas v. Superior Court*, 24 Cal.4th 627 (2000). In *Aas*, the California Supreme Court denied the homeowners recovery of the cost to repair construction defects that had not caused property damage or personal injury based on a negligence claim. The *Aas* Court acknowledged that any construction defect can diminish the value of a house, but explained that the "economic loss rule" precludes recovery for such damages based on negligence. "[T]he difference between price paid and value received, and deviations from standards of quality that have not resulted in property damage or personal injury are primarily the domain of contract and warranty law or the law of fraud, rather than of negligence."

In response to *Aas*, the Legislature enacted the "Right to Repair" Act (California Civil Code section 895 and following), which allows homeowners to recover "economic losses" from builders and others who violate the Act's building standards without having to show that the violation caused property damage or personal injury.

Greystone clarifies that builders who make an indemnity claim also may recover "economic losses" even if there is no personal injury or property damage. Accordingly, *Greystone* may have eliminated the "economic loss rule" in home construction disputes brought under the Act.

Factual Background

Greystone Homes, Inc. built condominiums in Chula Vista. *Greystone's* plumbing subcontractor, Production Plus Plumbing, installed a "RTI Plum-Pex" system in some units, which contained Midtec, Inc. plumbing fittings. Owners of some of the units that contained the Midtec fittings complained to *Greystone* about water leaks. The Midtec fittings failed primarily due to fatigue arising from a manufacturing problem. *Greystone* determined that it needed to replace all the Midtec fittings and did so at a cost of about \$1.5 million. The cost for repairs related to the fittings that had actually failed was approximately \$106,000.

Greystone sued RTI and Midtec. RTI settled by paying *Greystone* an amount in excess of the cost to repair the failed fittings. *Greystone's* action for negligence, indemnity and contribution proceeded against Midtec. Midtec filed a summary judgment motion based on the economic loss rule, arguing that *Greystone* could not recover additional damages from Midtec for the cost of replacing the fittings that had not failed or caused property damage.

Greystone argued that the Right to Repair Act had entirely abrogated the economic loss rule in residential construction defect litigation. The trial court disagreed and granted Midtec's motion for summary judgment, reasoning that the Right to Repair Act only created an exception to the economic loss rule for homeowners, not builders, such as *Greystone*.

In response to *Greystone's* appeal, the court of appeal reversed. It agreed with the trial court's conclusion that the Act only permits a direct action for negligence by a homeowner. However, it held that *Greystone* could bring an

equitable indemnity action against Midtec, since the homeowners would have been able to bring a claim against Midtec for its negligent violation of the Act's standards. Where more than one party causes injury, each is "jointly and severally liable" and any one may be held individually responsible for the entire loss—in this case, Greystone. The responsible parties are then left to work out among themselves any apportionment of the loss. Equitable indemnity is one manner of apportioning the loss in proportion to their relative culpability. Once Greystone paid the homeowners' entire loss, including economic losses, arising out of Midtec's violation of the Right to Repair Act's building standards, it was entitled to recover that loss from Midtec.

Conclusion

The *Greystone* decision is important because it allows a builder to avoid the economic loss rule – albeit indirectly, by an equitable indemnity claim that is based on the homeowner's right to recover under the "Right to Repair" Act. A builder who intends to file an equitable indemnity claim should comply with the Act's pre-filing notice requirements.

Maria J. Giardina concentrates her practice on the prosecution and defense of construction-related disputes. She provides claims analysis and litigation services on a wide variety of matters involving contract claims, payment disputes, mechanic's liens, unfair bidding, unfair competition and antitrust violations, false claims, and design and construction defects.

FAQs Concerning Continued Compliance With California Mandatory Sexual Harassment Prevention Training

By Holly Hublou Williams

California Government Code section 12950.1 requires California employers with 50 or more employees to provide harassment avoidance training to supervisors every two years. Employers that do not conduct the training face increased risks of liability in civil cases and the possibility of fines and penalties assessed by the state government. The California Department of Fair Employment and Housing generally requests proof of the training when investigating harassment and discrimination charges. Additionally, having such documentation on hand is useful to an employer defending against harassment and discrimination claims.

Below are answers to frequently asked questions about this law, its continuing requirements, and its potential application to your company.

Frequently Asked Questions:

1. Does This Law Apply to Your Company?

- The statute applies to California employers that have 50 or more employees. Temporary workers (for example, a temporary employee from a staffing agency) and independent contractors who regularly perform services are also considered "employees" when calculating the 50 employees.
- The statute makes no distinction between California employees and out-of-state employees when calculating the 50 employees.

2. What Type of Training Must an Employer Conduct?

Training must comprise at least two hours of **"classroom or other effective interactive training and education,"** including **"practical examples"** regarding:

- The legal prohibitions against sexual harassment under federal and state law;
- Prevention of sexual harassment;
- Correction of situations involving sexual harassment; and
- Remedies for victims of sexual harassment.

The regulations under the statute set forth in greater detail the required contents of the mandated training.

The regulations further provide that certain classroom, e learning, and webinar training qualifies as effective interactive training. However, video and handbook type training alone does not qualify.

3. Who Should Conduct the Training?

- The person who conducts the training must have "knowledge and expertise" in the prevention of harassment, discrimination and retaliation.
- It is the employer's obligation to ensure that the trainer is qualified and meets the criteria set forth in the regulations.

4. Who Must Receive Training?

- An employer must train all supervisory employees located in California.
- California law broadly defines "supervisory" employee to include not only individuals who have the authority to hire, fire, promote, discipline, reward and direct employees, but also those who act as "working leads." The law merely recommends the above-listed personnel actions. Therefore, the determinative factor is whether the employee has any ability to control, either directly or indirectly, a co-worker's employment.

5. When Must Employers Provide Training?

- Employers must provide sexual harassment training to each supervisory employee once every two years.
- Employers must provide sexual harassment training to each new supervisory employee within six months of the employee becoming a supervisor by hire or promotion.
- Employers must keep documentation of the training for at least two years that includes names of supervisors trained and other data set forth in the regulations. The regulations provide that management must track each supervisor's training using an individual or training year tracking method.

6. What Happens If Management Fails to Provide the Training?

- If an employer does not provide the training, the California Fair Employment and Housing Commission may issue an order mandating compliance.
- As a practical matter, a company that does not train its supervisors is foregoing the opportunity to minimize its potential liability if ever sued for sexual harassment.
- Although, under California law, conducting the training in accordance with the statute will not serve as a complete defense to a harassment claim, California courts have ruled that a judge and jury should consider such preventative measures when determining the amount of the employer's liability.
- Conversely, an employer's failure to comply with the law could, in effect, increase its liability and result in a more significant damages award against the business.

Holly Hublou Williams has extensive experience representing national and global companies on a full spectrum of employment law matters, including discrimination, unlawful harassment, wrongful termination, leave law violations, retaliation and whistle-blowing, unfair competition, and wage and hour related issues.

Despite Unprecedented Construction Slump, Contractors Remain Cautiously Optimistic

By Marilyn Klinger

While the residential sector of the construction industry is currently in a depression and it is difficult to see any other way to go but up, there will likely be more bad news on the horizon for the commercial sector because most commercial contractors came into this year with a significant backlog. Additionally, there continues to be a credit crunch as well as a government financing slowdown so that projects are still stopping in the middle of construction because the owners are unable to obtain continuing financing, lenders are refusing to continue to fund, or government funds are frozen, particularly in California with its budget woes. From the retail perspective, there will be smaller projects but there is likely to be renovation, improvement and redemise of commercial space. Although the current picture is grim, it can be weathered with look-ahead optimism.

Subcontractors. Where this recession has seemingly hit the hardest is with subcontractors. General contractors are dealing with subcontractor problems in several ways. They are agreeing to pay them on a biweekly basis rather than once a month. They are paying via joint checks to assure that suppliers and sub-subcontractors receive payment. They have also increased their scrutiny in the prequalification process, looking more closely at

their subcontractors' financial statements and cash reserves. And, of course, it is getting tougher for subcontractors to obtain surety credit.

Contractors have also seen subcontractor failures where the contractors needed to take over the work, either by virtue of a subcontractor's default or the subcontractor's acknowledgment that it needed to walk away from the project and allow the general contractor to bring in a substitute subcontractor so as not to delay the project. General contractors are concerned for the future because they have exposure for the failure of their subcontractors to pay withholding taxes, prevailing wages and employee benefits, and sub-subcontractor and supplier invoices by virtue of the general contractors' payment bonds and their indemnity obligations to their bonding companies.

Bonding. As to the contractors' own bonding relationships, so far contractors who have had long-term relationships with their bonding companies have not seen a significant change in the way the surety industry is handling their accounts and requests for surety credit. Contractors have noticed that sureties are busier as the bonding company accounts are asking for more bid bonds because of the increased number in the industry bidding on projects. In that regard, where there once were three to five bidders on any one project, people now are seeing 20 to 25 bidders. Indeed, contractors are seeing other contractors chase opportunities "to the bottom," that is, coming in at extremely low prices in order to get the work.

New Business Strategies. Contractors are responding to the significant increase in bidders in several ways. Many contractors, seeing that many potential bidders at a pre-bid job walk, are simply staying away. Others are sharpening their pencils as much as possible to assure that they can successfully complete the project with a slim margin for profit.

There are other business strategies as well, both good and bad, that contractors are using to address the current financial crisis. Those contractors that were previously in the private sector are attempting to move into the public sector. However, public sector construction is filled with pitfalls, such as increased reporting and notice requirements as well as regulatory compliance obligations not included on private projects. These pitfalls may trip up an inexperienced contractor. The fallout from the foray of private contractors to public work is yet to occur but many predict a heyday for the legal community. The same scenario is predicted to occur for those contractors venturing out to new geographic areas and/or new types of construction in order to obtain work. Some contractors are reaching out to potential joint venture partners as a way to move into new markets—potentially slightly safer than doing it on their own. Some contractors, who have both a construction side and a service side, are focusing on their service side during this recession.

If able, some contractors are simply running off their backlog, letting go of their employees as they finish up projects, and going into hibernation to await the turnaround in the market, which they are convinced will occur.

Owner Procurement. On the flip side, contractors are witnessing substantial changes in the way owners are procuring construction services. For example, contractors in the private sector are seeing an increased use of requests for proposal/quotation where previously the owners would negotiate contracts with their favored contractors. However, the owners are not going to the open market but are approaching four or five preferred contractors and requesting pricing from them. On public works projects, the situation is almost insane. There was one public works project where 74 potential bidders showed up a pre-bid job walk!

Future Predictions. It is predicted that public works is the sector of the construction industry that will recover first – including infrastructure, military and energy. Contractors are likely to follow the government money for the next couple of years. The more difficult question, however, is what happens with the private sector. There arguably is a vast amount of equity sitting on the sidelines. For example, there is a lot of cash in hospitality. It is possible that hotel owners will use their cash to renovate existing properties and, then, when the credit crunch is over, finance in order to obtain operating cash on a going-forward basis.

Getting back to the optimism noted at the beginning of this article, many contractors see significant opportunities from this economy—the potential to make lemonade out of lemons. Recessions can be good for the construction industry to allow the players to focus on their key markets, key relationships, and core values. This economy also provides an opportunity for construction companies to invest in their people—to decide who they want to keep, to whom they should give opportunities, and who will demonstrate their loyalty. It also becomes a buyer's market for picking up talent. It might also become an opportunity for growth allowing companies to purchase entire operations, not just individuals. This business slowdown also gives contractors a chance to evaluate their own performance, institute new processes, and install new systems--things that are difficult to do when everyone is busy. Downturns highlight weaknesses and reduce competition.

It is well known for those in the construction law business that the industry is made up of tremendous optimists. So, even in this very troubling time, it is good to see that some contractors, although sensitive to the concerns of

many companies and individuals, also see this time as an opportunity in all its many facets.

This article, written by Sedgwick partner, Marilyn Klinger, Los Angeles, is based on a May 1, 2009 panel presentation given at a recent construction industry conference in Seattle, Washington. Panelists included Richard Walker of Howard S. Wright, Andrew Beyer of Walsh Construction, and Scott Olson of S.D. Deacon, all West Coast commercial general contractors.



Mike Pipkin
Attorney Profile

Mike Pipkin heads the Texas Construction Practices Group for Sedgwick, leading a team that provides all aspects of counseling and litigation to owners, developers, sureties, contractors, engineering companies, subcontractors, and design professionals, including heavy and light commercial, industrial, high-rise condominium and office buildings, roads and bridges, schools, prison and jail facilities, and residential construction. Mike currently serves as construction counsel for a Dallas-based international commercial real estate development and construction management company, for which he assists in the preparation of traditional lump-sum and guaranteed maximum price contracts, general conditions, subcontracts, construction management contracts, and agreements with contractors and architects, in addition to claims investigation and administration, resolution of lien disputes, and the pursuit and defense of construction claims of all types.

In January 2009, Mike served as Program Co-Chair for the American Bar Association TIPS Fidelity & Surety Law Committee's Annual MidWinter Meeting, a two-day program in New York City on "Public-Private Partnerships

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Construction Practices Group - About Us

Sedgwick has established a record of successfully protecting the interests of general contractors, subcontractors, sureties, project owners and developers (commercial, public and residential), design professionals and material suppliers. The firm's construction attorneys represent clients in matters ranging from commercial and governmental projects to private and commercial residential construction.

We handle various aspects related to construction – from the contracting, bonding, insuring and development phase; construction disputes, including terminations for default and convenience, takeovers and completion, litigation, arbitration, DRB hearings, and mediation; and post-construction issues, including impact claims, mechanic's liens and stop notice enforcement and defense, compliance with regulatory authorities, product malfunction, construction site injuries, and construction defects. We work with specialized consultants with design and construction expertise.

Through exceptional legal skills, substantial industry experience, and access to leading consultants, Sedgwick consistently provides cost-effective and expeditious management of complex construction law matters. When matters cannot be resolved, we utilize our significant trial experience to try and win cases.

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