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GETTING A FIX ON THE RIGHT TO REPAIR

Builders must be careful when altering SB 800's pre-litigation procedures

Construction defect litigation is one of the many culprits blamed for the cost and scarcity of new residential housing in California and the lack of affordable construction insurance. In an effort to reduce the cost of litigation and insurance, while still protecting home buyers, the California Legislature enacted SB 800 (California Civil Code §895 et seq.) which, among other things, adds notice, repair and mediation procedures to residential construction defect claims.

These procedures can be modified by contract. However, if the modified procedures are invalidated, the claimant may proceed directly into litigation and bypass the SB 800 procedures.

These "pre-litigation" procedures start with the homeowner's written notice describing, in reasonable detail, the claim against the builder. The builder (defined as the developer or original seller) must acknowledge the claim within 14 days and may conduct an inspection within 14 more days. A second inspection may be conducted in an additional 40 days. Within 30 days after completion of the inspections, the builder may offer a specific repair plan and the payment of certain SB 800 damages.

The claimant then has 30 days (1) to accept the offer, (2) to request the names of three alternate contractors to perform the repair, or (3) to request mediation. The mediation must proceed within 15 days. The mediator is chosen by and paid for by the builder unless the claimant agrees to pay half the cost of the mediation, in which case the mediator is chosen jointly. The mediation is limited to four hours unless extended by the parties. At the end of mediation, the parties either agree on a resolution or the claimant must allow the repairs to be performed. Repairs must proceed with "ut-

most diligence" and reach completion within 120 days if possible. Also, the builder must compensate the claimant for damages resulting from the repairs. Alternatively, a builder may offer cash in lieu of repair and obtain a "reasonable release in exchange for the cash payment". (Civil Code §926 and 929.)

After the repair, if no prior mediation occurred, then the claimant must request mediation with the builder before bringing an action. The statute of limitations is generally extended during this repair and mediation process to 100 days after they are completed. (Civil Code §927.) If a claimant sues, damages are limited to the reasonable value of repairing any violation of the SB 800 standards, any damages caused by the repairs, cost of removing and replacing any improper repairs by the builder, reasonable relocation and storage expense, lost business income if the home is used as the principal place of business licensed to be operated from the home, reasonable investigative cost, and all other costs or fees recoverable by contract or statute. (Civil Code §944.)

AFFIRMATIVE DEFENSES

If litigation occurs, the builder may avail itself of numerous affirmative defenses pursuant to Civil Code §945.5. The affirmative defenses are (a) unforeseen acts of nature such as weather and earthquakes and man-made events such as war, terrorism or vandalism "in excess of the design criteria"; (b) failure by the claimant to reasonably minimize or prevent damages, including failure to give timely notice of or access to a defect; (c) failure to follow the recommendations or commonly accepted homeowner's maintenance obligations provided at the

time of sale; (d) ordinary wear and tear, misuse, abuse or neglect; (e) passing of the statute of limitations; (f) defects for which the builder has obtained a valid release; (g) successful repairs that corrected the defect; and (h) all other affirmative defenses.

CALDERON PROCESS

If the claimant under SB 800 is a homeowner's association, then the builder is required to follow the pre-litigation procedures set forth in SB 800 and the even more elaborate Calderon Process set forth in §1375, et seq. of the Civil Code. Compliance with the Calderon Process is excused if the requirements of SB 800 are enforced and are substantially similar to those set forth in the Calderon Process. (Civil Code §935.)

The Calderon Process takes a minimum of six months. The SB 800 procedures, which are focused on repairs and mediation, are much shorter. The Calderon Process is geared more toward reaching a settlement with no right to repair given to the builder. Accordingly, it generally appears advantageous for all parties to utilize SB 800, quickly repair the defects and avoid portions of the time-consuming Calderon Process.

SELECTING REPAIR CONTRACTORS

One problem with the SB 800 procedures concerns repair contractors. If the claimant does not like the builder's contractor, the claimant can force the repair to be conducted by one of three alternate contractors selected by the builder. The original contractor often has a right to repair defects without cost to the builder within a year of substantial completion. (See, AIA Document A201-1997 §12.2.2.1.) Therefore, if an alternate con-

tractor is selected, the builder will have to pay the cost of the alternate contractor instead of obtaining the repairs from the original contractor without charge.

'OPT-OUT' PROVISION

SB 800 includes an "opt out" provision that allows a builder to substitute alternative non-adversarial contractual procedures for those contained in SB 800. For example, a builder might opt out to simplify the repair process, to control selection of the repair contractor or to modify some of the procedural burdens imposed by SB 800.

If a builder elects to opt out, it must do so when the sales agreement is executed. (Civil Code §914.) If a builder elects to do so, then the election is binding, even if these alternative contractual procedures fail or are invalidated. (Civil Code §914.) If the alternate contractual procedures are invalidated, the claimant will be able to sue immediately without affording the parties a right to repair or mediate.

Because there is no safe harbor or guidelines for alternates to the pre-litigation procedures of SB 800, a builder is taking a substantial risk that if it opts out and tries to enforce its own non-adversarial contractual procedures, it may be losing both its non-adversarial contractual procedures as well as the notice, repair and mediation procedures under SB 800. Accordingly, the most conservative approach for a builder is not to opt out of SB 800.

ARBITRATION AND JUDICIAL REFERENCE

Notwithstanding the above, many builders are attempting to add contractual arbitration or judicial reference to arbitration after the SB 800 pre-litigation procedures are completed. In other words, these builders are arguing that they are not opting out of the pre-litigation procedures, but rather electing to go to arbitration rather than litigation after the SB 800 pre-litigation procedures are finished.

Unfortunately, California case law is making such provisions increasingly more difficult to enforce in real estate purchase agreements. The recent case of *Pardee v. Superior Court*, 100 Cal.App.4th 1081 (2002), held that contract clauses for judicial reference and for waiver of punitive damages were unenforceable because the underlying residential purchase and sale

agreement was an agreement of adhesion and the clauses were unconscionable.

Further, Code of Civil Procedure §1298.7 precludes binding arbitration in real estate purchase contracts involving construction defects. However, in *Basura v. U.S. Home*, 98 Cal.App.4th 1205 (2002), the appellate court held that the Federal Arbitration Act pre-empted §1298.7, and the court upheld a purchase agreement arbitration clause as "valid, irrevocable and enforceable, save upon ground such as exists at law or in equity for the revocation of any contract."

Therefore, even under *Basura*, "generally applicable contract defenses, such as fraud, duress or unconscionability, may be applied to invalidate arbitration agreements." *Id.*

With *Pardee* and *Basura* in mind, if a builder wishes to utilize arbitration or judicial reference in its residential purchase agreements, it should carefully follow the procedures outlined in Code of Civil Procedure §1298, et seq. The builder will also have to overcome the adhesion and unconscionability concerns raised in *Pardee* by providing alternatives to the purchaser and by eliminating issues regarding unfairness and surprise.

The following approaches may overcome the concerns raised in *Pardee*: (1) providing the purchaser with the right to choose arbitration, judicial reference or litigation along with a detailed description of the pros and cons of each choice in lay-

men's terms; (2) permitting claims for punitive damages since a waiver of punitive damage claims was found by the *Pardee* court to have taken away substantial rights of the homeowners; (3) providing that if litigation is chosen, a jury trial is not waived unless specific advantages can be articulated in laymen's terms to waive a jury trial such as a faster resolution of the dispute and avoiding juries and judges that do not understand the complexities of construction defect matters versus utilizing an expert construction arbitrator who can make a more informed or timely decision to the benefit of both parties; and (4) providing that the builder will pay for arbitration or judicial reference thereby avoiding the *Pardee* argument that the homeowners did not understand the economic burdens of judicial reference or arbitration.

CONCLUSION

To successfully opt out of the SB 800 pre-litigation procedures, a builder's proposed non-adversarial contractual procedures for resolution of claims under SB 800 will need to be carefully crafted. Considerable thought will have to be given concerning how the provisions can be imposed not only on purchasers, who can be bound by the provisions of their purchase and sale agreements, but on their successors in interest, who can be bound by a recorded document, such as recorded CC&Rs. (Civil Code §912 (i).)

Provisions to bind homeowner's associations will also need to be considered carefully, especially in light of the Calderon Process. Where the Department of Real Estate has jurisdiction, it will have to approve the builder's non-adversarial contractual procedures in question. Finally, any non-adversarial contractual procedures will need to be carefully drafted so as not to create contracts of adhesion or unconscionable provisions.

With numerous concerns and traps, and with no guidance from SB 800 regarding non-adversarial contractual procedures, many builders may be better off simply utilizing the pre-litigation procedures under SB 800 and modifying their contracts with architects, consultants, contractors, subcontractors and suppliers to track the provisions of SB 800.

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