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Mechanic's Lien Basics

California's mechanics lien law provides various rights and remedies to persons who provide labor, service, equipment, or material to real property. One such right is a mechanics lien, which is an involuntary encumbrance against the real property for the value of the items (labor, service, etc.) furnished. California's state constitution expressly provides that those contributing to a private work of improvement have rights to a mechanic's liens. Cal. Const. art. XIV, § 3. The purpose is to afford security for those who enhance the property of others. Thus, when a contractor, subcontractor, material supplier, or equipment lessor is not paid for contributing to a private work of improvement, the principal statutory remedies for obtaining payment are mechanics liens, stop notices, and bond actions. See Civ. Code, §§ 8302, 8402; see also *Mechanical Wholesale Corp. v. Fuji Bank, Ltd*. (1996) 42 Cal.App.4th 1647, 1654.

California's mechanics lien laws were enacted to prevent unjust enrichment of a property owner at the expense of laborers or material suppliers. "The mechanics' lien is the only creditors' remedy stemming from constitutional command and our courts 'have uniformly classified the mechanics' lien laws as remedial legislation, to be liberally construed for the protection of laborers and materialmen.'" *Basic Modular Facilities, Inc. v. Ehsanipour* (1999) 70 Cal.App.4th 1480, 1483 (citation omitted).

Requirements

There are three basic steps required before a contractor can recover money through a mechanics lien: (1) notice to the owner, (2) recording the lien; and (3) lien foreclosure action.

California requires that the property owner be informed about the specific work being done before the property owner can be held responsible. Therefore, a "Preliminary Notice" must be served by most types of lien claimants at the outset of their work, to preserve their lien claim, payment bond, and stop notice rights. Civ. Code, § 8200. California's Legislature imposed the preliminary notice requirements in order to alert owners, contractors, and lenders that "the property or funds involved might be subject to claims arising from contracts to which they were not parties and would otherwise have no knowledge." Romak Iron Works v. Prudential Ins. Co. (1980) 104 Cal.App.3d 767, 778. The theory is that if the property owner knows who is working on his project, he can make an effort

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to see that they will be paid. Civil Code section 8202 provides the required language for the Preliminary Notice.

A claimant other than a general contractor must provide a Preliminary Notice to the owner, direct contractor, and construction lender within 20 days of first furnishing work or materials. A general contractor must provide the notice to the lender. Civ. Code, § 8200 et seq. Contractors in a direct contractual relationship with the project owner need only provide a Preliminary Notice to construction lenders and reputed construction lenders, if any. Civ. Code, § 8200, subd. (e)(2). An individual worker or laborer, however, has lien rights without giving notice. Civ. Code, § 8200, subd. (e)(1).

The claimant must timely record the lien in the county where the work of improvement is located. The deadline for recording a mechanics lien is generally triggered by the completion of a work of improvement. Civ. Code, § 8180. Owners must record notices of completion within a window of 15 days after actual completion of the project. Civ. Code, § 8182, subd. (a). Acts signifying completion include: actual completion of all work on the project, occupation or use coupled with cessation of labor, a cessation of labor for 60 continuous days (or for 30 days after recording of a notice of cessation, and acceptance by a public entity. Note that following the 2012 amendments to California's mechanics lien law, acceptance by the owner is no longer one of the circumstances deemed to constitute completion. Moreover, a mechanic's lien should not be recorded in the middle of a project unless the contractor's scope of work is completed.

Civil Code section 8416 provides the specific requirements for a lien document. The lien must contain: (1) a statement of the demand; (2) the name of the owner or reputed owner; (3) a general statement of the services furnished; (4) the name of the party who hired the claimant; (5) a description of the jobsite; (6) claimant's address; (7) proof of service; and (8) a specific "Notice of Mechanic's Lien" statement. The claimant must then serve a copy of the mechanics lien upon the property owner contemporaneously with filing the lien itself in the Recorder's Office in the county where the project is located.

Enforcement and Foreclosure

A recorded mechanics lien is released by operation of law if the claimant does not bring a lien foreclosure action within 90 days after the lien is recorded. Civ. Code, § 8460. That is, once the lien is filed, it is only effective for a period of 90 days. After this 90 day period, if the lien is not foreclosed upon or extended, it will expire. Civ. Code, § 8412. If the owner files a valid notice of completion, a direct contractor must record its lien and mail a copy to the owner within 60 days after recording of the notice of completion, and any other claimant must record its lien and mail a copy to the owner within 30 days after the recording of the notice of completion. Civ. Code, § 8414.

A claimant generally must sue to enforce the stop payment notice no earlier than 10 days after the notice was given and no later than 90 days after expiration of the time within which stop payment notices must be given. Civ. Code, § 8550. The claimant must notify the persons to whom the stop notice was given of the commencement of the action within 5 days of commencing it. Any person who can record a lien can give a stop payment notice, as long as a preliminary notice has been given. Civ. Code, §§ 8520, 8530, 9100.

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The proper court in which to file a foreclosure action is the superior court in the county where the real property or some part of it is situated. Code Civ. Proc., § 392, subd. (a)(2); see also Automatic Sprinkler Corp. v. Southern Cal. Edison Co. (1989) 216 Cal.App.3d 627. A lien foreclosure action that is neither filed nor transferred to the proper county court within 90 days after the claim of lien is recorded is time barred under Civil Code section 8460. Moreover, the court has discretion to dismiss causes of action for both foreclosure of a mechanics lien and enforcement of a stop notice if the action is not brought to trial within two years after commencement. Civ. Code § 8462.

Although a judgment for foreclosure of a mechanics lien orders the sale of the affected property, like judicial foreclosure of a mortgage, actual sales rarely occur. However, when a sale does occur, the sheriff auctions the property pursuant to Code of Civil Procedure sections 716.010 et seq. A claimant who prevails on a lien foreclosure suit should record the actual judgment immediately, so that the lien will relate back to the commencement date of the work of improvement and the priorities among competing interests decreed by the court in the foreclosure action will bind the property accordingly.

Ability to Waive and Limitations on Lien Rights

In order to ensure that a "downstream" subcontractor has validly released its right to assert lien, stop notice, or payment bond rights, the law requires that specific waiver and release language be used. Civ. Code, § 8132 et seq. Any provision in a subcontractor's or material supplier's contract to the effect that the subcontractor or material supplier waives its future lien or other collateral rights is void "unless and until the claimant executes and delivers a waiver and release" under the statute. Civ. Code, § 8122. Thus, all lien releases must conform to the forms set forth in the statute to be enforceable. The statute provides required language to use depending on whether the waiver is conditional or unconditional, and whether it concerns progress or final payments. The form utilized for progress payments (as opposed to final payments) does not cover certain disputed or extra work items or claims based on breach of contract, so “upstream” parties may want to supplement the statutory form with additional releases.

Lien Release Bonds

Finally, note that if an owner desires to sell or refinance the property that is subject to a valid mechanics lien, or the owner disputes the correctness or validity of the lien, the owner can "bond around" the lien by posting cash or a bond for 125 percent of the face amount of the loan. § 8424, subd. (b).

The purpose of the release bond is to provide a means by which the property may be freed of the lien before a final determination of the lien claimant's rights. The principal and surety on the bond assume liability for the claim and thus the lien claimant is protected by providing an alternative source of recovery for the lien claim. The release bond does not extinguish the lien; the release bond is substituted for the property as security for the lien. Hutnick v. U.S. Fidelity & Guaranty Co. (1988) 47 Cal. 3d 456, 463; Dennis Electric, Inc. v. United States Fidelity & Guaranty Co. (1990) 219 Cal. App. 3d 1228, 1234 .

By issuing the bond, the surety will look to the principal to defend it. In turn, the surety/principal may assert whatever defenses the principal could assert to avoid liability to

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the bond obligee: A surety "is not liable if … there is no liability upon the part of the principal at the time of the execution of the contract, or the liability of the principal thereafter ceases …" Civ.Code § 2810; *Schmitt v. Insurance Co. of North America* (1991) 230 Cal.App.3d 245, 259; *Scott Co. of Calif. v. United States Fid. & Guar. Ins. Co.* (2003) 107 Cal.App.4th 197, 214-216 (disapproved on other grounds in *Le Francois v. Goel* (2005) 35 Cal.4th 1094).

The defenses of the principal are also defenses of the surety. Moreover, because the liability of the surety is commensurate with that of the principal (Civil Code §2808), when the principal is not liable on the obligation, neither is the surety or guarantor. See United States Leasing Corp. v DuPont (1968) 69 Cal.2d 275, 290. Civil Code §2809 states: "The obligation of a surety must be neither larger in amount nor in other respects more burdensome than that of the principal." See Kalfountzos v Hartford Fire Ins. Co. (1995) 37 Cal.App.4th 1655 (disapproved on other grounds in Wm. R. Clarke Corp. v Safeco Ins. Co. (1997) 15 Cal.4th 882, 896).

Public Project Claims

State and Local Public Work

For purposes of public project claims, "public work" refers to a work of improvement contracted for by a public entity. Civ. Code, § 9000. Similar to "private" works, public work claims involve the various rights and remedies available to a person who provides labor, service, equipment, or material to real property—except, in this case, the property belongs to state or local government. Unlike with a private work of improvement, however, mechanic's liens are not available on public works projects. Civ. Code, § 8160. As the California Court of Appeal explained, "principles of sovereign immunity do not permit liens for persons furnishing labor or supplies on public property . . . ." Dep't of Indus. Relations v. Seaboard Surety Co. (1996) 50 Cal.App.4th 1501, 1508, as modified on denial of reh'g (Dec. 20, 1996).

While persons providing material and labor for public works cannot file a mechanic's lien, they are provided with alternative remedies to collect payment under California Civil Code section 9100 et seq. Specifically, subcontractors, laborers and materialmen—other than the contractors who contracted directly with the public entity ("direct contractor")—have two options: (1) serving a public entity with a Stop Payment Notice or (2) asserting a claim against a Payment Bond. Civ. Code, § 9100 et seq.

Notices and Enforcement

Stop Payment Notices

A timely and properly served Stop Payment Notice, commonly referred to as a "Stop Notice," requires a public entity to set aside sufficient funds due to the direct contractor to satisfy the claim, pay interest, and provide for the cost of litigation.

Before serving a Stop Notice, claimants, other than laborers and entities and individuals who are contracted directly with the general contractor, must serve a Preliminary Notice no later than 20 days after the claimant has first furnished labor, services, equipment, or materials to the jobsite. Civ. Code, §§ 8204, 9302. The Preliminary Notice must provide a general statement of the work provided, to whom the work was provided, who is giving notice, and an estimated price for the work provided. Civ. Code §§ 8102, 9302, 9303. The Preliminary Notice must be served via

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registered, certified or express mail, overnight delivery, or by personal service on the direct contractor and officer in charge for disbursing funds for the public entity. Civ. Code, §§ 8106, 9302.

If the public entity records a Notice of Completion, a Stop Notice must be served within 30 days of the recordation date. Civ. Code, § 9356(a). If there is no Notice of Completion, a Stop Notice must be served within 90 days from when the work was completed or stopped. Id. The director of the public entity who awarded the main contractor the contract must be served with the Stop Notice, unless the director has delegated to another officer to accept service. Civ. Code, § 9354.

The Stop Notice must comply with the same requirements for a Preliminary Notice in terms of content, timing limitations, who to serve, and the manner of service. The Stop Notice must also be signed and verified by the claimant. Civ. Code § 9352.

If all the requirements for a Stop Notice are met, the public entity will withhold the appropriate amount needed to pay the claimant's claims. Civ. Code § 9358. To enforce the Stop Notice, the claimant must file a court action. The suit may not be filed until 10 days after the Stop Notice was filed and not more than 90 days after a Stop Notice could be filed. Civ. Code § 9362. Additionally, the scope of work claimed only extends to the 20 days before the filing of the Preliminary Notice. Civ. Code § 9304.

Payment Bonds

A main contractor is required to file a payment bond for public work contracts that exceed $25,000. Civ. Code § 9550.

To enforce a claim against a payment bond, a claimant must timely serve either a preliminary notice or a post-completion notice to the surety. Civ. Code § 9560. The post-completion notice must be provided within 15 days after a Notice of Completion is recorded. Id. If a Notice of Completion is not recorded, the time for giving written notice to the surety and bond principle is extended to 75 days after completion of the work of improvement. Id. The written notice must comply with the same requirements as Stop Notices in terms of content, timing limitations, who to serve, and the manner of service. Civ. Code § 9562.

A claimant may file a lawsuit to enforce the liability of a surety on a payment even if a claimant did not issue a Stop Payment notice to the public entity. A claimant may commence a claim against the bond at any point after the claimant stops providing work, but no later than the six months after the period in which a stop payment notice may be given under Section 9356. Civ. Code § 9558. This means a claimant may add 30 days to the six month period if the public entity timely records a notice of completion, acceptance, or cessation. If no notice is timely recorded, the claimant may add 90 days to the six month period.

A claimant may maintain an action to enforce liability on the bond without filing a lawsuit against the public entity that awarded the contract to the direct contractor. Civ. Code § 9564.

Claims to Public Funds

In effect, the Stop Notice procedures discussed above are claims against the public funds set aside by public entities for contracted public work projects. If a claimant follows proper procedures, the public entity will withhold the amount necessary to pay the claimant's claims, while the claimant attempts to foreclose on the Stop Notice through court action.

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Statutes of Limitation and Repose

Statutes of Limitation and Limitations on Application of Statutes

The following five statutes of limitation apply to California's construction contract litigation and run from the time when the plaintiff discovered, or should have discovered, the injury:

1. Four (4) year statute of limitation for breach of written contract under California Code of Civil Procedure section 337
2. Four (4) year statute of limitation for breach of contract of sale under California Uniform Commercial Code section 2725;
3. Three (3) year statute of limitation for injury to real or personal property under California Code of Civil Procedure section 338;
4. Three (3) year statute of limitation for actions under Porter-Cologne Water Quality Control Act or under specified statutory provisions on hazardous waste control under California Code of Civil Procedure section 338; and
5. Two (2) year statute of limitation for breach of oral agreement under California Code of Civil Procedure section 339.

Statutes of Repose and Limitations on Application of Statutes

The following two provisions are called "statutes of repose" because they run from the date the construction project is completed, rather than from the time the cause of action arises (i.e. when the defect is discovered). The statutes of repose cannot be used to revive causes of action that have expired under other applicable statutes of limitation. Thus, a claimant cannot rely on a statute of repose to save what would otherwise be a late claim under the statute of limitations. Additionally, with certain exceptions, the statutes of repose apply equally to numerous claim theories (i.e. breach of contract, negligence, strict liability), while the statutes of limitation are different for each particular theory of liability.

Patent Defects

Pursuant to California Code of Civil Procedure section 337.1, an action for injuries to persons or property arising from patent defects in the planning or construction of improvements to real property must be commenced within four (4) years after substantial completion of the work of improvement. A defect is patent if it is apparent/discoverable by reasonable inspection. Code Civ. Proc., § 337.1, subd. (e).

Section 337.1 does not apply to suits for defects in owner-occupied single unit residences. Moreover, the four-year period announced in section 337.1 not only applies to actions for damages caused by patent defects existing at the time of substantial completion of construction, but also to actions that involve patent defects that arose after substantial completion. See Tomko Woll Group Architects, Inc. v. Superior Court (1996) 46 Cal.App.4th 1326 (holding the four-year statute of limitation period under § 337.1 applies to actions involving a patent deficiency, whether the patent deficiency existed at the time of, or after, substantial completion of construction).

Section 337.1 protects developers and contractors but not product manufacturers. Robinson v. Chin & Hensolt (2002) 98 Cal.App.4th 702 (concluding total absence of legislative intent to protect mere manufacturers of devices solely because they happen to be installed in real property).

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Latent Defects

Pursuant to Code of Civil Procedure section 337.15, an action for injuries to persons or property arising from latent defects in the planning or construction of improvements to real property must be commenced within ten (10) years after substantial completion of the work of improvement. A defect is latent if the deficiency is not apparent/discoverable by reasonable inspection. Code Civ. Proc., § 337.15, subd. (b). Section 337.15 protects developers, design and engineering professionals, persons who perform construction, and the sureties of such persons. Code Civ. Proc. § 337.15.

Section 337.15 applies to actions based upon breach of contract and tort. Moseley v. Abrams (1985) 170 Cal.App.3d 355. However, the statute does not apply to the following actions: (1) Personal injury or wrongful death actions (Martinez v. Traubner (1982) 32 Cal.3d 755); (2) Nuisance actions under the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (Angeles Chem. Co. v. Spencer & Jones (1996) 44 Cal.App.4th 112); (3) Actions based upon willful misconduct or fraudulent concealment (Felburg v. Don Wilson Builders (1983) 142 Cal.App.3d 383); and (4) Certain product liability actions (Sevilla v. Stearns-Roger, Inc. (1980) 101 Cal.App.3d 608; see also Chevron U.S.A., Inc. v. Superior Court (1994) 44 Cal.App.4th 1009; San Diego Unified School Dist. v. County of San Diego (2009) 170 Cal.App.4th 288 ("When interpreting section 337.15, the courts do not determine when the particular construction defect claim accrued, but rather, the courts measure the timeliness of a cause of action by the date of substantial completion of the improvement. [citation] This approach is consistent with the authority of Chevron . . . in which the court characterized section 337.15 as a 'statute of repose created by the Legislature's fixed starting point and outer limit for latent construction defects'.").

Courts interpreting section 337.15 agree that an action must be filed within the shorter of the limitations and the repose periods. See Lantzy v. Centex Homes (2003) 31 Cal.4th 363, 369-370 (adopting two-step analysis that actions for latent defects based upon fraud or breach of written contract must be filed within three years (Code Civ. Proc. § 338) or four years (Code Civ. Proc. § 337) after discovery, but in any event within ten years (Code Civ. Proc. § 337.15) after substantial completion) (distinguished by McDonald v. Antelope Valley Community College Dist. (2008) 45 Cal.4th 88 (2008) (concluding there is neither an express limit on grounds for tolling, nor, as in Lantzy, a textual or legislative-intent-based rationale that would compel declining to extend the usual rule to FEHA claims, so FEHA claims may be equitably tolled during the voluntary pursuit of alternate remedies).

Finally, SB 800 or California's Right to Repair Act (discussed in more detail, infra, Part IV) creates a slightly more complex process for determining what statutes of limitation and what statutes of repose may apply to any particular construction defect. Civil Code section941 provides that Code of Civil Procedure sections 337.1 and 337.15 (the four-year and ten-year status of repose for patent and latent defects, respectively) do not apply to actions under the Right to Repair Act. Instead, Civil Code section 941, subd. (a) establishes a new statute of repose that expires "10 years after substantial completion of the improvement but not later than the date of recordation of a valid notice of completion." Civ. Code § 941, subd.(a). Section 941, subd. (e) provides that the "time limitations established by this title do not apply to any action by a claimant for a contract or express contractual provision." Civ. Code § 941, subd. (e).

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Moreover, although the Right to Repair Act maintains the 10-year limitation period for actions falling within the ambit of the Act, there are shorter time frames prescribed for certain types of defects. For example, plumbing systems must operate properly for up to four years after the close of escrow. Civ. Code, § 896(e). Irrigation and drainage claims shall operate properly so as not to damage landscaping or other external improvements for up to one year from close of escrow (Civ. Code, § 896, subd. (g)(7)), and painting shall be applied in a manner so as not to cause deteriorating of the building surfaces for up to five years from close of escrow (Civ. Code, § 896, subd. (g)(10)). There are also tolling rules that apply. The limitations period is tolled from the time of the original claim to, for example, 100 days from completion of repairs, or 45 days from response due of an unresponsive builder.

Pre-Suit Notice of Claim and Opportunity to Cure

There are two statutes that establish procedures for pre-litigation notice of claims and the opportunity to cure. One such statute is the Right to Repair Act or SB 800, which applies to residential construction defect actions. Another is the Calderon Amendment to the Davis- Stirling Common Interest Development Act, which applies to a homeowners association's right to sue for construction defects.

Although the two statutes are analogous, there are some significant differences. For example, the pretrial process in the Calderon Amendments are mandatory and involve a minimum 180-day period of information exchange, whereas SB 800's pre-litigation process lasts for a minimum of 101 days and the builder can opt out by using its own non-adversarial contractual provision. SB 800 also contains an express provision excusing compliance with the Calderon Amendments where the requirements of the two statutes are substantially similar. Civ. Code, § 935.

SB 800 applies new procedures and remedies for the making and resolving of construction defect claims for new residential construction. It is codified at Civil Code section 895 et seq. SB 800 applies to all newly constructed residential property intended to be sold as an individual dwelling unit, where the purchase agreement was signed by the seller on or after January 1, 2003. Civ. Code, §§ 896, 938. These provisions are also binding on original purchasers' successors-in-interest. Civ. Code, § 945. The goal of SB 800 is to provide homeowners with a means to have construction defects addressed, while allowing builders the right to fix problems prior to litigation. Another purpose is to stop defect claims for technical code violations, such as improper nail patterns, and instead focus on whether a home functions as "a home," such that the inclusion of the phrase "materially comply" throughout is intended to indicate that minor technical code violations are no longer actionable.

The Right to Repair Act displaces and supplants common law construction defect claims, provides a statutory basis for recovery for construction defects in the absence of property damage; and preserves the status quo for common law claims for personal injuries arising from construction defects. As such, the Right to Repair Act, and its related provisions, constitutes the exclusive remedy for economic losses and property damage arising from construction defects affecting residential construction projects. McMillin Albany LLC v. Superior Court (2018) 4 Cal.5th 241.

Civil Code sections 910 to 938 outline the pre-litigation procedures required under the Right to Repair Act. Section 910 provides that a claimant may not file an action against any party alleged to

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have contributed to a violation of a building standard until the claimant has initiated pre-litigation procedures by providing written notice to the builder. Civ. Code, § 910, subd. (a). If the homeowner does not file a written claim with the builder in advance of filing suit, SB 800 provides for a statutory bar to the action, and a court would have no authority to hear the case and would dismiss the case without prejudice (to be reinitiated after proper exhaustion of the SB 800 process). Civ. Code, § 930, subd. (b).

Note that until service of the notice, the builder has no obligation to respond to requests for documents pursuant to Civil Code section 912 (e.g., builder must provide copies of all relevant plans, specifications pertaining to residence, etc.). But within fourteen days of receipt of the notice, the builder must acknowledge the notice. If the builder does not acknowledge the notice, the pre-litigation procedures do not apply, thus enabling the claimant to file suit against the builder. Civ. Code, §§ 913, 915.

Where there is service of notice, the builder must provide copies of relevant plans and other documents within thirty days thereafter. If a builder fails to comply, then the homeowner may proceed with filing of an action without giving the builder an opportunity to fix the problem. When the builder is in compliance, however, the builder has the right to offer to repair the alleged violation within the timeframe for the repair set forth in the Act. Civ. Code, § 917. Upon receipt of the offer to repair, the homeowner then has thirty days to authorize the builder to proceed. If a builder has complied with the Act's requirements and has completed a repair prior to the filing of an action by a homeowner (and if there has been no previous mediation between the parties), the homeowner is then required to request mediation in writing.

The builder also has the right to inspect and test the alleged violations. Civ. Code, § 916. Within fourteen days after acknowledgement of receipt of the notice of the claim, builders can inspect the claimed unmet standards. Nothing that occurs during an inspection may be used or introduced as evidence to support a spoliation defense by any potential party in a subsequent litigation. Most significantly, if a builder intends to hold a subcontractor, design professional, individual product manufacturer, etc. responsible for its contribution, the builder shall provide notice to that person in advance to allow them to attend the initial inspection.

In short, under the Right to Repair Act, if no offer to repair the alleged defect(s) is made by the builder, or if the builder otherwise fails to adhere strictly to the process, the homeowner may proceed by filing a lawsuit.

Similarly, the California Legislature has established procedural (i.e., meet and confer) prerequisites to a civil action by a homeowners association against a common interest development builder for damages from construction defects. Known as the Calderon Amendment (Civ. Code, § 6000 (previously Civ. Code § 1375)), these prerequisites were added to the Davis-Stirling Common Interest Development Act (Civ. Code §§ 4000-6150). The Calderon Amendment expands the breadth of the prefiling dispute resolution process by involving not only the developer and the owner, but also the general contractor, all subcontractors, design professionals, and insurers of all potentially responsible parties. The Amendment also provided for the appointment of a dispute resolution facilitator to hold prelitigation case management and settlement meetings.

Like SB 800, the underlying objective of the Calderon Amendment is to reduce litigation. The Amendment specifically was enacted to reduce the number of construction defect lawsuits by

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mandating a series of privileged information exchanges and scheduled meetings between potential litigants as a precondition of litigation, through which settlement may be facilitated.

As such, before a homeowners association may file a complaint for damages against a builder, developer, or general contractor based upon a claim for defects in the design or construction of a common interest development project, a dispute resolution process must be followed. Civ. Code, § 6000(a). Civil Code section 6000, subdivisions (b) through (o) mandate a series of notices which commence the 180-day dispute resolution period, information exchanges, physical discovery (inspection and testing), meetings, and privileged communications conducted under the auspices of a dispute resolution facilitator, and involving all potentially responsible parties and their insurers. The Calderon notice tolls all statutes of limitation and statutes of repose by and against all potentially responsible parties regardless of whether they are named in the notice. Civ. Code, § 6000, subd. (c). Moreover, the Calderon process allows the parties to select a neutral dispute resolution facilitator and requires that party representatives and insurance carriers participate with settlement authority in prelitigation negotiations.

The builder, developer, or general contractor may submit a written settlement offer and request a meeting with the association's board. Civ. Code, § 6000, subd. (k). However, if the offer is not timely submitted, the association is relieved of all further Calderon objections. Civ. Code, § 6000, subd. (k)(1)(B). The board must meet to discuss the offer and, if the board rejects the offer, must call a meeting for the association members to consider the offer. Civ. Code § 6000, subd. (k)(1)(D). The respondent must pay the expenses of the meeting, and all discussions are privileged. Finally, defect lists, demands, communications, negotiations, and offers are inadmissible at trial under Evidence Code sections 1119 through 1124. See Civ. Code § 6000, subds. (k)–(l).

On completion of the 180-day dispute resolution process (or possibly 360-day period if an extension of 180-days is granted), if the matter has not been settled, the association may file a complaint, which will be assigned for trial at the earliest possible date. See Civ. Code § 6000(c).

Predicates For Claims Against Design Professionals

A key procedural prerequisite to filing a professional negligence claim against a design professional in California is the certificate of merit mandated by California Code of Civil Procedure section 411.35. The statute applies to every action — including cross-complaints for damages or indemnity — arising out of the professional negligence of a person holding a valid architect's certificate under Business and Professions Code § 5500 et seq., a valid registration as a professional engineer under Business and Professions Code § 6700 et seq., or a valid land surveyor's license under Business and Professions Code § 8700 et seq.

Typically, the attorney has reviewed the facts of the case, consulted with and received an opinion from at least one architect, professional engineer, or land surveyor who (a) is licensed to practice and practices in this state or any other state, or teaches at an accredited college or university and is licensed to practice in this state or any other state, (b) practices in the same discipline as the defendant, (c) is not a party to the litigation, and (d) is reasonably believed by the attorney to be knowledgeable in the relevant issues, and the attorney has concluded on the basis of this review and consultation that there is reasonable and meritorious cause for filing the action. The consulted

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expert must render an opinion that the defendant was or was not negligent in the performance of the applicable professional services.

Insurance Coverage and Allocation Issues

General Coverage Issues

General liability insurance (i.e. insurance that protects the insured against third party liability claims) is involved in practically every construction claim. General liability insurance typically provides defense and indemnity benefits. Commercial general liability (CGL) policies, formerly comprehensive general liability policies, provide broad coverage for liability arising out of property damage (i.e. "physical injury to or destruction of tangible property") and bodily injury (i.e. "bodily injury, disease, or sickness sustained by a person") to third parties. Insurers issuing this form of insurance are obligated to retain the attorneys and consultants necessary to defend the defendants.

To constitute property damage, the damage must be to tangible property. For example, because water intrusion nearly always causes physical injury to tangible property, satisfying the foregoing definition of "property damage" does not generally prove difficult. However, the definition of property damage does raise the question of whether incorporating defective material or workmanship into a building causes physical injury to the structure. See Economy Lumber Co. v. Ins. Co. of North America (1984) 157 Cal.App.3d 641 (examining the viability of the incorporation theory under the revised property damage definition and holding the diminution in value constituted property damage); cf., St. Paul Fire & Marine Ins. Co. v. Coss (1978) 80 Cal.App.3d 888 (holding that, under the definition of property damage, a building contractor's incorporation of both defective workmanship and defective materials in a house was not considered physical injury to the residence).

In contrast to property damage claims, bodily injury claims occur less often in construction litigation and generally are limited to emotional distress claims associated with the alleged deficient work by the contractor or developer. Moreover, the California Supreme Court established an important limitation to bodily injury claims in Waller v. Truck Ins. Exch. (1995) 11 Cal.4th 1, 43 (holding that a CGL policy does not cover emotional distress damages that flow solely from uncovered economic damages).

The most critical exclusion in determining the availability of coverage for construction defect claims is the "work product" or "your work" exclusion, the purpose of which is to exclude coverage for the cost to repair defective work by the insured, generally the contractor. California courts have consistently found this exclusion to bar coverage for the cost to repair the insured's defective work, reasoning that a contractor must be responsible for performing its work in a workmanlike manner. Thus, the contractor cannot be indemnified for its failure to fulfill its contractual obligation to construct the work in accordance with a project's plans and specifications. See Diamond Heights Homeowners Ass'n v. Nat'l Am. Ins. Co. (1991) 227 Cal.App.3d 563 (observing that if a contractor were able to insure the costs of repairing deficient work, it would have less incentive to perform the work without defects in the first instance).

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Another application of the work product exclusion occurs when the insured's defective work damages satisfactory work performed by the insured. See Western Employers Ins. Co. v. Arciero & Sons (1983) 146 Cal.App.3d 1027 (affirming holding in carrier's favor and observing that plain language of contractor's insurance policy extended the work product exclusion to resulting damage not only to defective work but also to satisfactory work).

The work product exclusion covers only property damage to the completed work of others or completed work performed on the insured's behalf. Consequently, an insured seeking coverage for a construction defect claim must demonstrate that its alleged deficient work has caused damage to the work of other trades or to completed work performed on its behalf.

Moreover, the exclusion applies only to damage to the insured's work; thus, damage to the work of others even during the repair of the insured's work is exempt from exclusion. See St. Paul Fire & Marine Ins. Co. v. Sears, Roebuck & Co. (9th Cir. 1979) 603 F.2d 780, 784 (holding that coverage would be afforded for the damage to the work of others "when the Named Insured's product becomes so integrated into other tangible property such that a repair or replacement of that product would entail some injury to or replacement of a part of the existing property which did not originate from the Named Insured"); cf., New Hampshire Ins. Co. v. Vieira (9th Cir. 1991) 930 F.2d 696 (distinguishing Sears on the grounds that the repairing of defective installation required adding not removing the defective material). Thus, Sears and Vieira, when read together, provide that coverage exists when the removal of defective work damages the work of others, but the work product exclusion applies when damage to other work is unavoidable in installing the omitted work.

Trigger of Coverage

In addition to determining whether a claim involves damage sustained during the policy period, it must also be established that the property damage or bodily injury resulted from an occurrence. CGL policies defined "occurrence" as an "accident, including continuous or repeated exposure to substantially the same general harmful conditions."

An occurrence of property damage, not an occurrence of injury to the claimant, triggers coverage. See Century Indem. Co. v. Hearrean (2002) 98 Cal.App.4th 734 (holding coverage was not determined by the occurrence of injury to the particular claimant but by the continuous and progressive injury to the hotel property caused by defective design and construction because to hold otherwise would transform an occurrence-based policy into a "claims made" policy); see also Baroco West, Inc. v. Scottsdale Ins. Co. (2003) 110 Cal.App.4th 96 (denying coverage because damage to property occurred during construction operations, which was excluded under the policy). Finally, California courts have concluded that claims for negligent and intentional misrepresentation do not involve an accident and thus are not covered under a standard CGL policy. See also Miller v. Western Gen. Agency, Inc. (1996) 41 Cal.App.4th 1144.

Even if the damage and occurrence requirements are satisfied, courts must still determine whether the complaining party sustained damage during the policy period. This requirement is often referred to as the "trigger of coverage," i.e., the operative event that must occur during the policy period in order to invoke, or trigger, coverage. In most claims for property damage, including construction defect disputes, the timing of the damages is fairly clear. In some instances, however,

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the timing of the property damage is not so clear. This is because a latent defect may cause damage that first manifests long after it occurred, or the nature of the property damage may implicate one or multiple policies. For example, a single event could result in progressively deteriorating injury, such as poorly installed windows allowing intermittent water intrusion and mold growth and resulting damage.

California courts have adopted the continuous trigger theory of coverage in progressive property damages cases. Liability coverage under a CGL policy for bodily injury and property damage is therefore established at the time the complaining party was actually damaged. Therefore, each insurer that issued a policy during the period that damage potentially occurred must defend the claim. See Montrose Chem. Corp. Admiral Ins. Co. (1995) 10 Cal.4th 645. That is, if the damage is progressively deteriorating over multiple policy periods, the property damage may trigger coverage under each policy in effect during that period. Maryland Cas. Co. v. Nat'l Am. Ins. Co. (1996) 48 Cal.App.4th 1822. Pepperell v. Scottsdale Ins. Co. (1998) 62 Cal.App.4th 1045 reaffirmed this and held that all covering policies effective during the period that damage potentially occurred must defend a construction defect claim.

The significance of Montrose and its progeny to construction defect litigation is that coverage is not limited to the policy in effect at the time when the precipitating event or condition occurred, or to the policy in effect when the property damage first manifested itself. Further, the policy's full limit may be exposed, even if the property damage continues after the policy is terminated. As the California Supreme Court later explained in Aerojet-General Corp. v. Transport Indem. Co. (1997) 17 Cal.4th 38, 56, "if specified harm is caused by an included occurrence and results, at least in part, within the policy period, it perdures to all points of time at which some such harm results thereafter."

Allocation Among Insurers

The duty to defend is broader than the duty to indemnify, because an insurer is obligated to defend its insured against claims that create a potential for coverage under the insured's policy. Thus, even though the allegations may be false or ultimately never proved at trial, they will trigger the insurer's defense obligation if they create a bare potential or possibility of coverage. See Buss v. Superior Court (1997) 16 Cal.4th 35; Montrose Chem. Corp. v. Superior Court (1993) 6 Cal.4th 287. Moreover, the duty to defend arises when the policy is ambiguous, and the insured would reasonably expect coverage. See also La Jolla Beach & Tennis Club v. Indus. Indem. Co. (1994) 9 Cal.4th 27. However, if the claim does not involve damages that possibly occurred during the policy's effective period, there is no defense obligation. See Waller v. Truck Ins. Exch. (1995) 11 Cal.4th 1.

The duty to defend arises when the insured tenders the defense. See Montrose Chem. Corp., supra. Once the defense obligation attaches, it usually continues until the claim is resolved. An insurer's unreasonable refusal to defend an action can subject the insurer to bad faith liability. See Campbell v. Superior Court (1996) 44 Cal.App.4th 1308 (insurer's alleged failure to defend a general contractor that claimed to be an additional insured under a subcontractor's policy).

For example, as noted above, a progressive damage construction defect case creates a unique situation where multiple policies can be triggered. Because California has adopted the

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continuous trigger theory of coverage, construction defect claims often trigger multiple policies to defend the claim. In Aerojet-General Corp. v. Transport Indem. Co., supra, 17 Cal.4th 38, 70, the California Supreme Court established that each carrier has a duty to defend the insured that is "separate and independent" from the duty of other carriers. Moreover, the Aerojet court explained that if covered damages potentially occurred during the insurer's policy period, the insurer is obligated to defend claims of damage occurring outside that policy period if the potential damages relate to harm during that period. Id. at p. 73.

Other hotly contested issues include defense and indemnity between a general contractor and its subcontractors, i.e., allocation between direct coverage and additional insured coverage. Generally, additional insured issues arise because an owner may require the general contractor to name the owner as an additional insured on the contractor's policies. The contractor, in turn, generally instructs and requires the subcontractors to name the contractor and owner as additional insureds on the subcontractors' policies. The purpose of the additional insured endorsement is to receive additional insurance benefits for liability arising out of the work by the principal named as insured under the policy. While the insured has direct rights, a question of allocation occurs once the insured's defense and indemnity has been covered.

Assuming that the general contractor has direct primary insurance, contribution will apply, and the court will equitable distribute costs of defense and indemnity between the triggered policies. Maryland Casualty Co. v. Nationwide Mutual Insurance Co. (2000) 81 Cal.App.4th 1082. The court has wide discretion to do equity to allocate liability. Axis Surplus Ins. Co. v. Glencoe Ins. Ltd. (2012) 204 Cal.App.4th 1214, 1231.

Contractual Indemnification

In 2008, the California Supreme Court issued its ruling in Crawford et al. v. Weather Shield Mfg. Inc. (2008) 44 Cal.4th 541. In its decision, the California Supreme Court dealt with the contractual duty to defend in a non-insurance context. The court summarized the issue as follows: "We consider whether, by their particular terms, the provisions of a pre-2006 residential construction subcontract obliged the subcontractor to defend its indemnitee — the developer- builder of the project — in lawsuits brought against both parties, insofar as the plaintiffs' complaints alleged construction defects arising from the subcontractor's negligence, even though (1) a jury ultimately found that the subcontractor was not negligent, and (2) the parties have accepted an interpretation of the subcontract that gave the builder no right of indemnity unless the subcontractor was negligent."

More specifically, the California Supreme Court posed this question: "Did a contract under which a subcontractor agreed 'to defend any suit or action' against a developer 'founded upon' any claim 'growing out of the execution of the work' require the subcontractor to provide a defense to a suit against the developer even if the subcontractor was not negligent." The California Supreme Court answered this question in the affirmative and ruled that the contractual defense obligation in an indemnity provision of a construction subcontract operates in the same manner as the defense obligation of a general liability policy. The contractual duty to defend is prospective or prophylactic in nature and arises on the tender of defense. Further, the duty to defend is triggered by allegations of damage embraced by the indemnity agreement, regardless of whether the subcontractor is ultimately found negligent.

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Regarding the availability of indemnification for active versus passive negligence, California courts have historically permitted Type 1 indemnity provisions in construction contracts. A Type 1 provision requires a party to indemnify and defend another from any claim arising out of or related to the indemnitor's scope of work, including the active negligence or misconduct of the indemnified party.

Starting in 1967, the California Legislature restricted the ability to contract for Type 1 indemnity in construction contracts. Civ. Code, section 2782. Thus, subject to very limited exceptions, California's construction contract anti-indemnity statute (Civ. Code, § 2782) makes broad form indemnity provisions unenforceable by prohibiting a party from requiring indemnity against its own sole negligence or willful misconduct.[1] 2 The practical effect of Civil Code section 2782 is that no one can be forced to indemnify another party for that other party's sole negligence or willful misconduct. A recent expansion of this law makes clear that indemnity for active negligence is also generally unenforceable for both public and private contracts entered into on or after January 1, 2013.

However, Civil Code section 2782 does not prevent a party to a construction contract and the owner from negotiating and expressly agreeing to allocate, liquidate, or limit liability between themselves for design defects or other liability arising from the contract. Civ. Code § 2782.5. Section 2782.5 provides: "Nothing contained in Section 2782 shall prevent a party to a construction contract and the owner or other party for whose account the construction contract is being performed from negotiating and expressly agreeing with respect to the allocation, release, liquidation, exclusion, or limitation as between the parties of any liability (a) for design defects, or (b) of the promisee to the promisor arising out of or relating to the construction contract."

The California Legislature enacted Civil Code section 2782 because of the increasing use of hold-harmless agreements in construction contracts. Such hold-harmless agreements attempted to shift, to general contractors, responsibility for liabilities not historically the general contractors', such as liability for latent defects in a building caused by negligence of the [owner's] architect or engineer. Thus, while section 2782 was intended to eliminate indemnity agreements forced upon parties to construction contracts, and which required the promisor to indemnify the promisee for the promisee's sole negligence, section 2782.5 was enacted to permit parties to continue to

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[1] Civil Code section 2782(a) provides as follows:

> Except as provided in Sections 2782.1, 2782.2, 2782.5, and 2782.6, provisions, clauses, covenants, or agreements contained in, collateral to, or affecting any construction contract and that purport to indemnify the promisee against liability for damages for death or bodily injury to persons, injury to property, or any other loss, damage or expense arising from the sole negligence or willful misconduct of the promisee or the promisee's agents, servants, or independent contractors who are directly responsible to the promisee, or for defects in design furnished by those persons, are against public policy and are void and unenforceable; provided, however, that this section shall not affect the validity of any insurance contract, workers' compensation, or agreement issued by an admitted insurer as defined by the Insurance Code.

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negotiate and limit their respective liability to each other. See Markborough California, Inc. v Superior Court, 227 Cal App 3d 705 (1991).

Also of significance is Civil Code section 2782.05, which the California Legislature added in 2012. As explained above, section 2782 protects certain contractors, subcontractors, and suppliers from having to indemnify public or private owners for the owners' active negligence. The more recently enacted section 2782.05 expands the protections for subcontractors under new contracts. Section 2782.05 extends the provisions of section 2782 to any construction contract executed on or after January 1, 2013. The statute prohibits indemnity provisions that attempt to shift liability or defense obligations for the active negligence of the party to be indemnified. Although it is not applicable in a number of circumstances, including residential projects, section 2782.05 now prevents other participants from imposing certain indemnity, insurance, and defense duties on subcontractors.

Specifically, Civil Code section 2782.05 provides that construction subcontracts may not require a subcontractor to indemnify, defend, or insure a general contractor, construction manager or other subcontractor for: (1) claims of personal injury or property damage or other loss to the extent that the claims relate to the active negligence or willful misconduct of the indemnified parties; (2) claims that arise from any defects in designs provided by the indemnified parties; or (3) claims that do not arise out of the subcontractor’s scope of work set forth in the subcontract. That is, general contractors, subcontractors and construction managers may not obtain indemnity for their own active negligence or willful misconduct, nor may they obtain a defense against allegations of their active negligence or willful misconduct. However, indemnity may still be required for the owner or general contractor’s “passive negligence.” In other words, the Legislature has provided that the parties may enter into certain types of agreements, as long as the indemnitee cannot avoid its obligations for its active negligence or willful misconduct. Passive negligence (such as failure to discover a dangerous condition) on the part of the general contractor is still subject to indemnity.

Note that the Legislature has placed the onus on the party seeking indemnification to notify the indemnitor of their demand to indemnify. Section 2728.05 provides that the subcontractor has no obligation to defense or indemnify the general contractor until the general contractor provides a written tender of the claim. Likewise, the new regime adds two further subcontractor protections. A subcontractor can no longer be forced to indemnify or insure a general contractor or another subcontractor (or their agents) for defects in the project's design provided by them to that subcontractor, or to the extent the claims at issue arise outside the scope of that subcontractor's work. Civil Code, § 2782.05, subd. (a).

In short, the California Legislature has taken big steps towards holding construction participants accountable for their own "active negligence" by not allowing them, in many circumstances, to foist their liability onto other participants. Additional protections have been added to protect a subcontractor from having to indemnify other participants for their active negligence, for defects in the project's design, and for claims arising outside the scope of the subcontractor's work.

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Contingent Payment Agreements

A contingent payment clause is a contractual provision that makes payment contingent upon the happening of some event. In construction subcontracts, the typical contingent payment clause makes the subcontractor's payment contingent upon the payment of the contractor by the owner. Such clauses take on one of two forms in subcontract agreements. Some clauses link the timing of the subcontractor's payment to the time when payment is made by the owner ("pay-when-paid clauses"). Other clauses specify that the owner must pay the contractor in order for the subcontractor to ever receive payment ("pay-if-paid clauses").

Enforceability

In California, "pay-if-paid" clauses are unenforceable because they unlawfully inhibit subcontractor's mechanics lien rights. William R. Clark Corp. v. Safeco Ins. Co. (1997) 15 Cal.4th 882. Because Civil Code section 3262 prevents a waiver of lien rights, "pay-if-paid" provisions are prohibited for their indirect effect on lien rights. A pay-if-paid clause is, in essence, an indirect forfeiture of a subcontractor's constitutionally protected lien rights. As noted herein, a subcontractor may not waive its mechanics lien rights except under certain specific circumstances. Civil Code, § 8122.

As to pay-when-paid clauses, those are upheld as valid and enforceable, but the contractor may avoid payment for a reasonable period of time only. Yamanishi v. Bleily & Collishaw, Inc. (1972) 29 Cal.App.3d 457, 462; see also William R. Clark Corp., supra, 15 Cal.4th at p. 885. As noted by the California Supreme Court: "[I[f reasonably possible, clauses in construction subcontracts stating that the subcontractor will be paid when the general contractor is paid will not be construed as establishing true conditions precedent, but rather as merely fixing the usual time for payment to the subcontractor, with the implied understanding that the subcontractor in any event has an unconditional right to payment within a reasonable time." William R. Clark Corp., supra, 15 Cal.4th at p. 885. See also, Crosno Construction, Inc. v. Travelers Cas. & Sur. Co. (2020) 47 Cal.App.5th 940.

Requirements

As noted above, only pay-when-paid clauses are enforceable. The contractor may avoid payment, but only for a reasonable amount of time. A pay-when-pay clause is valid and allows the general contractor to delay payment to the subcontractor for a reasonable time while awaiting payment from the owner.

The net effect of the William R. Clark Corp. Supreme Court decision is that the contractor must pay the subcontractor whether or not the owner pays the contractor and regardless of what is in the contract.

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Damages Limitation

Personal Injury Damages vs. Construction Defect Damages and the "Economic Loss Rule"

In Aas v. Superior Court (2000) 24 Cal.4th 627 the California Supreme Court held that homeowners could not recover in negligence against defendant developers of a condominium project for prospective property damage from construction defects – the so-called "economic loss rule." The economic loss rule precludes tort recovery in the absence of personal injury or property damage. In Aas, the California Supreme Court explained that under the economic loss rule, "appreciable, nonspeculative, present injury is an essential element of a tort cause of action." Aas, supra 24 Cal.4th at p. 646. As such, "Construction defects that have not ripened into property damage, or at least into involuntary out-of-pocket losses. do not comfortably fit the definition of 'appreciable harm'–an essential element of a negligence claim." Id.

In 2002, the California Legislature responded by passing comprehensive construction defect litigation reform, commonly known as the Right to Repair Act, Civil Code sections 895–945.5. The Act sets forth detailed statewide standards that the components of a dwelling must satisfy. It also establishes a prelitigation dispute resolution process that affords builders notice of alleged construction defects and the opportunity to cure such defects, while granting homeowners the right to sue for deficiencies even in the absence of property damage or personal injury. The Right to Repair Act specifically provides that upon a showing of violation of an applicable standard, a homeowner may recover economic losses from a builder without having to show that the violation caused property damage or personal injury. In such an instance, the Act abrogates the economic loss rule, thus legislatively superseding Aas v. Superior court, and allows plaintiff homeowners to recover for prospective property damage in this circumstance.

Proof of actual damage to real property is not required for most of the stated actionable defects. If a claim for damages is made under the Act, the homeowner is entitled to damages for the reasonable value of repairing any violation of the standards defined under the Act, the reasonable costs of repairing any damage caused by the repair efforts, the reasonable cost of repairing and rectifying any damages resulting from the failure to meet the standards, the reasonable cost of removing and replacing any improper repair by the builder, reasonable relocation and storage expenses, lost business income if the home was used as a principal place of business.

That being said, Civil Code section 944 of Right to Repair Act provides a "limitation" on what damages are recoverable by a claimant, including but not limited to: reasonable value of repairing any violation of the standards, reasonable cost of repairing any damages caused by repair efforts, reasonable cost of repairing and rectifying any damages resulting from the failure of the home to meet the standards, and reasonable investigative costs for each established violation.

In McMillin Albany LLC v. Superior Court (2018) 4 Cal.5th 241, the California Supreme Court found that the Act is the virtually exclusive remedy not just for economic loss but also for property damage arising from construction defects. Thus, a common law action alleging construction defects resulting in both economic loss and property damage is subject to the Act's prelitigation notice and cure procedures.

As to emotional distress damages, in Erlich v. Menezes, 21 Cal.4th 543 (1999), the California Supreme Court held that homeowners cannot recover emotional distress damages for

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negligent construction of their homes when negligence directly causes only economic and property damage and no independent tort duty is breached. As such, the available damages for defective construction are limited to the cost of repairing the home or the diminution in value, whichever is less.

Attorney's Fees Shifting and Limitations on Recovery

California follows the American Rule whereby each party must pay his or her own attorney fees, except as specifically provided for by statute or agreement of the parties. Code Civ. Proc., § 1021. Civil Code section 1717 governs attorney fees awards for enforcing contracts that include fee-shifting clauses. Section 1717 awards attorney fees to the party prevailing on the contract in any action on a contract where the contract specifically provides for an award of attorney's fees and costs incurred to enforce the contract.

Specifically pursuant to California's mechanics lien law, the prevailing party is entitled to reasonable attorney fees in an action to enforce payment of the claim stated in a bonded stop payment notice. Civ. Code, § 8558. Previously, the prevailing party in an action to release a property from a mechanic's lien could only recover a maximum of $2,000 in attorneys' fees. Recent amendments to the statute removed that cap and a prevailing party is now entitled to recover its reasonable attorney fees.

Finally, note that under Code of Civil Procedure section 1029.8, an unlicensed person who causes injury or damage as a result of providing goods or services for which a license is required may be liable for attorney fees in the discretion of the court, unless the person had a good faith belief that he or she was licensed. Treble damages may also be recovered within the court's discretion.

Consequential Damages

Contractual provisions that mutually waive the rights of the owner and contractor to recover consequential damages are frequently used in construction contracts. Consequential damages are those that do not follow directly and immediately from breach of contract (direct damages), but follow instead from some of the consequences of the breach. The most common example in the construction context is lost profits.

When a party breaches a construction contract, the law requires the non-breaching party to be placed in the position that it would have been but for the breach. The non-breaching party can recover both direct/general damages or indirect/consequential damages. To be recoverable, however, consequential damages must be contemplated by the parties at the time of contracting. Parties to a contract are deemed to have expected the normal and usual risks in the absence of specific contractual language to the contrary. Accordingly, general or direct damages, which represent the normal and expected risks, are always recoverable. However, consequential damages, which represent additional risks due to unusual circumstances of the non-breaching party, are not awarded unless the non-breaching party can establish that the parties were aware of the special circumstances at the time they entered into the contract.

Waiver of consequential damages between sophisticated parties is generally enforceable. Cal. Com. Code § 2719(3). But courts will not enforce a waiver that is unconscionable, against public policy, or prohibited by statute. Some courts will enforce consequential damages waivers to narrow

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the issues to be resolved without a trial. Other courts find that it is a question of fact for a jury to decide whether certain categories of damages are consequential and thus barred. Thus, even where the parties have agreed to waive their right to recover all consequential damages, courts may still find that whether a particular damage is a consequential damage is a question of fact that should be decided by a jury. As such, owners and contractors should retain counsel to carefully draft consequential damages waivers to fit the particular type of construction project at issue to increase the odds that: (1) the parties will not dispute what types of damages are recoverable under the contract; and (2) if there is such a dispute, the waiver will be found to be enforceable.

In short, both owners and contractors should avoid general boilerplate or "catch-all" consequential damages waivers that do not define what the parties mean by consequential damages. Waivers should be project specific in that they should anticipate and define the potential types of damages that could arise with this project and ensure they are clearly waived.

Delay and Disruption Damages

Homeowners are entitled to damages for losses suffered because completion of the project was delayed beyond the completion date provided in the contract. The damages are based on a cause of action for a breach of the contract. The measure of damages is the rental value of the property, or other value of the loss of the use of the property, during the period of delay. Amerson v. Christman (1968) 261 Cal.App.2d 811, 824–825. In addition, as noted herein, California courts also allow for any other losses that are foreseeable and naturally result from the damage caused to the owner's property, including lost profits during the period repairs are being performed. Diamond Springs Lime Co. v. American River Constructors (1971) 16 Cal.App.3d 581, 598–599.

Interest

Under Civil Code section 3287, "A person who is entitled to recover damages certain, or capable of being made certain by calculation . . . is entitled also to recover interest thereon from that day . . . ." Damages are deemed certain or capable of being made certain within the provisions of section 3287 where there is no dispute between the parties concerning the basis of computation of damages if any are recoverable but where their dispute centers on the issue of liability giving rise to damage." Esgro Central, Inc. v. General Ins. Co. of America (1971) 20 Cal.App.3d 1054.

Punitive Damages

Punitive or exemplary damages are permitted in California in actions not arising from a contract where a defendant is guilty of oppression, fraud, or malice. Civ. Code, § 3294. As such, tort liability is a necessary predicate for punitive damages.

Liquidated Damages

Liquidated damages are an attempt by owners and contractors to arrive at some modicum of certainty regarding the amount of damages in the event of construction delays. In California, liquidated damages are governed by Civil Code section 1671, which provides in pertinent part: "[A] provision in a contract liquidating the damages for the breach of the contract is valid unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made."

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However, California courts have struggled with awarding liquidated damages when forced to apportion among the owner and contractor. In Gogo v. Los Angeles County Flood Control Dist. (1941) 45 Cal.App.2d 334, the Court refused to award liquidated damages to the owner where delays were caused by both parties:

> The correct rule is that where such delays are occasioned by the mutual fault of the parties the court will not attempt to apportion them but will refuse to enforce the provision for liquidated damages. There is no way for summing up the defaults of each and apportioning the damages to them, but the whole must be allowed or none; and, as all cannot be, none must be.

Id. at 344.

In Peter Kiewitt Sons' Co. v. Pasadena City Junior College Dist. (1963) 59 Cal.2d 241, the California Supreme Court similarly refused to award an owner liquidated damages:

> An owner who is a party to a construction contract is a creditor. . . [and] in the absence of a contractual provision for extensions of time, the rule generally followed is that an owner is precluded from obtaining liquidated damages not only for late completion caused entirely by him but also for a delay to which he has contributed, even though the contractor has caused some or most of the delay.

Id. at 244-245.

See also, Aetna Cas. & Sur. Co. v. Board of Trustees (1963) 223 Cal.App.2d 337.

However, two California cases have allowed for apportionment of liquidated damages between owner and contractor: Nomellini Constr. Co. v. Cal. Dep't of Water Resources (1971) 19 Cal.App.3d 240 and Jasper Construction, Inc. v. Foothill Junior College Dist. (1979) 91 Cal.App.3d 1. Nevertheless, both cases addressed liquidated damages provisions prior to the enactment of Civil Code section 1671.

One way for owners and contractors to avoid the uncertainties encountered with delays and liquidated damages is to include contractual provisions that mandate apportionment of where both sides contribute to the delay. For example:

> Contractor and Owner understand and agree that if the work is not completed within the time specified, damages will be sustained by the Owner, and that it is impracticable or extremely difficult to determine the actual damages which the Owner will sustain in the event of and by reason of such delay. Therefore, it is stipulated that the Contractor will become liable to the Owner for the sum of $_____ per day for each and every day's delay beyond the time specified. However, said damages shall be apportioned among Contractor and Owner according to each parties' comparative fault.

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Stipulations for entry of judgment may not be enforceable as a liquidated damage component under Civil Code section 1671(b). Graylee v. Castro, (2020) 52 Cal. App. 5th 1107.

Other Damage Limitations

Expert costs incurred investigating how to repair construction defects (known as Stearman costs or fees) are recoverable as damages without any contractual provision. Stearman v., Centex Homes (2000) 78 Cal.App.4th 611, 625; see also Civil Code § 3333. Civil Code section 3333 provides that the measure of damages is the amount that will compensate for all the detriment proximately caused by the breach. The expenses incurred by a party in having professionals investigate construction deficiencies in order to formulate an appropriate repair plan are inclusive of the costs of remedying the defects and are recoverable as part of the cost of repair. Stearman, supra, at pp. 624-25.

The Right to Repair Act, supra, also specifically provides for recovery for investigative costs. Civil Code § 944. In contrast, expert costs incurred to prove up or defend a litigated case ordinarily are not recoverable as costs in the absence of an attorney's fees clause in a contract, or a statutory settlement offer. But contractual attorney fees provisions often support recovery of costs of experts incurred in litigation.

Cases of Interest Update

Care, Custody Or Control Exclusion. In McMillin Homes Construction v. Natl. Fire & Marine Ins. Co. (2019) 35 Cal.App.5th 1042, a California appeals court held that a "care, custody or control" exclusion did not bar coverage for defense of a general contractor as an additional insured under a subcontractor's policy, because the exclusion requires exclusive control. But the specific facts and allegations of the lawsuit posed a possibility of shared control with the subcontractor.

Mechanics Liens. In Carmel Development Company, Inc. v. Anderson (2020) 48 Cal.App.5th 492, the court of appeals upheld the right of a creditor to determine payment allocation, and addressed applicable interest rates for prejudgment interest in a foreclosure action.

Licensure. In Eisenberg Village of the Los Angeles Jewish Home for the Aging v. Suffolk Construction Co. (2020) 53 Cal.App.5th 120, the court applied a one year statute of limitations to the remedy of disgorgement without proof of injury, as compensation against an unlicensed contractor.

Latent Defect Trigger**.** In Guastello v. AIG Specialty Ins. Co. (2021) 61 Cal.App.5th 97, the court held, in a case involving a claim for latent construction defect damages, that a motion for summary judgment was not appropriate for determining whether property damage has occurred during the policy period.

Lack of Contractual Privity. In *Lynch v. Peter & Associates, Engineers, Geologists, Surveyors, Inc.,* (2024) 104 Cal.App.5th 1181 (2024), the Court addressed the legal duty of care owed by construction professionals – specifically geotechnical consultants – to property owners with whom they are not contractual privity. The case reaffirms prior caselaw and represents the growing

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willingness of courts to impose liability beyond contract boundaries, especially in residential construction.

Contract Law, Incorporating By Reference. In Remedial Constr. Servs. LP v. AECOM, Inc.(2021) 65 Cal. App.5th 658, the court of appeal limited the effectiveness of contractual incorporation of terms by reference, in holding that an arbitration provision in a prime contract as incorporated in a subcontract was unenforceable as against the subcontractor.

Faulty Workmanship/Design Exclusion in Builders Risk Policy. In Webcor-Obayashi Joint Venture v. Zurich American Ins. Co. (2021) 476 F.Supp.3d 987, the court applied a "divisibility" approach to deny the carrier's motion for summary judgement. The court held that the presence of faulty design or workmanship did not preclude a finding of covered property damage.

Property Damage, Work Product Exclusions. In Pacific Bay Masonry, Inc. v. Navigators Specialty Ins. Co. (2021) 561 F. Supp.3d 881, the court held that while the insured's own work product was damaged and therefore at issue, coverage could still exist where such damage was potentially caused by another subcontractor.

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