Courts Differ Over Who Can Sue for Construction Defects

Focus Column

Construction Defects

By Daniel Lee Jacobson

When it comes to construction defects, in whom does the right to sue in tort accrue - the original owner of a piece of real property or the subsequent owner? An examination of three leading state Court of Appeal cases reveals that there are two opposing answers to this question.

The split of authority is over whether the "discovery rule" applies to the issue of when a construction defect action accrues in tort. Under the discovery rule, an action accrues when the factual basis for a suit is or reasonably should have been discovered. *Leaf v. City of San Mateo* 104 Cal.App.3d 398 (1980) (disapproved on another point in *Trope v. Katz* 11 Cal.4th 274 (1995).

One line of Court of Appeal cases holds that only the original property owner "owns" a cause of action for construction defects. These cases announce that accrual of an action happens at the moment that there is "actual and appreciable harm" to the property. Under this theory a subsequent owner would have no cause of action if such actual and appreciable harm occurred before the subsequent owner took ownership of the property.

Another line of cases embraces the discovery rule and says that a cause of action accrues in a subsequent owner if that subsequent owner is the first to discover actual and appreciable harm to the property.

Keru Investments Inc. v. Cube Co. 63 Cal.App.4th 1412 (1998), decided by the 2nd District Court of Appeal, and *Krusi v. S.J. Amoroso Construction Co.* 81 Cal.App.4th 995 (2000), decided by the 1st District Court of Appeal, teach that the right to bring a construction defect case in tort accrues in the original owner.

The May 20 case of *Siegel v. Anderson Homes* 2004 DJDAR 6005 (Cal. App. 5th Dist. May 20, 2004), decided by the 5th District Court of Appeal, professes that the discovery rule applies to such cases, and thus the right to sue might accrue in the original owner - or it might accrue in a subsequent owner, depending upon the timing of the discovery (or the timing of when there reasonably should have been such discovery).

Keru dealt with a general contractor's 1988 seismic retrofit to an apartment building. Despite the retrofit, the building allegedly suffered severe damage during the 1994 Northridge earthquake. After the earthquake the building was sold to Keru Investments, the subsequent owner.

The land sales contract had a clause in it stating that the subsequent owner was taking the building "as is" and that it knew that the building had suffered "severe earthquake damage." Nonetheless, the subsequent owner sued the seismic retrofit contractor for negligence. The *Keru* court observed, "not only was the defective construction work done on behalf of a previous owner, the building itself sustained the damage for which ... [the subsequent owner] seek[s] recovery prior to the transfer of ownership ... This leads to the question of whether ... [the subsequent owner] suffered any injury for which tort recovery is warranted."

The subsequent owner argued that it had not discovered the damage until the property had been transferred to it. (Somehow it made this argument even in light of the land sales contract's explicit acknowledgment of at least some of the

damage.) The court generally defined when a cause of action accrues.

'"A cause of action accrues at the moment the party who owns it is entitled to bring and prosecute an action thereon.' [Citations.]" "That is said to occur when '... events have developed to a point where plaintiff is entitled to a legal remedy, not merely a symbolic judgment such as an award of nominal damages.'" [Citation.]

Then the court applied that general definition to the facts of the case. "Under this definition of accrual, a tort cause of action arose against appellant [the contractor] either when the defective work was completed or when the building sustained damage as the result of the Northridge earthquake. Neither the wrongful act [the performing the retrofit in a negligent manner] nor the damages [which happened during the 1994 earthquake] occurred while Keru Investments was the owner."

The court decided that standing to sue accrued in the original owner, and not the subsequent owner, because the actual and appreciable harm happened to the building when the original owner owned it. In coming to this conclusion the court relied in part on *Vaughn v. Dame Construction Co.* 223 Cal.App.3d 144 (1990). The *Vaughn* court had to decide "whether a real party in interest somehow loses standing to sue for damages suffered as a result of defective construction by the subsequent sale of the defective premises." In other words, *Vaughn* looked at the accrual issue from the opposite end than did *Keru*. In *Vaughn* the plaintiff sold the property, and then made a claim for construction defects.

The *Vaughn* court observed, "the real party in interest is the party who has title to the cause of action, i.e., the one who has the right to maintain the cause of action. ... [T]he essential element of the cause of action is injury to one's interests in the property - ownership of the property is not [an essential element]." So, even though the plaintiff no longer owned the property, the plaintiff had owned the property when it experienced actual and appreciable harm, giving the plaintiff standing to sue. Perhaps to assuage the fears of the defendant of perpetual litigation from continually succeeding owners, the *Vaughn* court said, "Since it was the plaintiff's interest in the property which was injured by the defendant's defective construction, she is the owner of the cause of action entitled to maintain the present action." "No one other than plaintiff can recover for the damages she sustained as owner of the property at the time the injury occurred."

In answer to the argument that the cause of action should accrue upon discovery of damage, the *Keru* court said, "Respondents cannot claim to own the cause of action simply because they discovered the reason for the damage after the building was transferred. Under respondents' reasoning, every party who purchased a hulk of a building would automatically have a right to bring a lawsuit if they could find some previously unknown factor which contributed to the building's destruction."

So, *Keru* stands for the proposition that accrual of a construction defect action in tort does not exist in a subsequent owner. But, note that (a) *Keru* recognized that the question is who owns the cause of action, as opposed to who owns the real property; (b) in *Keru* the original owner had discovered the actual and appreciable harm before the sale to the subsequent owner; and (c) despite its protestations to the contrary, the subsequent owner knew of at least some of the construction defects upon taking title to the building. So, there wasn't an issue as to what happens to a subsequent owner who is the first to discover the defects, and who first discovers those defects after buying the impacted property.

Two years after *Keru* came *Krusi v. S.J. Amoroso Construction Co.* 81 Cal.App.4th 995 (2000). *Krusi* dealt with a commercial building. The fourth owners of the building brought a construction defect negligence action against

the original architects and contractors who designed and built the building. (The first two owners were related entities, and it is unclear as to whether the third owner was related to the first two.)

Prior to the fourth owners' (the subsequent owners') purchase, the third owner discovered manifestations of construction defects (leaks and a problem with the gypcrete underlayment on the second floor). There is an indication that the price of the building may have been reduced because of the cost of repairing the leaks.

The subsequent owners claimed that the only defective conditions about which they knew before they bought the building were the leaks, and those they thought had been fixed.

They contended that since their purchase of the building it "has sustained damages such as new leaks in the decks and deteriorating interior underlayment on the second floor." They claimed that those conditions resulted from "building wide deficiencies in the original design and construction of the subject building," and that the "nature and cause for the defects and resultant damages ... were not and are not exposed, open or evident without an invasive inspection," and that they would not be apparent to laymen.

The *Krusi* court cited *CAMSI IV v. Hunter Technology Corp.*, 230 Cal.App.3d 1525 (1991) for the rule that "a cause of action for damage to real property accrues when the defendant's act causes '"immediate and permanent injury"' to the property or, to put it another way, when there is 'actual and appreciable harm' to the property." It cited *San Francisco Unified School District v. W.R. Grace & Co.*, 37 Cal.App.4th 1318 (1995), for the rule that a property damage case accrues "when 'damage' or 'physical injury to property' occurs."

As did *Keru*, the *Krusi* court recognized *Vaughn* and its admonishment that, "No one other than plaintiff can recover for the damages she sustained as owner of the property at the time the injury occurred."

With these precedents in mind the *Krusi* court stated its rule. "[I]f owner number one has an obviously leaky roof and suffers damage to its building on account thereof, a cause of action accrues to it against the defendant or defendants whose deficient design or construction work caused the defect.

"But, if that condition goes essentially unremedied over a period of years, owners two and three of the same building have no such right of action against those defendants, unless such was explicitly (and properly) transferred to them by owner number one. But owners two and three could well have a cause of action against those same defendants for, e.g., damage caused by an earthquake if it could be shown that inadequate seismic safeguards were designed and constructed into the building. Such is, patently, a new and different cause of action."

But, note that the *Krusi* court took pains to explain that the subsequent owners' claims of new and different defects were belated and contradicted other evidence put forth by the subsequent owners themselves.

So, in *Krusi*, as in *Keru*, there is stated a strong rule of accrual at the time of actual and appreciable injury. Note the underlying similarities between *Keru* and *Krusi*: (a) both recognized that the question is who owns the cause of action, as opposed to who owns the real property; (b) both observed that the original owner had discovered the actual and appreciable harm before the sale to the subsequent owners; and (c) in both the subsequent owners had at least some knowledge about some of the defects prior to their purchase of the property.

In *Siegel*, two people each purchased a home built by Anderson Homes. They did not purchase the homes from Anderson, they were subsequent purchasers.

Like the *Keru* and *Krusi* courts, the *Siegel* court recognized that the question is who owns the cause of action, as opposed to who owns the real property. Unlike the previous owners in *Keru* and *Krusi*, the previous owners in

Siegel knew nothing of the alleged construction defects.

Also unlike the facts in *Keru* and *Krusi*, the *Siegel* subsequent owners knew nothing about any construction defects before they purchased their homes. (Or, at least the *Siegel* court assumed that this was the state of the facts for the purpose of its opinion.)

So, while the *Keru* court, faced with a subsequent owner who knew of the construction defects, if not the cause of those defects, was concerned about embracing a discovery rule that would allow "every party who purchased a hulk of a building [the ability to] ... automatically have a right to bring a lawsuit if they could find some previously unknown factor which contributed to the building's destruction," the *Siegel* court was faced with subsequent owners who knew nothing about the construction defects.

Thus, the *Siegel* court was concerned about embracing a rule of accrual at the time of property damage that would be "'manifestly unjust ... [in that it would] deprive plaintiffs of a cause of action before they are aware that they have been injured.'" *Siegel*, citing *Leaf*, supra (*Leaf* disapproved a different point in *Trope*.).

Commenting on the rule announced in *Keru* and *Krusi*, the *Siegel* court said, "We disagree with the definition [of accrual of a construction defect action] insofar as it fails to take account of the owner's discovery of the damage, and we believe it was unnecessary to employ this very restrictive definition of accrual to reach the results in *Keru* and *Krusi*."

In trying to reconcile the law, facts, and policy concerns raised by *Keru*, *Krusi*, *Vaughn*, *CAMSI IV* and its own case, the *Siegel* court stated a rule that may satisfy all of those things, "The answer seems to be that the cause of action belongs to the owner who first discovered, or ought to have discovered, the property damage.

"It is only then that some entity capable of maintaining a legal claim will have suffered a compensable injury, e.g., the cost of repair and/or the loss in the property's value (inasmuch as the owner then has a duty to disclose the damage to potential buyers). This rule is entirely consistent with the results in both *Keru* and *Krusi* (if not with their statements of the rule)."

Daniel Lee Jacobson is an attorney at Veatch, Carlson, Grogan & Nelson and a professor at Pacific West College of Law.