Snell & Wilmer L.L.P.

UNDER CONSTRUCTION

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contents

Message from the Editor:

This month's Under Construction newsletter highlights a recent ruling from the Arizona Court of Appeals in a case called *The Lofts at Fillmore Condominium Association v. Reliance Commercial Construction, Inc.* regarding implied warranty claims to non-vendor homebuilders. Next, we highlight recent developments in the Colorado construction law. These developments include an enactment of an anti-indemnity statute, limitations in recovery in residential construction contracts, alternative procurement methods for public projects, and surveyor license requirements for basic control for engineering projects.

Finally, we will also highlight new Utah cases from the New Year and how they may affect your organization. These new cases come from two decisions from the Utah Court of Appeals and provide analysis to parties of construction agreements, regarding prejudgment interest and the joint check rule.

These above topics, addressed in this newsletter, can serve as a reference to provide awareness of legal updates in the construction industry throughout our regional practice area. Under Construction is provided as a service to highlight legal trends and issues commonly faced. Please contact us if you have any questions or suggestions. Let us know how we can improve this publication to provide even more value to you.

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Arizona Court of Appeals Precludes Application of Implied Warranty Claims to Non-Vendor Homebuilders

By Ron Messerly and Kelly Kszywienski


The Arizona court of appeals recently ruled in *The Lofts at Fillmore Condominium Assoc. v. Reliance Commercial Construction, Inc.* (Nov. 2007) ("*Lofts*") that owners of residential property cannot seek recovery from homebuilders under the implied warranty of habitability unless: (1) the owner had a contract with the homebuilder; or (2) the homebuilder was also the vendor of the property to a predecessor in interest to the owner. Arizona law has long imposed an implied warranty of habitability and workmanlike construction in residential construction. This implied warranty permits a purchaser to seek damages for latent defects in the home, even if the contract did not explicitly provide such a remedy. Because the implied warranty of habitability and workmanlike construction is based on the contractual expectations of the parties, it is generally available only to the parties to the contract. However, in 1984, the Arizona Supreme Court carved out an exception to this general rule for claims against homebuilder-vendors. In *Richards v. Powercraft Homes, Inc.* (1984) ("*Richards*"), the Arizona Supreme Court permitted a subsequent purchaser of residential property to recover against a homebuilder-vendor for "latent defects which become manifest after the subsequent owner's purchase and which were not discoverable had a reasonable inspection of the structure been made prior to purchase."

In *Lofts*, the Arizona Court of Appeals refused to extend the *Richards* exception to homebuilders who are not also the vendors of the residential unit. In *Lofts*, two developers contracted with Reliance Commercial Construction to construct condominiums, which the developers then sold to The Lofts at Fillmore Condominium Association ("Association"). The Association, in turn, sold the condominiums to individual condominium owners. When the Association (as to the common elements) and the condominium owners (as to the condominium units themselves) discovered latent defects in the properties, they had no traditional contractual remedies to pursue against Reliance because neither the Association nor its members had a contractual relationship with Reliance. Thus, the parties attempted to assert a claim against Reliance under the implied warranty of habitability and workmanlike construction.

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The Association argued that the *Richards* exception should apply to its claim against Reliance because the public policy that imposed liability on homebuilder-vendors should also apply to homebuilders regardless of whether they were also vendors of the property. Alternatively, it argued that Arizona law recognizes implied warranties irrespective of the contractual relationship between the parties. Both the trial court and the court of appeals rejected these arguments, granting and affirming summary judgment for Reliance on the Association's implied warranty of habitability claim, and holding that the *Richards* exception applies *only* to homebuilder-vendors, or "a contractor who also sells to a purchaser who will live in the home."

In rejecting the Association's claim, the Court of Appeals noted the purpose underlying the *Richards* exception, that "public policy favored protection of innocent purchasers against builder-vendors who tend to be larger, more sophisticated entities." Despite the Association's contention that "no single entity builds and sells homes anymore," the Court of Appeals refused to extend that public policy to homebuilders that are not also the vendor of the property, finding that only the legislature—not the court—has the authority to determine the public policy for the state. Further, the court held that the cases the Association relied on did not support its claim that implied warranties exist separate from contractual remedies, because in each case a contractual relationship *did* exist between the parties.

As a result of the *Lofts* decision, it appears that residential contractors will only face liability to homeowners for latent defects that arise after construction if: (1) the contractor had a direct, contractual relationship with the homeowner; or (2) the contractor is a builder-vendor and the *Richards* exception applies. Where a residential contractor's client is the developer, rather than the homeowner, the *Lofts* opinion indicates that the homeowner has no remedy against the contractor based on breach of the implied warranty of habitability.

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Recent Developments In Colorado Construction Law

By Scott Sandberg

Anti-Indemnity

Colorado recently enacted anti-indemnity legislation that significantly affects the enforceability of indemnification provisions in Colorado construction contracts. Under C.R.S. §13-21-111.5(6)(a), construction contracts imposing "broad" or "intermediate" form

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indemnity obligations—i.e., obligations requiring one party to an agreement to cover losses associated with another party's negligence—are now void. This mandate applies to any type of construction agreements entered on or after July 1, 2007. This prohibition does not apply to property owned or operated by railroads or public districts, nor does the prohibition apply to rental agreements. Colorado law still permits contract clauses requiring that one party purchase insurance covering its own acts of negligence and to name the party as an additional insured.

Limitations In Recovery In Residential Construction Contracts

Colorado's recently-enacted Homeowner Protection Act voids any contract provision that waives or limits construction claims more restrictively than Colorado's Construction Defect Action Reform Act ("CDARA"). CDARA imposes limitations on recovery of damages, the time period in which a claim may be brought, and the manner in which claims may be asserted. After CDARA's enactment, many residential construction contracts imposed limitations that were more restrictive than those imposed by CDARA. The Homeowner Protection Act voids such provisions. The Act applies only to claims arising out of residential construction, and does not apply to settlement agreements, certain charitable donations, express warranties, and arbitration or mediation agreements.

Alternative Procurement Methods for Public Projects

A number of Colorado public agencies have long sought alternatives to Colorado's competitive bidding statutes. The recently-enacted "Integrated Delivery Method for Public Projects Act," now provides such an alternative. "Integrated Project Delivery," or IPD, is a method of project delivery in which the public agency contracts with a single entity for "design, construction, alteration, operation, repair, improvement, demolition, maintenance, financing *or any combination of the listed services* for a public project." The Act authorizes Colorado public agencies to award IPD contracts "upon the determination by such agency that integrated project delivery represents a timely or cost-effective alternative for a public project." The Act also sets forth a contracting process, including guidelines for prequalification and criteria for the evaluation and award of IPD contracts.

Surveyor License Now Required for Basic Control for Engineering Projects

Many contractors have historically relied upon experienced employees who were not necessarily licensed surveyors to accomplish layout of lines and grades for new construction. In 2007, Colorado modified its licensure requirements to include "Basic Control for Engineering Projects" within the definition of surveying tasks for which a surveyor's license is required. "Basic Control for Engineering Projects" is defined as establishing survey markers on or in the vicinity of a construction

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project to enable all components of the project to be built in compliance with plans and specifications with respect to the project location, orientation, elevation, and relationship to property, easement, or right-of-way boundaries.

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Recent Utah Cases for the New Year and How They May Affect You

By Mark Morris and Tim Dance


Two decisions from the Utah Court of Appeals in this New Year provide warnings to parties to construction agreements. In the first published opinion of the year, *Iron Head Construction Inc., v. Gurney ("Iron Head")*, the Court affirmed a trial court's award of prejudgment interest to the beneficiary of a settlement agreement to a disputed construction claim, in spite of the fact that the amount was not liquidated until settlement. Additionally, in *SFR, Inc. v. Comtrol, Inc.*, the Court formally adopted the "joint check rule," allowing owners to better protect themselves from lien foreclosures by materialmen.

Iron Head – Prejudgment Interest

Traditionally, awards for prejudgment interest have been reserved for actions in which damages were liquidated and subject to fixed standards of valuation. Thus, whenever a jury was asked to determine the amount of an award in their best judgment, prejudgment interest has rarely been permitted. Many states, in an attempt to compensate plaintiffs of valid claims, have enacted laws that allow for prejudgment interest under certain circumstances. In addition to compensating plaintiffs for the time lag between the time when the cause of action arose and final determination of damages, these statutes have the additional goals of reducing the delay of litigation and encouraging settlement. The practical effect of prejudgment interest statutes, however, has often resulted in overcompensated plaintiffs and impediments to speedy settlements.

Utah courts have historically followed the common law rule of awarding prejudgment interest only where fixed standards of valuation were available. While the Utah legislature has not seen fit to enact a prejudgment interest statute, the Utah Court of Appeals recently took the initiative in fashioning a new precedent in *Iron Head*. This case could cause a significant change in construction and other litigation. *Iron Head* involved a dispute between a homeowner and a general contractor. The parties disagreed over changes to the scope of the plans and payment for the work done. Plaintiff contractor filed suit against homeowners. During the course of the trial, the owner agreed to settle

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by paying $43,500, but asked the court to determine whether prejudgment interest was appropriate. The trial court decided that based on the agreed settlement amount of $43,500, the contractor was owed $12,835 in prejudgment interest. On appeal, the Court of Appeals affirmed the trial court's conclusion.

In reaching their decision, the Court of Appeals applied the century old case of *Fell v. Union Pacific Railroad ("Fell")*. In *Fell*, the Utah Supreme court stated in order to determine whether prejudgment interest should attach, courts look to "whether the injury and consequent damages are complete and must be ascertained as of a particular time and in accordance with fixed rules of evidence and known standards of value." The Court in *Iron Head* opined that the parties' settlement of their claims, except for the question of prejudgment interest, required the Court to look at the nature of the claims and apply the *Fell* factors. The Court concluded that a jury could look to factors such as hours worked, materials, submitted invoices, time cards, bills paid, and labor costs and determine fixed values for damages based on such evidence. Additionally, the Court found that these damages were complete and fixed as of a particular date based on evidence presented that the parties met on a certain day and failed to reach an agreement, after which no work was performed on the project. Thus, the Court ruled, interest should run from that date forward.

In the aftermath of *Iron Head*, the question of which situations are appropriate for the award of prejudgment interest is in even greater flux. In his dissenting opinion, Judge Orme raised important questions about the appropriateness of awarding prejudgment interest in such a settlement. Orme stated that the "rather round sum of $43,500 is – not unlike an award for pain and suffering or damage to reputation – a figure that has essentially been plucked from the air," which "…no doubt includes some component for unpaid work…[b]ut it also includes the value of being spared additional days in court…potentially significant amounts allocable to stanching the flow of additional bills for attorney fees and to avoiding the risk in any litigation of a judgment reflecting a worst-case scenario." His counterparts on the court, however, found this loss to be specific to the amounts outstanding and not based on any such intangibles.

Now that the Utah Court of Appeals has attached to all settlement agreements the potential that the paying party will also be liable for prejudgment interest[1], some precautions are now necessary, and obvious:

- When documenting a settlement as the paying party, include language in the agreement that the parties agree there will be no interest running on the amount of the settlement at any time prior to the date of the settlement agreement.

1 There remains the possibility this decision will be the subject of a petition for Certiorari to the Utah Supreme Court.

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- Know your insurance liability coverage for prejudgment interest; some liability policies cover interest only from the time of a court decree until the date of payment.

SFR Inc. v. Comtrol, Inc. – Joint Check Rule

Whether you are an owner, developer, lender, or contractor, you have likely dealt with materialmen's liens in some fashion. When an owner pays the contractor, there is an inherent risk and tension that the contractor will not pay subs. One way by which the industry has attempted to add some certainty to the situation is through joint checks made payable to a contractor and the subcontractor, since the sub should protect its interest and not endorse the check unless he has been paid. Once the check has the subcontractor's endorsement, they have presumably given up any claim to the money represented by the check.

Although already a widespread practice within the construction industry, the Utah Courts had never addressed the issue of whether the acceptance of part payment from a joint check would be treated as a waiver of claims to the remaining portion. In the 2008 decision of *SFR Inc. v. Comtrol, Inc.*, Utah joined other states, including Arizona, California, and Nevada, in adopting the joint check rule. The California Supreme Court summarized the rule as follows: "When a subcontractor and his materialman are joint payees, and no agreement exists with the owner or general contractor as to allocation of proceeds, the materialman by endorsing the check will be deemed to have received the money due him." The rule protects the contractor and owner from having to pay materialmen twice, as well as protecting the materialmen by giving the contractor an interest in ensuring that the materialman is paid.

Although issuing joint checks is a great protection from materialman's liens, the payor is generally only protected from liens up to the amount on the face of the check. Thus, owners will still want a lien waiver from the subcontractor if the check does not represent the total paid for the subcontractors' work.

These two cases from the Utah Court of Appeals present new rules for the construction industry in Utah. While the adoption of the joint check rule will add a degree of clarity for owners and contractors on a day to day basis, the opinion in *Iron Head* gives pause to anyone involved in construction related settlement negotiations. If you have any questions regarding this new case law, you should contact your Utah construction attorney who can advise on their implication to you and your business.

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Upcoming Events

AIA Documentation Update,
Denver

Thursday, April 17, 2008

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