Snell & Wilmer L.L.P.

UNDER CONSTRUCTION

www.swlaw.com | May 2009

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Message from the Editor:

Once again, we bring you another informative installment of the *Under Construction* newsletter. This quarter's edition kicks off with an article by Gerard "Jerry" Morales and Kathryn Hackett, which discusses what employers should know about the Employee Free Choice Act (EFCA). The subsequent article, authored by Ronald Messerly and Kelly Kszywienski, delves into Arizona homeowner's implied warranty rights relative to claims against builders for residential construction defects. Our third article is a submission from Marc Erpenbeck and Benjamin Mitsuda, which examines the economic loss rule related to negligence suits involving constructions projects. Furthermore, this article emphasizes the different court interpretations regarding the economic loss rule in both Arizona and Nevada. Our final article from Leon Mead, II compliments the previous article on the economic loss doctrine. Leon's article specifically details the Nevada Supreme Court's application of the economic loss rule as it relates to design professional negligence, especially in cases that do not involve personal injury or property damage.

These topics can serve as a reference to provide awareness of updates in the construction industry throughout our regional practice areas. *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 on how we can improve this publication to provide added value to you.

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The Employee Free Choice Act – What Employers Should Do Now

By Gerard Morales and Kathryn Hackett

Most observers predict that the Employee Free Choice Act ("EFCA") will become a reality during the first sixth months of the new Obama administration. Without a doubt, this would be the most significant reform to the Nation's labor laws since the enactment of the Labor Management Relations Act in 1947. It is well known that over the last 30 years, the percentage of the American workforce represented by labor unions has declined dramatically. The EFCA's clear purpose, the stated goal of those who support its passage, is to reverse that trend.

Current Status

Under current law, an employer may decline to recognize a labor union as the representative of its employees, and insist on a secret ballot election conducted by the National Labor Relations Board ("NLRB"), to determine whether its employees actually want union representation. Only if the union wins the election and becomes certified by the NLRB, is the employer then required to recognize and bargain with the union over its employees' terms and conditions of employment. Once that duty arises, the employer and the union are required to negotiate in good-faith to reach a collective bargaining agreement. They are not required, however, to agree on any particular term or condition.

EFCA

Under the EFCA, the NLRB would certify the union after the union presents cards demonstrating majority support among the employees. There would be *no secret ballot election*, and *no election campaign* to discuss with employees the advantages and disadvantages of union representation. Upon certification by the NLRB, the employer will have the obligation to recognize and bargain with the union.

Equally important, under EFCA, if the union and the employer are unable to agree to a first contract within a certain period of time (130 days under the current EFCA draft), a Federal Mediation and Conciliation Services ("FMCS") appointed arbitrator would then decide the terms of the contract. Thus, an employer could be presented with terms and conditions of employment that it would otherwise find unacceptable.

Furthermore, EFCA significantly increases penalties for the employers for various unfair labor practices. Available remedies include treble backpay and civil penalties, up to $20,000 per violation against employers for certain unfair labor practices ("willfull" or "repeated") that occur during the union's efforts to obtain authorization cards and/or during the first contract negotiations.

What To Do Now

It is important that *all* supervisors become familiar with EFCA's impact on their company and be trained on the steps the company may legally take to: (a) minimize risks, and (b) avoid the commission of unfair labor practices.

The Arizona Supreme Court Expands Homeowners' Right to Assert Claims Directly Against Builders for Construction Defects

By Ron Messerly and Kelly Kszywienski


Arizona courts have long implied a warranty of habitability and workmanlike construction in residential construction contracts. Because warranty claims arise out of a contractual relationship, the implied warranty remedy was initially available only to homeowners who contracted directly with the builder. In the 1984 decision of Richards v. Powercraft Homes, Inc., however, the Arizona Supreme Court held that this implied remedy was also available to subsequent purchasers against the original contractor 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 the February 2008 edition of the *Under Construction* newsletter, we highlighted a decision handed down by the Arizona Court of Appeals, *The Lofts at Fillmore Condominium Association v. Reliance Commercial Construction, Inc.*, in which the court **limited** the *Richards* exception to claims against a homebuilder-vendor. The *Lofts* plaintiff was an association of persons who had purchased condominiums from a developer, but had no contract with the original contractor. Nonetheless, the plaintiff sought damages for alleged construction defects directly from the condominiums' builder under an implied warranty theory. Both the trial court and the court of appeals found that plaintiff's implied warranty claim failed as a matter of law because plaintiff had no contractual relationship with the builder and the *Richards* exception did not apply because Reliance, the builder in the *Lofts* case, was not also the seller or vendor of the property.

That Court of Appeals decision is no longer good law. On August 19, 2008, the Arizona Supreme Court **vacated** the *Lofts* ruling, analyzing the plaintiff's claim in three steps. First, the Court considered whether the implied warranty applies to all residential builders or only to a builder-vendor, and held that "an implied warranty arises from construction of the home, without regard to the identity of the vendor." In other words, it did not matter that Reliance was not the seller of the property, it only mattered that it constructed a residential project. Second, the Court disagreed with the appellate court's finding that *Richards* had created an exception to the requirement that the parties have a contractual relationship. Instead, the Court found that *Richards* was based on a longstanding policy "to protect innocent buyers and hold builders responsible for their work." Stated differently, the *Richards* Court's focus was on a policy of consumer protection as opposed to contractual theories of liability. Thus, in contrast to the appellate court's narrow reading of the policy articulated in *Richards*, the Arizona Supreme Court found that the *Lofts* case involved concerns "identical" to those in *Richards*, and that contractual arrangements of a particular case "should not affect the hom-

eowner's ability to enforce the implied warranty against the builder." Third, the Court rejected the builder's argument that the Court's holding would expand liability for residential builders, finding that "a developer-vendor sued for defective construction will typically seek indemnity from the builder," and, therefore, its decision did "not impose liability on builders where none existed in the past."

The result of the Arizona Supreme Court's ruling in *Lofts* is that all residential home builders impliedly warrant, to both current and future owners – even those with whom they have no contractual relationship – that the home they construct will be habitable and built in a workmanlike manner. Residential homebuilders seeking to allocate some or all of the liability for construction defects to the developer can do so via contract. Doing so, however, will not prohibit the homeowner from suing the builder directly and it will not eliminate or reduce a builder's liability in circumstances where the developer cannot satisfy a judgment. Thus, it is important that builders consider the parties' respective liability for construction defects and the availability of adequate insurance or other assets in order to attempt to establish reasonable risks for anticipated construction defect lawsuits when drafting and reviewing construction contracts for residential projects.

Can You Be Sued in Negligence for Purely Economic Losses on a Construction Project? Maybe and it May Depend on What Court You Are in!

By Marc Erpenbeck and Ben Mitsuda

The economic loss rule can be stated with ease, but it is very difficult to apply. Simply stated, "the economic loss rule bars a party from recovering economic damages in tort unless accompanied by physical harm, either in the form of personal injury or secondary property damage." The Ninth Circuit (Federal) Court of Appeals previously held that the Arizona (State) Supreme Court "reads the 'economic loss' rule broadly." Yet, in a case we litigated, the Arizona (Federal) district court claimed to "adopt Arizona's narrow view of the economic loss rule." So which is it, narrow or board? It appears that the economic loss rule was broad and is now narrowing in Arizona. In the case we litigated, the federal court stated that the economic loss rule only applies in product liability and construction defect cases, concluding that the other federal court opinions that applied Arizona's economic loss rule to other types of cases were simply incorrect. Other states are experiencing similar conflicting rulings.

A Tale of Two States

The end result is uncertainty. To a large extent, it remains unclear when the economic loss rule would apply. Often, the determination must be made on a case by case basis. To make matters worse, different states apply the economic loss rule differently. For example, Arizona and Nevada recently came to the exact opposite conclusion on the economic loss rule's application to design professionals in decisions issued just two days apart. These decisions demonstrate that Arizona is narrowing the application of the economic loss rule while Nevada is broadening it.

The Economic Loss Rule and Design Professionals

In March, the Arizona Court of Appeals held that the economic loss rule does *not* operate to bar tort claims against design professionals for purely economic losses. *See Flagstaff Affordable Housing v. Design Alliance, Inc.*, 2009 Ariz. App. LEXIS 54 (App. Mar. 24, 2009). In *Flagstaff*, the owner brought a lawsuit against its architect claiming that it was negligent because it failed to follow the requirements of applicable law. In response, the architect claimed the economic loss rule barred the owner's negligence claims because there was no personal injury or property damage.

Focusing on the purpose behind the economic loss rule, the court refused to apply it to the owner's negligence claim against the architect. Specifically, the court reasoned, "[b]ecause Architect's professional duties arise independently of any contract, the purpose of the economic loss doctrine – maintaining a distinction between tort and contract actions – is not implicated." The court also noted that the law imposes special duties upon professionals, such as architects.

Importantly, the Arizona Court of Appeals distinguished *Flagstaff* from prior construction defect decisions by noting that, "[u]nlike [previous Court of Appeals decisions], this case alleges negligent design, not negligent construction [and] Architect owed a duty of care to Owner in rendering its professional services." Thus, *Flagstaff* is another example of the narrowing reach of the economic loss rule in Arizona and indicates, or at least implies, that the rule may be limited to certain types of tort claims (i.e. products and construction defect claims).

In contrast, two days later the Nevada Supreme Court reached the exact opposite conclusion, holding that the economic loss rule *does* bar tort claims against design professionals where there is no personal injury or property damage. *See Terracon Consultants Western, Inc. v. Mandalay Resort Group*, 125 Nev. Adv. Op. No. 8 (March 26, 2009) In *Terracon Consultants Western, Inc.*, Mandalay Resort Group hired Terracon as a subcontractor in the construction of a resort in Las Vegas. Terracon provided geotechnical engineering services about the subsurface soil conditions of the site. Mandalay claimed that excessive settling occurred under the new resort's foundation – exceeding Terracon's projections and filed a lawsuit seeking economic damages to repair the foundation. Terracon moved to dismiss arguing that the economic loss rule barred Mandalay's tort claims. The Nevada Supreme Court ultimately held that the economic loss rule barred Mandalay's tort claims for purely economic damages reasoning:

> Guided by the doctrine's purpose – "to shield [defendants] from unlimited liability for all of the economic consequences of a negligent act, particularly in a commercial or professional setting, and thus to keep the risk of liability reasonably calculable," …

> we conclude that the economic loss doctrine should apply to bar the professional negligence claim at issue here.

Ironically, the Arizona and Nevada decisions came to completely opposite results by focusing on the same thing – the purpose behind the economic loss doctrine. The difference appears to stem from the way each court framed the purpose of the rule. Arizona's Court of Appeals concentrated on the rule's function of "maintaining a distinction between tort and contract actions." On the other hand, Nevada's Supreme Court focused on the rule's role in shielding defendants "from unlimited liability." Such subtle distinctions of the economic loss rule's purpose can result in significant differences in its application. Consequently, predicting how a court will apply the economic loss rule in a particular case remains difficult.

Other Distinctions

In addition to the design professional issue, Nevada and Arizona also apply the economic loss rule differently in other situations. For example, Nevada, by statute, has different treatment for residential (economic loss rule does not apply) and commercial claims (economic loss rule applies). Conversely, Arizona has not definitively drawn a distinction between residential and commercial properties when applying the economic loss rule. In another example, Nevada specifically acknowledges negligent misrepresentation as an exception to the economic loss rule. Again, no Arizona state court decision has expressly reached a conclusion on whether negligent misrepresentation is an exception to the economic loss rule, and federal district court cases interpreting Arizona law have gone both ways. Different courts have simply reached different conclusions applying the same rule.

Additional Arizona Developments

In March, the Arizona Court of Appeals added another confusing decision to this issue. In *Valley Forge Insurance Company v. Sam's Plumbing, LLC*, the Court of Appeals (Division Two) held that the economic loss rule did *not* bar an owner's negligence claim against a contractor. In *Valley Forge*, the owner's insurance company attempted to recover the amount it paid the owner for the defendant plumbing company's negligence. The complaint alleged that the defendant negligently constructed a gas line that resulted in an explosion causing significant *real* property damage to the owner's shopping center. In response, the plumbing company claimed the plaintiff's negligence claim was barred by the economic loss rule because there was no personal injury or damage to *personal* property.

The Court of Appeals held that the economic loss rule did not bar the owner's negligence claim. In coming to that conclusion, the court rejected the *per se* rule used previously by the Arizona Court of Appeals, which applied the economic loss rule to bar any negligence claims involving only the *real* property. Instead, *Valley Forge* used the following three factor analysis to determine whether "tort or contract law should apply to a particular claim: (1) the nature of the defect causing loss, (2) how the loss occurred, and (3) 'the type of loss for which the plaintiff seeks redress.'"

The *Valley Forge* court also seemed to be influenced by the fact that the contractor's work in that case "presented an extreme risk of danger to everyone and everything around the piping." Thus, *Valley Forge* arguably only applies to cases involving extremely hazardous conditions. Yet, this case also casts doubt on the bright line application of the economic loss rule set forth in

earlier Arizona construction defect cases. It seems more cases will be resolved on a case by case basis.

Take Aways

Consult with your attorney prior to entering into construction contracts so you understand your rights and responsibilities.

1. In Nevada, on commercial projects, the economic loss rule probably bars most tort claims against design professionals. It will not apply in residential cases.

2. In Arizona, the economic loss rule generally may not apply to professionals for design services but, again, it may vary from case to case.

3. Arizona Courts appear to be narrowing the application of the economic loss rule, and it may only apply to tort claims for defective products or defective construction.

4. Additional cases on the economic loss rule will be required to iron out the remaining unanswered questions.

Nevada Supreme Court Applies Economic Loss Rule to Design Professional Negligence Claims in the Absence of Personal Injury or Property Damage, Of Course….

by Leon F. Mead II

In an isolated and limited opinion, the Nevada Supreme Court has opined that a design professional cannot be sued for tort damages on a commercial construction project under the Economic Loss Rule, so long as there is no claim of personal injury or property damage associated with the alleged negligent conduct. In *Terracon Consultants Western, Inc. v. Mandalay Resort Group, etc., et al.*, 125 Nev.Adv.Op. 8, ___ P.3d ___ (Nev. 2009), the Nevada Supreme Court accepted a reference from the United States District Court for the District of Nevada of a certified question. While the question was actually in multiple parts, the Supreme Court actually re-wrote the question focusing on the facts that the person who had been allegedly negligent was a design professional and that the damages were to be "presumed as purely economic". Taking great pains to emphasize that the decision did not reach situations where there were associated personal injury or property damage, and that the involved project was not residential in nature, the Court determined that the economic loss rule would be applicable in such design professional cases since so applying it would further its purpose and promote certainty in commercial settings.

The case arose from geotechnical and soils evaluations performed and recommendations for foundation design prepared by Terracon Consultants Western, Inc., on the Mandalay Bay Resort and Casino project, located in Las Vegas, Nevada. After the foundation was constructed according to the recommendations from the geotechnical engineers, the building inspection department of the jurisdictional authority required substantial amounts of additional foundation work as a result of the actual settling of the project beyond the estimates set forth in the reports. As a result, the project owner suffered significant economic losses including additional costs of repair, and sued the geotechnical engineer for negligence to recover those costs. The geotechnical engineer moved for partial summary judgment on the grounds that the Economic Loss Rule applied and barred the negligence claim. The U.S. District Court hearing the case temporarily denied the motion and referred the question to the Nevada Supreme Court for determination.

The Nevada Supreme Court first noted that the particular case did not fall within the parameters of Nevada's constructional defect law (known as "Chapter 40"), since the project was not residential in nature. It next analyzed the issue with a purpose of determining whether the Economic Loss Rule made sense within the context of negligence by a design professional in undertaking the duties of his profession. The Court determined that it did, and so limited the tort liability of design professionals for negligence in the performance of their professional duties on commercial projects.

First, the Court determined that the purpose of the Economic Loss Rule was to mark the fundamental boundary between contract law and tort law, and that the Economic Loss Rule exists to "shield the defendant from unlimited liability for all the economic consequences of a negligent act, particularly in a commercial or professional setting, and to thus keep the risk of liability reasonably calculable." This boundary generally makes sense, especially when there is no consequential personal injury or property damage, because there is a need to balance the "need for useful commercial economic activity and the desire to make injured plaintiffs whole". The "useful commercial activity would be deterred" by allowing unfettered liability for tort losses, and contract law can better cover such losses, as contracts more accurately define the expectations of the parties in a commercial context.

In keeping to this purpose, the Court indicated that none of the common exceptions to the Economic Loss Rule would necessarily achieve their intended goal, if they were applied to the design professional negligence context. In the Court's view, "contract law is better suited to resolve professional negligence claims", since doing so would "promote[] useful commercial economic activity, while still allowing tort recovery when personal injury or property damage are present." As such, the Court held the Economic Loss Rule does apply to bar tort liability for negligent professional design services, so long as no personal injury or property damage is involved.

While the initial review of this case may raise the comfort level of design professionals in Nevada, it should be kept in mind that in most cases of professional design negligence, substantial property damage claims are alleged. For instance, in the case of the Mandalay Bay, the Court specifically noted that "according to Mandalay's complaint, Terracon's negligence also caused property damage to the resort structure itself, we do not address this aspect of Mandalay's claim because the U.S. District Court asked this court only whether tort recovery is permitted *assuming the losses are purely economic*." Accordingly, it is possible that if the

Court were to review professional negligence when property damage is considered, the economic loss rule would not bar the complaint in tort.

As a result, anyone looking to assert design professional negligence claims in Nevada should clearly allege resulting property damage or personal injury if appropriate in order for the claim to be advanced. Conversely, design professionals should do their best to determine if any negligence issues have caused resulting property damage or personal injury when they are evaluating any risk of potential liability, and attempt to restore those claims if at all possible.

Snell & Wilmer L.L.P. is pleased to announce partner Leon F. Mead II recently completed a book titled Nevada Construction Law (2009 Edition). The treatise, published by West®, a Thomson Reuters business and a provider of integrated information solutions to the U.S. legal market, explores issues unique to Nevada construction law. It will serve as a legal reference guide dedicated to Nevada law and to the practical realities of handling construction cases within the state. Specific topics examined include mechanic's and materialman's liens, contract interpretation, bond claims on public works projects, bids, negotiations, purchase orders, public contracts, supply contracts and subcontracts, insurance, breach, and negligence. The book can be purchased at Thompson Reuters / West's website - http://west.thompson.com

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