

Limiting the Period of Liability for Construction Defects

Under California law, contractors may be held liable for their defective work for a period of four (4) years following the date: (i) of actual discovery of the defect and its negligent cause, or (ii) that the defect and its negligent cause could have been discovered through the exercise of reasonable diligence. As most construction defects are latent (*i.e.*, not apparent by a reasonable inspection) and subject to delayed discovery, this “Delayed Discovery Rule” permits lawsuits against contractors many years after they have finished their work and is limited only by the ten-year statute of repose set forth in Code of Civil Procedure Section 337.15. Accordingly, most contractors assume that they are liable for their defective work for a period of ten (10) years following completion of the project. However, a recent California Court of Appeals decision holds that such liability may be shortened to as little as four (4) years for prime contractors, provided the prime contract includes provisions whereby the “Delayed Discovery Rule” is unambiguously waived by the parties.

In *Brisbane Lodging, L.P. v. Webcor Builders, Inc. et. al*, 216 Cal.App.4th 1249 (2013), the plaintiff/owner and defendant/contractor extensively negotiated a prime contract for the design and construction of a eight-story hotel, which was based, in large part, on the 1997 edition of the American Institute of Architects (“AIA”) Form A201 General Conditions – 1997 Edition (“1997 A201”). The final vision of the prime contract included, unaltered, the following provision from the 1997 A201:

13.7 Commencement of Statutory Limitation Period

13.7.1 As between the Owner and Contractor:

.1 **Before Substantial Completion.** As to acts or failures to act occurring prior to the relevant date of Substantial Completion, any applicable statute of limitations shall commence to run and any alleged cause of action shall be deemed to have accrued in any and all events not later than such date of Substantial Completion

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The hotel that was the subject of the prime contract was substantially completed in July 2000. Formerly latent sewer line plumbing defects were discovered in early 2005, and the plaintiff/owner subsequently filed suit against the defendant/contractor in May 2008. The lawsuit was filed within four (4) years of discovery of the formerly latent defective work, and would have been timely under the Delayed Discovery Rule and the ten-year statute of repose. However, the Court found that the above-quoted language from the prime contract constituted an unambiguous waiver of the Delayed Discovery Rule, and required that the applicable four (4) year statute of limitations commence to run upon substantial completion of the project, and not from discovery of the latent defect. The Court rejected various arguments raised by the plaintiff/owner offered to save its claim, including that the above-quoted language was void as against California public policy. As a result, the plaintiff/owner’s lawsuit filed almost eight (8) years after substantial completion was found to be untimely and was ultimately dismissed.

While *Brisbane Lodging* provides a contractor the ability to reduce the period of its exposure for liability for defective work through specific contractual language, it is important to note that its holding is based on a number of factors that may limit the breadth of its application.

- The holding is based on the specific language in the 1997 A201, which is not the most current version of AIA Form A201 General Conditions. The most current version of the AIA Form A201 was published in 2007 and omits the specific language upon which the *Brisbane Lodging* decision is based.
- The lawsuit at issue in *Brisbane Lodging* was brought by the same owner who entered into the prime construction contract with the defendant/prime contractor, and, thus, a direct contract existed between plaintiff and defendant that provided for the waiver of the Delayed Discovery Rule. If the subject construction project is subsequently sold to a third party, such privity of contract between the new owner and prime contractor will no longer exist, and the waiver language could not be applied to the new owner.
- In reaching its holding, the Court relies in several instances on the fact that the prime contract was entered into between parties sophisticated and experienced in the construction industry, each of whom was represented by counsel during the extensive negotiations that ultimately lead to the prime contract. The *Brisbane Lodging* decision is likely to have limited, if any, application to construction contracts entered into by homeowners or other similarly unsophisticated purchasers of construction services.
- The *Brisbane Lodging* decision is based on the specific language in the prime contract between the plaintiff/owner and defendant/prime contractor whom were in privity of contract. Although most subcontracts include the terms of the prime contract by incorporation, whether a subcontract incorporating the language in *Brisbane Lodging* would result in the waiver of the Delayed Discovery Rule for claims by the owner against the subcontractor directly is uncertain and will likely depend on the other terms of the prime contract and the specific language of the subcontract.

The *Brisbane Lodging* decision provides the potential for prime contractors to limit their liability exposure for construction defects, as the vast majority of construction defect claims are brought more than four (4) years after substantial completion of the construction project. Prime contractors should consult with their counsel to determine if, and to what extent, their standard construction contract forms should be revised to take advantage of the *Brisbane Lodging* decision.

If you would like further information, please contact your Rutan attorney.

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