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BEWARE THE GARDEN VARIETY NEGLIGENCE CLAIM
MASQUERADING AS AN UNFAIR COMPETITION CLAIM –
NEVER THE TWAIN SHALL MEET

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Tort litigation is never a static legal concept, especially in California, which some commentators say is a bellwether jurisdiction for the rest of the United States.\(^1\) Creative legal theories can be asserted, sometimes improperly, in a proverbial effort to put lipstick on a pig. One of these areas of questionable legal theories is found in Construction Defect litigation, which originated in Southern California and is now found through the country.

As Construction Defect litigation continues to evolve, the plaintiff bar asserts new, and sometimes novel, legal theories in a calculated effort to maximize recovery for themselves and their clients. One of those new and novel legal theories is to sue the builder, general contractor and trade contractors for violation of California’s unfair competition law under Business & Professions Code Section 17200.

A typical pleading allegation in a case where the plaintiff purchased property while it was under construction (such as a remodel) is that the defendants engaged in an unfair business practice whereby they negligently planned, designed, improved, installed, constructed and inspected the subject property. The plaintiff alleges that it is forced to repair those conditions, and requests both restitution of the contract price and an injunction against the defendants’ ongoing unlawful conduct.

But is this really a violation of the unfair competition law? Under Business & Professions Code Section 17200, “unfair competition shall mean and include any unlawful, unfair or fraudulent business act or practice.” Although broad, this definition does not encompass every act and is not intended to supersede tort law. It applies only to acts which can properly be called a business practice.\(^2\) Unless the pleading asserts that the defendants intended to perform negligently as part of an illegal practice, scheme or purpose, the viability of an unfair competition claim seems doubtful.

For example, in *Kim v. Westmoore Partners, Inc.*\(^3\), the plaintiff alleged that some investment brokers had committed unfair business practices by wasting a construction loan and failing to repay the loan as required by promissory notes. The Court of Appeal concluded that, while actionable, these allegations did not rise to the legal of an unfair business practice.\(^4\)

Hence, whether a builder, general contractor or trade contractor may have fallen below the standard of care in performing construction-related work is not necessarily the equivalent of an unfair business practice. To illustrate this point, a plaintiff’s request for an injunction to prevent a defendant from engaging in negligent future practices is nothing more than an ethical admonition of “thou shalt not be negligent,” which is unenforceable because of its inherently vague and ambiguous parameters.\(^5\)

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Otherwise, to allow an unfair business practice claim to be pled in a garden-variety Construction Defect case, or any general negligence case for that matter, runs the danger of eviscerating the overall law of torts. California courts are generally reluctant to extend the law that far. A classic example of this judicial restraint was enunciated in a case where the City of San Diego sued in nuisance for asbestos contamination in various buildings, alleging a definition of nuisance which included anything which is injurious to health. The Court of Appeal rejected such a sweeping legal theory, and instructed the City to limit its claim to a traditional products liability theory, because nuisance in this context would “become a monster that would devour in one gulp the entire law of tort.”

The lesson in all this is that pleadings should be scrutinized carefully for improper legal theories at the outset of litigation because pleadings frame the issues to be litigated. A plaintiff who asserts an unfair competition claim in a garden-variety negligence action, whether Construction Defect or otherwise, may have unrealistic expectations which will make a successful resolution problematic unless and until the unfair competition claim is dismissed from the lawsuit.

Courts must accept as true the factual allegations of a Complaint, but not a plaintiff’s contentions, deductions, or conclusions of fact or law. We recommend that you do not take the pleadings at face value even if the damage claims appear to be standard. Rather, analyze the plaintiff’s legal theories for potential pitfalls and take control of the case by challenging them at the outset whenever practicable.

CAVEAT: THE FOREGOING DOES NOT CONSTITUTE LEGAL ADVICE. PLEASE CONSULT AN ATTORNEY FOR INDIVIDUAL ADVICE REGARDING INDIVIDUAL SITUATIONS.

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6 Serrano v. Priest, 5 Cal.3d 584, 591 (1971).
BEWARE OF CONSTRUCTION PRACTICES WHICH CAN LEAD TO CRIMINAL PROSECUTIONS AND POSSIBLE LOSS OF LICENSURE

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When is a construction defect claim not just a construction defect claim? When the contractor finds itself facing a criminal prosecution and possible loss of licensure because the contractor allegedly either performed substandard work, or else failed to perform all the work promised, or diverted funds from the project.

Consider the case of People v. Williams, 218 Cal.App.4th 1038 (2013). The California Attorney General prosecuted a fire sprinkler installer under California Penal Code Section 386 for the unlawful construction or maintenance of a fire protection system which posed a life-safety hazard – which resulted in a criminal conviction on 26 counts of violating Section 386 and one count of conspiring to violate the same statute. The contractor also was convicted of grand theft for diversion of construction funds (Penal Code Section 484b), and 26 misdemeanor charges for violating various State Fire Marshall regulations. Finally, the contractor was convicted of an enhancement allegation under Penal Code Section 12022.6(a)(1).

On appeal, the convictions under Penal Code Sections 386 and 12022.6 were dismissed due to insufficient evidence, but the remaining criminal convictions were affirmed. Therein lies the cautionary tale.

The contractor’s Responsible Managing Officer held a C-16 specialty license for installation and maintenance of fire protection systems. It contracted with a large commercial bakery operation to repair an old, deficient automatic fire sprinkler system at the bakery’s newly-acquired large production facility. Extensive repair work was performed, and paid for, until the local fire inspector determined that numerous deficiencies and fire code violations still existed. A task force conducted an undercover interview of the contractor and inspected other customers’ premises where the contractor had performed work. The investigation led to a grand jury indicting the contractor on multiple felony and misdemeanor charges.

In dismissing the convictions under California Penal Code Section 386, the Court of Appeal analyzed the legislative intent behind the statute. The Court was concerned that the prosecution’s statutory interpretation could create a rule of strict liability despite a lack of evidence showing that the contractor had the requisite specific intent either to install an inoperable fire protection system or else to impair an existing system. “This would have illogical and absurd consequences,” stated the Court. “Performing suboptimal maintenance which leaves a fire protection system in less than perfect condition is not the same as intentionally disabling the system or worsening its effectiveness.”

Although some of the criminal convictions were dismissed on appeal, the contractor’s business practices and ethics supported inferences of fraud, negligence, or incompetence. For example, the contractor failed to obtain a permit before replacing some component parts, and he did not contact the fire department for a system inspection. Also, if he agreed to maintain customers’ systems but failed to train his employees thoroughly on how to perform maintenance work, or failed to provide his employees with the requisite equipment, that could constitute aiding and abetting.
The contractor’s conviction was affirmed for unlawful diversion of funds received for improvements under Penal Code Section 484b, which provides:

Any person who receives money for the purpose of obtaining or paying for services, labor, materials or equipment and willfully fails to apply such money for such purpose by either willfully failing to complete the improvements for which funds were provided or willfully failing to pay for services, labor, materials or equipment provided incident to such construction, and wrongfully diverts the funds to a use other than that for which the funds were received, shall be guilty of a public offense ...

Examples of this kind of violation are where a contractor fails to use construction funds to pay laborers or suppliers on a particular project, or diverts the funds for use on a different project. Unlike the specific intent required under Penal Code Section 386, diversion of funds under Penal Code Section 484b is a general intent crime. This entails a lower burden of proof, and requires evidence only that the contractor failed either to complete the work or to pay the costs with the funds issued specifically for that project. The conviction under Penal Code Section 484b was affirmed because there was sufficient evidence to show that the contractor did not use the bakery’s construction payments to purchase the requisite components, and that he did not pay the labor costs necessary to ensure adequate time and effort were devoted to the project.

As the Court stated, “It does not matter that some of the work was actually performed. If all funds received are not earned or used for bona fide project costs, there is evidence of an unlawful diversion.”

The contractor’s conviction of grand theft under Penal Code Section 487(b) likewise was affirmed. Grand theft is a more serious version of regular theft, i.e., the amount of money or value of property taken exceeds $950. Theft can happen in a construction setting when a contractor makes a false pretention or representation with the intent to defraud, and the property owner makes payment in reliance on that representation. A critical inference which supported the grand theft conviction in this case was that the contractor had enough years of experience and specialized knowledge to know that the agreed-upon repairs were not completed, or in some instances were never even started.

These were all serious charges, worthy of our notice as we work with the construction industry. The Court of Appeal did not suggest that these types of incidents happen frequently, and we should not make that presumption either. The Court’s lengthy factual discussion of what was alleged and proven shows a contractor who arguably is the exception, not the norm.

Nonetheless, this case should caution us that what appears at first blush to be a garden-variety claim for construction deficiencies or breach of contract/warranty might turn into something far more serious, especially when life-safety concerns are raised. Contractors may face criminal prosecution and loss of licensure if they engage in the types of practices which the Williams Court condemned.

Caveat: The foregoing does not constitute legal advice. Please consult an attorney for individual advice regarding individual situations.
When the California Legislature enacted the Right to Repair Act (SB 800) for construction defect claims in 2003, many plaintiff attorneys and home builders alike thought that traditional tort litigation would become a thing of the past. Like many new statutes, SB 800 was a compromise solution but nonetheless it was envisioned as an effective way to both streamline and bring consistency to sometimes idiosyncratic property damage claims.

Not so fast. In the last few months, two panels of the California Court of Appeal have issued key decisions which cast into doubt whether SB 800 is really the panacea that some experts expected it to be.

In August 2013, the Fourth District ruled in the very significant case of *Liberty Mutual Insurance Company v. Brookfield Crystal Cove, LLC*, 219 Cal.App.4th 98 (2013) that SB 800 does not eliminate common law rights and remedies when actual damage has occurred. More importantly, the shortened statutes of limitation provided by SB 800 did not supplant the longer statutes of limitation and the 10-year statute of repose for latent property damage claims even when common law claims are asserted alongside SB 800 claims.

In March 2014, the Fifth District ruled for the first time in *McCaffrey Group, Inc. v. Superior Court*, 2014 WL 1153392 (Cal.App. 2014) that a home builder which inserts its own alternate dispute resolution procedures into home purchase agreements, and expressly opts out of SB 800, is not obligated to comply with SB 800’s requirements. Contractual provisions which do not provide compliance deadlines, or require homeowners to pay half the cost of mediation, or compel homeowners to “describe the nature and location of the Claim in reasonable detail” are not per se substantively unconscionable.

Typically the California Supreme Court does not review intermediate appellate court decisions unless they create a conflict or raise a new legal theory which causes the Supreme Court to want to weigh in. Neither situation seems likely here. The Supreme Court can just as easily order a lower court’s decision depublished if the ruling is not considered noteworthy. That did not happen with the *Liberty Mutual* case last year. Nor does there seem any reason for the Court to depublish the new *McCaffrey Group* case. The case follows existing law which upholds the freedom of contract so long as it does not shock the conscience or allow one party to wield an unfair advantage over the other.

What these two cases indicate, when taken together, is that construction defect litigation is neither dead nor dying in California. Its pundits may decry the smaller number of claims being litigated statewide in the aftermath of the Great Recession. But the appellate courts think enough of these claims to publish new decisions which offer guidance on how to litigate them. And that shows that construction defect litigation is still alive and well in California.

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