



LEGAL BRIEFING

The Perfect Litigation Wave Gathering Speed

By Joseph A. Ferrentino

(This is the first of two parts dealing with the worsening construction defect litigation climate; the second article will offer tactics and strategies on how best to handle this wave.)

An enormous wave of construction defect litigation is in the forecast, and several factors are contributing to this condition.

Of course, the decline in the market is the first factor. Not surprisingly, homeowners who cannot sell their homes are easy targets for plaintiff attorneys. When homes are selling quickly, owners don't want to have their ability to sell hampered by a lengthy suit. Also, if they plan to sell soon, homeowners might live through a winter with a small leak, but they will not live with a leak for an extended period of time. Moreover, when the equity in their home is increasing, homeowners are not as enticed to fight a builder in court to net an extra \$5,000-\$10,000.

Second, homebuilders have reacted to declining revenues by reducing their customer service departments. Meanwhile, due to the market decline, homeowners are submitting more and more customer service requests. As a result, very few customer service departments have the resources to keep up. At the same time, homeowners are less patient because of the economic stresses they are facing, and unhappy homeowners are more likely to join a suit.

Third, homebuilders in California fought hard to get legislation approved that gives them the "right to repair" a home before a homeowner can sue. To retain the right to repair, however, a

homebuilder has to maneuver quickly and meet multiple deadlines. One slip-up on any of these deadlines and the homeowner can file suit.

Even if a homebuilder is able to navigate these deadlines, it will need resources to coordinate and pay for the repairs. This is challenging with a reduced staff and unmotivated or bankrupt subcontractors.

Finally, the right-to-repair law also gives homeowners the ability to sue for new types of defects. Previously, a homeowner had to suffer actual property damage to sue for negligence or strict liability. The right-to-repair law has eliminated this requirement from many component parts of the home. These new claims will likely motivate plaintiff attorneys to investigate those issues and seek higher amounts in court.

Between the downturn in the market, reductions in customer service, and the right-to-repair law, the ingredients for the perfect litigation wave are all present. Builders are advised to "batten down the hatches" by carefully reviewing their risk management strategies.

Joe Ferrentino is a litigation partner in our Newport Beach office whose practice encompasses complex actions in the areas of business, construction, real estate, government tort, products liability and insurance. He may be reached via e-mail at joe.ferrentino@ndlf.com.

(A version of this article will appear in the May 2008 edition of *Builder & Developer* magazine.)



Dealing With 'Buyer's Remorse' In A Down Economy

By Jan A. Gruen

It's no secret that the building industry has been hard hit by a declining real estate market. Not only are homebuilders seeing an increase in defect claims, as mentioned in the above article, but these claims are often coupled with demands that builders buy back those homes.

In a strong real estate market, the voluntary buy-back concept emerges only where there are severe defects, when a defective home can be repaired and resold without much delay or loss, or in other extreme situations. Under such circumstances, a buy-back may sometimes be preferable to the outcome of litigation. Voluntary buy-backs are accomplished by repurchasing a home at the current market value or at some other fixed point in time plus any additional reimbursement of reasonable out-of-pocket expenses incurred.

Faced with strong resistance to the voluntary buy-back concept, especially for weak defect claims, some owner-claimants are filing suits and demanding the rescission of their purchase contracts in lieu of more traditional monetary compensation. Armed with laundry lists of claimed defects, the goal is to force builders into a buy-back, even years after purchase of the home.

Under the law of rescission, a party can rescind the contract and return the property where there is proof of fraud or mistake. Rescission requires the complaining party to prove the intentional withholding of material information that would have affected their decision to purchase the home (fraud) or the existence of severe defects sufficient to establish that the home was materially different than that bargained for (mistake).

Strong defenses to rescission exist and make the likelihood of victory even more questionable, including where a buyer: (1) fails to file a timely suit; (2) waives the right to rescind having accepted benefits under the agreement with **full knowledge of facts warranting** rescission; (3) fails to perform obligation(s) under the contract; (4) unreasonably delays in asserting a claim to the prejudice of the seller; or (5) seeks unreasonable or uncompensable damages.

While an aggrieved party is entitled to recover bona fide, non-duplicative losses incurred, not all claimed losses are recoverable. The rescission of a housing contract allows the purchaser to collect only "reasonable" out-of-pocket expenses such as costs or repairs and improvements, taxes, interest paid to the seller, escrow and closing costs, operating losses during the buyer's maintenance of the property, and payments made to reduce existing encumbrances on the property. A credit is then given for the reasonable rental value of the property during occupancy.

Until the real estate market strengthens, we will certainly continue to see questionable rescission claims brought against

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Eight attorneys from our Newport Beach headquarters were named to the 2008 roster of Southern California *Super Lawyers*®. Making the list since its original publication in 2004 were co-founding partners **Greg Dillion**, a real estate litigator, and **Tom Newmeyer**, a business lawyer, as well as litigation partner **John O'Hara**. The three were also listed in the 2008 roster of Orange County's "Top 50 *Super Lawyers*". Also named again to *Super Lawyers* were real estate-transactional partners **Mike Cucchissi** and **Jane Samson**, insurance and real-estate litigation partner **Reed Archambault**, and construction litigation partners **Joe Ferrentino** and **Mark Himmelstein**. The latest edition of the peer-review survey was featured in the February 2008 issue of *Los Angeles* magazine.

We congratulate **Bonnie T. Roadarmel** and **Carol Sherman Zaist**, who have been named partners in our Newport Beach headquarters office. Bonnie is an insurance specialist and Carol focuses on business and real estate litigation.

Kudos to **Jan Gruen**, managing partner of our Walnut Creek office, who was honored with the prestigious 2007 Chairman's Award from the Home Builders Assn. of Northern California. Jan was also recognized by the *East Bay Business Times* as one of 25 Women of Distinction for 2008.

The firm's Newport Beach office was recognized among 23 Orange County companies as a "Green Team" in the Jan. 31, 2008, issue of *OC Metro Business*, for "making less waste, with real haste." Since it has been advising homebuilding clients on adopting green-building, the firm decided to "practice what it preaches" by implementing a "green office" campaign. Also, thanks to the members of our Green Committee, **Newmeyer & Dillion** is the first Orange County firm to earn recognition as a partner in the American Bar Assn./U.S. EPA "Law Office Climate Challenge."

Continuing growth has prompted the addition of several new associates to the firm. We welcome **Salman Alam** to the transactional practice and **David E. Beser** to our litigation group in Newport Beach. Litigator **Jenni Khuu Katzer** has been hired as an associate in the Walnut Creek office.

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builders. Less certain is the relative success of rescission as a method offsetting decreased property values.

Jan Gruen is the managing partner of the firm's Walnut Creek office and has more than 18 years' litigation experience representing home builders, landowners and businesses, in insurance and real estate matters. She may be reached at jan.gruen@ndlf.com.

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UPCOMING EVENTS

15th Anniversary West Coast Casualty Construction Defect Seminar

May 7-9, 2008

Disneyland Hotel, Anaheim

Among the premier events addressing construction defect issues, this year's edition features **Jay Freedman** as a panelist on "Going Green: Is the Grass Greener on the Other Side?", from 9:15 a.m.-10:15 a.m., Thurs., May 7, and **Joe Ferrentino** on a panel discussing "How Current Market and Economic Forces May Impact Construction Defect Litigation," from 8:30 a.m.-9:30 a.m. on Friday, May 8. *More info at <http://www.westcoastcasualty.com/evitem.cfm?ID=757>*

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About Newmeyer & Dillion LLP

Newmeyer & Dillion LLP, originally formed in 1984, is comprised of creative, highly motivated business attorneys who possess outstanding credentials, training and experience in their respective fields of practice. The firm represents a wide variety of clients, which include national and local financial institutions, real estate development companies, manufacturers and service organizations, as well as individuals.

Litigation

- *Business*
 - Unfair Competition/Trade Secret
 - Business & Professions Code §17200
 - Partnership Dissolution
 - Lender Liability
 - General Business Disputes
- *Real Estate*
 - Construction
 - Real Estate Finance
 - Environmental Warranty
 - Title
 - Inverse Condemnation and Eminent Domain
 - Government Tort Claims
 - Regulatory Takings
- *Labor & Employment*
 - Wrongful Termination
 - Employment Discrimination
 - Sexual Harassment
- *Insurance & Risk Management*
 - First and Third Party Coverage
 - First and Third Party Bad Faith
- *Products Liability*
- *Appellate Practice*

Business Arrangements

- Formation, Structuring, Maintenance and Evaluation of Business Entities (Corporations, Limited Liability Companies, General Partnerships, Limited Partnerships, Joint Ventures)
- Shareholder, Partnership and Stock Option Plan Agreements
- Purchase and Sale of Businesses
- Business Dissolutions
- Employment and Independent Contractor Matters
- Licensing and Franchising Arrangements

Corporate Finance, Securities and Mergers & Acquisitions

- Venture Capital Financing
- Mergers, Acquisitions, and Leveraged Buyouts
- Public and Private Securities Offerings
- Federal Securities Law

Real Estate Transactions

- Acquisition, Development, Option, Sale and Lease of Real Property (Residential, Retail, Multifamily, Office, Industrial, Agricultural)
- 1031 Like-Kind Exchanges
- Master Planned Community Developments and Community Associations
- Department of Real Estate and Other Regulatory Filings
- Construction Related Matters
- Military Base Reuse
- Due Diligence

Real Estate Lending & Finance

- Documentation of Real Estate, Personal Property and Unsecured Loans
- Coordination of Loan Transactions for Borrowers

Land Use/Environmental

- Development Agreements
- Mitigation Agreements
- Subdivision Map Act
- Environmental Permitting