

**STATE OF THE UNION ON CONDOMINIUM CONSTRUCTION
ISSUES**

and

**HOW TO PROTECT YOUR LEGAL INTERESTS AND
PRESENT A POTENTIAL CLAIM**

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I. INTRODUCTION

This paper focuses on the numerous issues that the authors have encountered over the past 19 years in practicing construction related litigation, and in particular multi-family or condominium related cases. In the early years of practice, the authors practiced primarily on the defense side; however, the last ten years have been devoted almost exclusively to the representation of owners or Condominium or Townhome Associations. Accordingly, the manuscript will have a bias toward that perspective. However, we have attempted to include, in detail, a discussion of the plethora of defense arguments that are typically encountered. While we have had great success for owners in Condominium related litigation, the typical case is filled with numerous complex issues which must be carefully navigated and resolved. This paper will discuss in detail the three main issues which arise in every condominium case- namely, standing, viable causes of action, and applicable statutes of limitation and repose. In other words, who can pursue a claim, what claims can be pursued, and when must those claims be filed? In addition, the paper will discuss the practical steps and critical considerations which must be dealt with on every case.

II. DIFFERENCES BETWEEN CONDOMINIUMS AND TOWNHOMES

It is important to understand the basic differences between a condominium and a townhome. Condominium unit owners own the inside of their units. For example, the common elements, such as the exterior walls and roofs are owned by the Association, which is comprised of the unit owners. Townhouse owners own the complete unit, including exterior surfaces and the land on which the unit is built.

The creation, sale and management of condominiums are governed by the "North Carolina Condominium Act" for condominiums created on or after October 1, 1986. There are

no specific statutes governing most townhouses. However, townhouse projects of more than 20 units and created on or after January 1, 1999 are covered by the North Carolina Planned Community Act which also governs planned developments.

When purchasing a new condo unit created on or after October 1, 1986, the developer (or the developer's agent) must give you a public offering statement. This statement is prepared by the developer and contains information about the size of the development, the projected completion date, the legal documents which govern the property, and the projected common expense assessment. It will also inform the buyer of his/her right to cancel the purchase contract within seven calendar days following the execution of the contract. No public offering statement is required to be given to the buyer when purchasing a condominium created before October 1, 1986, a condominium which is not new, or a townhouse, and there is no automatic right to cancel a buyer's purchase contract. However, when purchasing any pre-owned condominium unit created on or after October 1, 1986, the seller must give a buyer a "resale certificate." This statement sets forth the monthly assessment for common expenses and any other fees payable by the unit owner.

Another and important difference between condominiums and townhouses regards the transfer of control from the developer to the Association. As discussed in detail later in this paper, the transfer of control is very important for purposes of determining when the statute of limitation or repose begins to run.

Finally, under both the North Carolina Planned Community Act and Condominium Act, a declaration creating the condominium or planned community shall be executed in the same manner as a deed by being recorded in every county in which any portion of the condominium is located and indexed in the Grantor/Grantee index. It is very important to review the Declaration

and By-laws of the Association when dealing with any construction issue. These documents often describe who can pursue a claim and in what manner.

The North Carolina Planned Community Act does not discuss what must be included in the declaration of the planned community. However, the North Carolina Condominium Act clearly outlines what must be included within the contents of the declaration. N.C. G. S. § 47C-2-105 sets forth what must be included in the declaration of a condominium, including: The name of the condominium and the name of the association; The name of every county in which any part of the condominium is situated; A legally sufficient description of the real estate included in the condominium; A statement of the maximum number of units which the developer reserves the right to create; A description of the boundaries of each unit created by the declaration, including the unit's identifying number; A description of any limited common elements; Any restrictions on use, occupancy, or alienation of the units; The recording data for recorded easements and licenses appurtenant to or included in the condominium or to which any portion of the condominium is or may become subject by virtue of a reservation in the declaration; and any other matters the developer deems appropriate.

III. WHO HAS STANDING TO PURSUE A CLAIM

1. Early Cases: Association Lacked Standing Because It Was Not The “Real Party In Interest”

The growth of planned unit development has been accompanied by a similar growth in construction defect litigation. See Charles L. Stoff, Stigma Damages: The Case for Recovery in Condominium Construction Defects Litigation, 21 California Western L. Rev. 367 (1988-89); Paul S. Jacobsen, Standing of Condominium Associations to Sue One for All or All for One?, 13 Hamline L. Rev. 15 (Winter 1990); E. Richard Kenney, and Ross Feinberg, Standing of Homeowners' Association to Sue Either on Their Own Behalf or on Behalf of Individual

Property Owners: Procedure Problems and Possible Conflicts Between Homeowners' Associations and Their Members in the Context of Construction Defects Litigation, 25th Annual Community Association Institute Law Seminar (February 20-21, 2004). When faced with construction and design deficiencies resulting in damage to common areas, the litigation attorney must decide who has standing to bring the claim. While we steadfastly believe that the Association should be the proper party in most instances, unfortunately some Courts disagree. A review of the case law surrounding this issue reflects a degree of inconsistency as to whether Associations have standing to file suit. See Rick McConnell, You Can't Always Get What You Want-But if You Try Sometimes, You Might Find, You Get What You Need: The Search for Single Family Homeowner Protections in Missouri, 69 UMKC L. Rev. 409 (Winter 2000).

2. Modern Trend: Associations Possess Standing

The history of these decisions indicates that the momentum has generally turned towards allowing an Association to bring the claims. Initially, the Courts refused such standing. See e.g., Friendly Village Community Association v. Silva Hill Construction Co., 107 Cal. Rptr 123 (Cal. Ct. App. 1973); Equitable Life Insurance Society of United States v. Tinsley Mill Village, 294 S.E. 2d 495 (Ga. 1982); Deal v. 999 Lakeshore Association, 579 P.2d 775 (Nev. 1978); Stoff, *supra* at 371 n. 27 (indicating that Courts traditionally were reluctant to find an association has standing); Restatement (Third) of Property (Servitudes) § 6.11 cmt. a (2000) (acknowledging that, historically, Courts in certain states refused to find that condominium associations have standing to bring claims, even with regard to common elements); Kennedy & Feinberg *supra* at pp 4-5.

The primary basis for determining that Associations lacked standing was the requirement that the Plaintiff be the “real person in interest”. Courts tended to reason that the Association

was not, in reality, the real party in interest and instead only the Association's members had standing to sue, even if the defects affected the common areas. See Jacobsen, *supra* at 16; Kennedy & Feinberg *supra* at pp 4-5. The rationale for these cases arises from the concept that, in the context of a condominium regime, owners typically have two separate real property interests. Kennedy & Feinberg *supra* at p. 5. First, each unit owner has a fee simple ownership interest in his or her unit, as defined by the condominium documents. *Id.*, Jacobsen, *supra*, at 16. Second, each unit owner has an undivided interest in the common elements of a condominium as a tenant in common with all of the other unit owners. *Id.*¹ As explained in some detail by one authority:

Typically, a condominium consists of an apartment house in which the units consist of individual apartments and the common areas consist of the remainder of the building and the grounds. Individual owners maintain their own apartments, and an association of apartment owners maintains the common areas. The major characteristics of a condominium are: (1) individual ownership of a unit or 'apartment', (2) an undivided interest in certain designated common elements which serve all the units in the condominium, and (3) an agreement among the unit owners regulating the administration and maintenance of the property. Because of this mixed joint and separate form of ownership, difficult problems may be presented in determining the proper party to bring an action involving the condominium real property.

Thomas G. Fischer, Standing to Bring Action Relating to Real Property of Condominium, 74 A.L.R.4th 165 §2 at 171 (1989); *see also* Stoff, *supra*, at 368 (also discussing the two types of ownership interests possessed by condominium unit owners).

¹ Typically, the common areas (or "common elements") consist of such things as the outer structure, roofing, hallways, stairwells, elevators, plumbing, landscaping, and outside open areas. Charles L. Stoff, Stigma Damages: The Case for Recovery in Condominium Construction Defect Litigation, 21 California Western L. Rev. 367, 367-68 (1988-1989).

The tide has begun to turn, in large part, due to the complexity of bringing cases in the names of individuals or as a class action. Thus, even absent a statute conferring standing upon an association, some Courts have found such standing to exist. See Doyle v. A&P Realty Corp., 414 A. 2d 204 (Conn. Super. Ct. 1980); 1000 Grandview Association v. Mount Washington Associates, 434 A. 2d 796 (Pa. Super Ct. 1981); Queens Grant Villas Horizontal Property Regimes v. Daniel International Corp., 335 S.E. 2d 365 (S.C. 1985); See also Dockside Ass'n, Inc. v. Detyens, Simmons and Carlisle, 337 S.E.2d 887 (S.C. 1985).²

Some Courts have found that the standing is conferred by reason of the states' corporation statutes, which grant corporations the power to sue or be sued in their own name. See Jacobsen, *supra* at 21-22; Kennedy & Feinberg *supra* at p. 7. In other instances, the power to bring the suit in the name of the Association was premised upon the Association's By-laws and the condominium's Declarations, which require that the Association repair and maintain the common elements. Id.

Various States have enacted statutes to deal with the issue of whether a condominium or an Association has standing to bring suit on its own behalf and in its own name. These statutes are often modeled after the Uniform Common Interest Ownership Act (2001) (hereinafter "UCIOA") and the Restatement (Third) of Property (Servitudes). Section 3-102(a)(4) of the UCIOA states that "the [homeowner's] association...may....institute, defend or intervene in litigation or administrative proceedings in its own name on behalf of itself or two or more unit owners or matters affecting the common interest community." One commentator has opined that the UCIOA's grant of power to associations "is very broad, with the only requirement appearing

² In Dockside, the South Carolina Supreme Court held that the association had standing to sue the contractor because the association had a property interest in the construction defects of the common elements that the association had a duty to maintain.

to be that the issue must affect either the association itself or two or more unit owners.” McConnell, *supra* at 430. Section 6.11 of the Restatement (Third) of Property (Servitudes) (2000) is very similar to the aforementioned UCIOA grant of authority and, in fact, the Reporter’s Notes make it clear that this section is patterned after UCIOA § 3-102(a)(4) and common law authorities.

3. North Carolina Statutory Law on Association Standing

North Carolina has enacted legislation which grants, under the proper circumstances, the right of an HOA to institute litigation on matters affecting the community. N.C. Gen. Stat. § 47C-3-102(4) provides that an Association may: “[i]nstitute, defend, or intervene in its own name in litigation or administrative proceedings on matters affecting the condominium.” The Uniform Comment to this section provides:

Many state condominium statutes give the association the power to sue and be sued in its own name. In the absence of a statutory grant of standing such as that set forth in paragraph (4), some courts have held that the association, because it has no ownership interest in the condominium, has no standing to bring, defend, or to intervene in litigation or administrative proceedings in its own name.

As stated above, the Author of this manuscript believes that nearly all of the applicable claims should be brought by the Association rather than the individual owners if the defect that gives rise to the action is a common element. This right and standing arises from N.C. Gen. Stat. § 47C-107 and the applicable condominium documents that authorize and require the Association to maintain and repair defects to the common areas. N.C. Gen. Stat. § 47C-107 states, in relevant part:

Except as provided in G.S. 47C-3-113(h), the association is responsible for causing the common elements to be maintained, repaired, and replaced when necessary and to assess the unit owners as necessary to recover the costs of such maintenance, repair, or replacement except that the cost of maintenance, repair or replacement of a limited common element shall be assessed as provided in G.S. 47C-3-115(b). Each unit owner is responsible for maintenance, repair and

replacement of his unit. Each unit owner shall afford to the association and when necessary to another unit owner access through his unit reasonably necessary for any such maintenance, repair or replacement activity.

Also, N.C. Gen. Stat. § 47A-26 states: “[w]ithout limiting the rights of any unit owner, actions may be brought by the manager or board of directors, in either case in the discretion of the board of directors, on behalf of two or more unit owners, as their respective interests may appear, with respect to any course of action relating to the common areas and facilities or more than one unit.” See also, The Planned Community Act, N.C. Gen. Stat. § 47F-1-101 *et seq.* (enacted in January 1999 and pursuant to N.C. Gen. Stat. §47F-1-102(d) may be made retroactive); N.C. Gen. Stat. § 47E- 3-102(4) specifically allowing an Owners’ Association to “initiate, defend, or intervene in litigation or administrative proceedings on matters affecting the planned community.”

4. Case Law from Other Jurisdictions

The right of an association to bring a lawsuit has been addressed throughout the State Courts of this country as well as by the United States Supreme Court. The cases addressing this issue have established that associations may bring lawsuits both in their individual capacity and as a representative of its members. Lujan v. Defenders of Wildlife, 504 U.S. 555, 112 S.Ct. 2130 (1992); Hunt v. Washington State Apple Advertising Commission, 432 U.S. 333, 97 S.Ct. 2434 (1977); Warth v. Seldin, 422 U.S. 490, 95 S.Ct. 2197 (1975); Creek Pointe Homeowner’s Association, Inc. v. Happ, 146 N.C. App. 159, 552 S.E.2d 220 (2001).

The following cases ruled that homeowners’ associations possessed standing to sue for defects in common areas or areas of the project where it has the duty to repair or maintain. See *eg.* Raven’s Cove Townhomes, Inc. v. Knuppe Development Co., 114 Cal. App. 3d783, 171 Cal. Rptr. 334 (1st Dist. 1981) (Homeowner’s Association had standing to bring an action for strict

liability and breach of warranty as to defects in common area because association held title to the common areas.); Central Mut. Ins. Co. v. Del Mar Beach Club Owners Assoc., 123 Cal. App. 3d 916, 176 Cal. Rptr. 895 (4th Dist. 1981) (Association had standing to sue as owner of the common areas and buildings for damage to its property and in a representative capacity for individual owners); Orange Grove Terrace Owners Assoc. v. Bryant Properties, Inc., 176 Cal. App. 3d 1217, 222 Cal. Rptr. 523 (2nd Dist. 1986) (Condominium Association had standing to bring an action against Developers for damages occurring to the common areas without joining the individual unit owners); Juno by the Sea Condominium Apartments v. Juno by the Sea Condominium Assoc.(Tower), Inc., 418 So. 2d 1190 (Fla. App. D4, 1982) (Condominium Association had standing to bring an action against Developer for breach of implied and express warranties and negligence in the construction of the building, explaining that it was firmly established that an association may sue on behalf of all unit owners concerning matter of common interest, including but not limited to, common areas.); Starfish Condominium Assoc. v. Yorkridge Service Corp., 295 Md 693, 458 A.2d 805 (1983) (Condominium Association had standing to maintain an action for damages for breach of warranty relating to common elements); Stony Ridge Hill Condominium Owners Assn v. Auerbach, 64 Ohio App.2d 40, 18 Ohio Ops.3d 25, 410 N.E.2d 782 (Erie Co. 1979) (Condominium Association had standing to bring action against developers for negligent construction of roofs, breach of express and implied warranties as to the roofs and for willful breach of contract); Brickyard Homeowners' Assoc. Mgmt. Committee v. Gibbons Realty Co., 668 P2d 535 (Utah 1983) (Association had standing to maintain action against Developer alleging damages for negligent design and workmanship of common areas); Greentree Condominium Asso. v. RSP Corp., 36 Conn. Supp. 160, 415 A.2d 248 (1980) (Association had standing either directly or in a representative capacity, to maintain

an action against Builders for breach of implied warranties for failure to construct common areas in a competent manner because it was charged by its bylaws with the upkeep of such common areas); Roundtree Villas Asso. v. 4701 Kings Corp., 282 SC 415, 321 S.E.2d 46 (1984) (Association had standing to bring an action against Developers for negligence and breach of express and implied warranties with respect to roof defects, because the master deed and bylaws imposed a duty on it to maintain the common areas, which included the roofs); Queen's Grant Villas Horizontal Property Regimes I-V v. Daniel International Corp., 286 SC 555, 335 S.E.2d 365 (1985) (Association had standing to bring an action for construction defects in common elements that it had a duty to maintain); Doyle v. A&P Realty Corp., 36 Conn. Super.126, 414 A2d 204 (1980) (Association has standing to sue on construction and design deficiencies based on contractual duty to maintain the project); Council of Unit Owners of Sea Colony East v. Carl M. Freeman Assoc., Inc., 531 A.2d 1217 (1987) (Association had standing to sue on behalf of owners for defects in common areas by virtue of its responsibility to maintain and repair the common areas and individual owners need not be joined to pursue relief); Standing Rock Homeowners Assoc. v. Misich, 23 P.3d 520 (Wash Ct. App. 2001) (Association that maintained and replaced gates had standing to sue for damages).

5. North Carolina Case Law: Creek Pointe

Creek Pointe Homeowner's Association, Inc. v. Happ, is a recent North Carolina appellate dealing with standing. In Creek Pointe, a homeowner's association and an individual brought a lawsuit to enforce the restrictive covenants of the Creek Pointe community. Creek Pointe at 161, 552 S.E.2d at 222. The Plaintiffs sought both injunctive relief and monetary damages against the Defendant. Id. at 161, 552 S.E. 2d at 223. The Defendant filed a 12(b)(6) Motion to Dismiss as against the HOA asserting a lack of standing to bring the lawsuit. Id. The

Motion did not distinguish between the HOA's standing in a representative or individual capacity.

The Court found that the pertinent features of the Association were that it was contemplated and formed by the developer, that the Articles of Incorporation stated the purposes of the Association are to “provide for the maintenance, preservation and architectural control of the residence lots and roads” and that the Articles of Incorporation further indicated the Association had “any and all powers, rights and privileges which a corporation organized under the Non-profit Corporation Law of the State of North Carolina by law may now or hereafter have or exercise”. *Id.* at 163, 552 S.E. 2d at 224. The Court recognized that HOA's “historically have enjoyed the general right to participate in litigation”. *Id.* The Court further recognized that N.C. Gen. Stat. § 47F allows an HOA standing to institute a lawsuit although they clarified that it is not an automatic right. *Id.* at 164, 552 S.E. 2d at 224 *citing* N.C. Gen. Stat. § 47F *et seq.* (1999).

The Creek Pointe Court stated that an HOA may have standing in either a representative or individual capacity to institute a lawsuit. *Id.* at 165, 552 S.E. 2d at 225. The Court determined that Creek Pointe had standing to maintain the lawsuit for injunctive relief and for money damages in its own capacity. *Id.* at 169, 552 S.E. 2d at 227. The Declaration of Covenants, Conditions and Restrictions, and the By-laws of the HOA stated that the HOA had maintenance responsibilities for the roads and that a fence across the road causally injured the HOA, which injury could be redressed by a favorable verdict. *Id.* Although the HOA may lack standing to bring a representative suit for its members, it had standing in its own capacity, as the entity responsible to maintain the roads, to bring the lawsuit claiming injury to itself. *Id.*

With respect to the representative capacity, relying on Hunt v. Washington State Apple Advertising Commission, the Creek Pointe Court undertook a three part analysis. The Court

found that the Creek Pointe Association met the first two prongs of the tests.³ The Court, however found that the third prong was not met, which is: whether the claims or relief sought require individual participation. *Id.* On this prong, the Creek Pointe HOA's representative capacity case failed because each individual unit owner suffered vastly different damages. Simply put, the financial impact of the restrictive covenant violation (the encroaching fence) varied from significant to minimal. *Id.* at 167-168, 552 S.E. 2d at 226-227.⁴ The Court stated:

An organization generally lacks standing to sue for money damages on behalf of its members if the damage claims are not common to the entire membership, nor shared equally, so that the fact and extent of the injury would require individualized proof.

Id. at 167, 552 S.E. 2d at 226

Therefore, the participation of the individual homeowners was necessary to prove the individual financial damages thereby defeating the standing in a representative capacity. *Id.* at 167-168, 552 S.E. 2d at 226-227.

Thus, based on Creek Pointe, Plaintiffs will argue that the Association has the right to bring claims both in its own capacity and in its representative capacity. The primary argument Plaintiffs will make is that the Association has the right to sue for the defects in its own property (common areas) and sue for the damages that IT will incur when it is required to repair defects in the individual Units; roofs, gutters, down-spouts, exterior walls and exterior building surfaces.

³ "We find that the association meets the first prong of the *Hunt* test", where the individual members of the HOA had standing to bring the suit as individuals. *Id.* at 166, 552 S.E. 2d at 226. The Court stated that owners in a subdivision are beneficiaries of any and all restrictive covenants of the subdivision and have standing to sue on those covenants, even if the documents do not specifically set out this right. *Id.* citing Taylor v. Kenton, 105 N.C. App. 396, 413 S.E.2d 576 (1992).

On the second prong of the Hunt test, the Creek Pointe Court held that the injury for which the HOA sought recovery was "germane" to the purpose of the HOA, which was to maintain and preserve the lots and roads in the community. *Id.* at 167, 552 S.E. 2d at 226. The maintenance and preservation of the roads was part of the "core functions" of the HOA. *Id.*

⁴ The calculation of the damages would require consideration of the homeowner's individual circumstances ranging from preventing access to the road, to spoiling the view from the front porch or reduced the value of the property. *Id.*

These damages will be incurred by the Association and not the individuals. The only individual damages will be the assessment levied by the Association, which pursuant to the Declarations must be uniform. Thus, the Unit owners will be assessed without regard to the amount of damage on their particular Unit but, instead, will be charged based upon the costs to fix all the Units as well as the common areas. This uniform method of assessments mandates that each individual Owner will be damaged in the exact same amount for the defects, which the Association is pursuing. Simply put, each individual's judgment should be identical as to these items.⁵ The "common" manner of these damages qualifies the Association to sue in a representative capacity according to Creek Pointe v. Happ.

6. How to Avoid Standing Issues and Maintain Control

Now, after you have read, or skipped, the proceeding sections and citations, what is the best course of action? Plaintiff's counsel often attempts to avoid standing arguments by suing in the name of all owners and the Association when possible. In order to maintain control, we have the individual unit owners sign a Limited Power of Attorney and Assignment of Claims and Proceeds, which attempts to grant to the Association the individual's right to prosecute settle and expend the proceeds. We have many forms of this document and have attached a simple version to this manuscript. If you are dealing with non-common areas or claims where the HOA does not have standing or simply run across a Judge who refuses to grant the HOA standing, then you can bring a class action, which is discussed below.

Finally, if the Court rules that the Association does not have standing to assert a claim, this is not grounds for dismissal. Rule 17 (a) of the North Carolina Rules of Civil Procedure provides that the failure to join the "real party in interest" shall not be grounds for dismissal of

⁵ Of course, the individuals may have separate claims for interior damages to their home, which the HOA has no standing to pursue.

the case. Accordingly, the Court must allow the opportunity to join in the individual owners if there is a ruling that the Association lacks standing.

IV. COMMON CLAIMS OF PLAINTIFFS IN CONDOMINIUM CONSTRUCTION CASES

In order to advise your clients what to do when they have a construction related claim, you should know what types of claims are typically involved in construction defect, water intrusion and mold litigation. These may involve quite a variety of Defendants and causes of action. Common Defendants include building components manufacturers, appliance manufacturers, general contractors, HVAC, roofing, and plumbing contractors, grading subcontractors, architects, engineers, home building inspectors, sellers of real estate, real estate agents, landlords, homeowners and condominium owners associations, mold remediators, insurance carriers and employers.

Typical causes of action include breach of contract, breach of express warranty, breach of various implied warranties, negligence, negligent misrepresentation, unfair and deceptive trade practices, fraud, product liability, bad faith and workers' compensation claims. Which causes of action are appropriate for your client will be dependent upon the defect or the source of water intrusion causing the mold proliferation, as well as your client's relationship with the potential responsible parties. This paper will discuss the possible causes of action against the more common potential responsible parties. Specifically, this paper will address typical claims asserted by Plaintiffs and common defenses asserted by Builders, Developers and Manufacturers.

We typically assert a standard set of claims in multi-family construction defect cases depending on the type of Defendant. The claims, which are set forth in more detail in the following subsections, include:

Claims against Developers and General Contractors

1. Breach of Contract
2. Breach of Express Warranties
3. Breach of Implied Warranties
 - A. Habitability
 - B. Workmanship
4. Negligence
5. Misrepresentation claims
 - A. Negligent Misrepresentation
 - B. Unfair and Deceptive Trade Practices
 - C. Fraud

Claims against Subcontractors

1. Negligence
2. Breach of Express Warranties

Claims against Manufacturers

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Claims against Design Professionals and Engineers

- 1. Negligence
- 2. Breach of Contract
- 3. Breach of Warranties (express and implied)

Perhaps the most common type of construction defect case is when an owner sues the developer or contractor (including subcontractors) for defective construction of the home. Plumbing leaks, improper window/roof flashing, improper roof construction, installation/application of a defectively designed or installed exterior wall cladding (i.e. hard coat stucco, Exterior Insulation and Finish System (“EIFS”)), improper/defective installation of an otherwise appropriate wall cladding, defective windows, improper and/or over-sized HVAC installation, and improper/defective attic or basement/crawlspace construction or design are all prime examples of improper/defective construction resulting in mold proliferation. Other claims, such as bad concrete, or non-water intrusion related issues are also prevalent. When faced with damage as a result of improper/defective construction by the contractor you will have several causes of action at your disposal to seek recovery.

1. Breach of Contract

Everyone remembers the elements of this cause of action from law school as being: (a) a contract; (b) a breach; (c) causation; and (d) damages. Plaintiffs should only assert this claim

against parties with whom they are in privity of contract. Thus, you will have no breach of contract claims against subcontractors. You will have privity of contract with contractors that undertake maintenance work on the condominium. Also, we look at the condominium documents as contracts and look for expressions of quality in those documents.

Standard contracts, such as those promulgated by the American Institute of Architects (“AIA”) and the Association of General Contractors (“AGC”), as well as custom contracts, often contain representations that the materials being utilized on the construction project are of good quality, new or similar representations.⁶

The express warranties in these forms will be addressed more fully in the next section. The addenda of the contract, specifications, and architectural drawings are also useful documents to determine what representations have been made regarding the quality and types of components and products to be used on the project. Accordingly, pleading this claim is simply a brief description of the contractual provisions which require “quality” or “new” or a certain type of component, along with an allegation asserting that the said component has failed.⁷

⁶ See i.e., Section 3.5.1 AIA A201 (1997) which provides that: the contractor warrants to the owner and architect that materials and equipment furnished under the contract will be of good quality and new unless otherwise required or permitted by the contract documents, that the work will be free from defects not inherent in the quality required or permitted, and that the work will conform to the requirements of the contracted documents. Work not conforming to these requirements, including substitutions not properly approved and authorized, may be considered defective. The contractor’s warranty excludes remedy for damage or defect caused by abuse, modifications not executed by the contractor, improper or insufficient maintenance, improper operation, or normal usage. If required by the architect, the contractor shall furnish satisfactory evidence as to the kind and quality of materials.

⁷ A sampling of cases which hold the general contractor responsible to the owner for construction defects and workmanship deficiencies are as follows: Earls v. Link, Inc., 38 N.C. App. 204, 247 S.E.2d 617, 619 (1978) (general contractor liable for fireplace and attached chimney which failed to adequately remove smoke); Lyon v. Ward, 28 N.C. App. 446, 221 S.E.2d 727 (1976) (general contractor liable for failure to provide useable water supply); Sims v. Lewis, 374 So.2d 298 (Ala. 1979) (contractor responsible for defective septic tank); Carpenter v. Donahoe, 154 Colo. 78, 388 P.2d 399 (1964) (contractor responsible for cracks in basement wall); Weeks v. Slavick Builders, Inc., 24 Mich. App. 621, 180 N.W.2d 503, *affirmed*, 384 Mich. 257, 181 N.W.2d 271 (1970) (contractor responsible for leaky roof); Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 207 A.2d 314 (1965) (contractor responsible for failure to install boiler valve which regulated temperature for water used for domestic purposes); Waggoner v. Midwestern Development, Inc., 83, S.D. 57, 154 N.W.2d 803 (1967) (contractor responsible for water seepage in basement); Humber v. Morton, 426 S.W.2d 554 (Tex. 1968) (contractor responsible for fireplace and chimney defects); Langley

2. Breach of Express Warranties

In any construction defect case against a contractor or developer, Plaintiffs' counsel should immediately and carefully review the contract, marketing materials, websites, correspondence with real estate agents, contract specifications and architectural drawings and models for *any reference* about the quality of the construction materials and components being utilized.

Generally, in the construction industry, an express warranty is a promise, statement or representation in reference to the character or quality of work, goods, or services which becomes a part of the bargain. See Burke County Public Schools Board of Education v. Juno Constr. Corp., 50 N.C. App. 238, David A. Sentor, Construction Warranties and Guarantees: A Primer, The Construction Lawyer (Winter 2003 pp. 17-25). An express warranty represents an assurance by one contracting party of a fact upon which the other party may rely. See 17A C.J.S. Contract § 342 (1963); Foster, Design and Construction Law (1991). These express warranties may arise in the contract documents, by oral statements, or by statute. Obviously oral express warranties may prove problematic because of the merger clauses in most offers to purchase and contract, but this has never stopped any of our claims. Thus, you may begin your research by looking at

v. Helms, 12 N.C. App. 620, 184 S.E.2d 393 (1971) (the court held that an agreement to construct a house in a good and workmanlike manner did not exclude undertaking to protect the purchaser against the use of bad and unsuitable material in doing the work undertaken); Delly v. Lehtonen, 21 Ohio App.3d 90, 486 N.E.2d 251 (1984) (the court upheld an owner's suit against the general contractor based on the subcontractor's improper installation of drain tile, which resulted in water damage in the basement. The contractor chose the subcontractor and was responsible for the poor workmanship of the sub.); Shaw v. Bridges-Gallagher, Inc., 174 Ill. App.3d 680, 528 N.E.2d 1349 (1988) (The general contractor was responsible for the work of the roofing contractor.); Rivnor Properties v. Herbert O. Donnell, Inc., 633 So.2d 735, 744 (La. Ct. App. 1994) (court held against the general contractor who was charged by contract with the sole responsibility for all construction means, methods, techniques, sequences and procedures and for coordinating all portions of the work under the contract. Thus, his duty to the owner was to conduct periodic inspections as needed to assure all work was performed properly, resulting in a building free from defects); Point East Condominium v. Cedar House, 663 N.E.2d 343 (Ohio App. 1995) (the contractor was responsible for the work of his subcontractor); Brooks v. Hayes, 395 N.W.2d 167 (Wis. 1986) (delegation of performance of masonry work did not relieve general contractor of liability for breach of construction contract when mason, and independent contractor, negligently performed that part of general contractor's contractual obligation).

your state's statute. For example, in North Carolina we often cite N.C. Gen. Stat. § 25-2-313, which provides:

(1) Express warranties by the seller are created as follows:

(a) Any affirmation of fact or promise made by the seller to the buyer which relates to goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

(2) It is not necessary to the creation of an express warranty that the seller use formal words such as “warrant” or “guarantee” or that he has a specific intention to make a warranty, but an affirmation merely of the value of the goods or a statement purporting to be merely the seller’s opinion or commendation of the goods do not create a warranty.

Although this UCC statute typically only applies to goods, it has also been applied to construction projects. See Westover Products, Inc. v. Gateway Roofing Co., 94 N.C. App. 63, 380 S.E.2d 369 (1989); Russell v. Baity, 95 N.C. App. 422, 382 S.E.2d 217 (1989).

Generally, the essential elements of a breach of express warranty claim are:

(1) Existence of a warranty to the damaged party;

(2) Breach of the warranty; and

(3) Damage caused thereby.

13 Am Jur.2d, Building and Construction Contracts, 115.⁸

⁸ A sampling of relevant cases include: Elmore v. Blume, 31 Ill. App.3d 643, 334 N.E.2d 431. (Builder-vendor’s oral assurance to purchasers that after “rainy season” basement would be dry constituted express warranty and subsequent water problems in basement resulted in breach of express warranty as well as breach of implied warranty

Plaintiffs should think very broadly when alleging breach of express warranties. If a particular building material or component failed within the applicable statutory limitations period, an express warranty was breached. Defense counsel will attempt to narrowly construe any alleged express warranty. It is important to carefully review the contract documents in this regard. Moreover, oral representations made by the developer or builder or their agents about the quality of construction provide a basis to assert this course of action.

A plethora of case law exists over whether certain words or conduct rise to the level of an express warranty. The cases dealing with a Developer's express warranties are fairly straightforward and this will not be discussed in depth in this manuscript. However, the express warranties from contractors demands attention. All construction industry form documents include express warranties with regard to services and goods. Claims on these warranties often arise when remedial construction activities are poorly performed and the HOA is forced to sue the repair contractor or when the HOA settles with the Developer and receives an assignment of the Developer's claims against the Builder. Too often general contractors naively think that a specific express warranty provision in the contract, such as, "one year", is the only express warranty made. Typically, these types of express warranty provisions pertain to a contractor's obligation to correct or perform repair work itself, which is separate from other express warranties within the contract. However, a careful review of the construction contract will reveal other express warranties, not just those related to the contractor's obligation to correct or repair

of habitability); Leggette v. Pittman, 268 N.C. 292, 150 S.E.2d 420 (1966) (failure to correct cracks and squeaks in flooring violated express warranty) Salem Towne Apartments, Inc. v. McDaniel & Sons Roofing Co., 330 F. Supp 906 (E.D.N.C. 1970) (roofing contractor's failure to obtain uniform color in violation of express warranty to do so); Russell v. Baity, 95 N.C. App. 422, 382 S.E.2d 217 (1978) (failure of heating system to "meet state and local codes" is a breach of express warranty); Haywood Street Redevelopment Corp., Inc. v. Peterson, 120 N.C. App. 832, 463 S.E. 2d 564 (1995), *cert. denied*, 342 N.C. 655 (1996) (a breach of warranty continues as a new breach every day that the work fails to comply with the express warranty).

work. Courts have held that repair warranties are in addition to, and not in lieu of, defect-free warranty obligations. See McDevitt & Street Co. v. K-C Air Conditioning Serv., 203 Ga. App. 640, 418 S.E.2d 87 (Ga. App. 1992); All Seasons Water Users Assoc. v. Northern Improvement Co., 399 N.W.2d 278 (N.D. 1987).

Most contracts utilize the American Institute of Architects (AIA) forms. When dealing with AIA Document A201 (1997 ed.), the Contractor warrants that the materials and equipment will be of good quality and new, that the work will be free from defects, and the work will conform to the requirements of the contract documents.⁹ Article 3.12 of A201 addresses the submission of shop drawings, product data and samples, all of which should give rise to express warranties.

The Associated General Contractors of America (AGC) Document No. 200 (2000 ed.) § 3.8.1 provides for similar warranties that the materials and equipment will be new, of good quality and free from defective material defects. This document also calls for the contractor to obtain warranties from subcontractors and material suppliers.

The Construction Owners Association of America (COAA) has published a set of contract documents that are loaded with contractor warranties that will prove very helpful. See COAA Document No. B-200CG. These contracts provide, among other things, that the materials will be new, conform to specifications, descriptions, instructions, drawings, data, and samples, be merchantable and be free from defects. All of these warranties add to the warranties that are required from the manufacturer. It further provides for a one-year warranty to correct, that all work and materials will comply with the contract documents, and that

⁹ Similar language is found in Article 4.5.1 of the A401, Standard Form of Agreement Between Contractor and Subcontractor. Your HOA client may prove to be a third-Party beneficiary of such warranties or you may be able to capitalize on this warranty should you settle with the Contractor and receive an assignment of claims against the subcontractors.

subcontractor/supplier warranties comply with the contract documents and run to the benefit of the owner.

This brings us to one of the most misunderstood concepts of express warranties, at least in the public context. We often hear about the “Contractor’s one year warranty”. Contractors who have yet to be forced through the litigation process typically insist that their only obligation is to “come back” during the one year warranty period. Of course, this is incorrect. The AIA, AGC and COAA documents referenced above make clear that the referenced one-year period is a correction period that is in addition to the contractor's other warranties. Many non-standard contracts are far less clear. However, just like the Court’s dealings with prior versions of AIA 201, most jurisdictions will and should adopt the majority position that this language is simply a correction warranty that is non-exclusive. See Burton-Dixie Corp. v. Timothy McCarthy Constr. Co., 436 F.2d 405(5th Cir. 1971); Bridges v. Ferrell, 685 P.2d 409 (Okla. App. 1984).

Certain defenses deserve special attention. We always look to see whether the Contracts have specific notice and opportunity to cure provisions, such as that contained in Article 12 of AIA A201. Typically, however, we are more concerned with Statutes of Limitation and Repose and file right away. We follow up with letters and provide opportunities to cure based upon our experts advice and scope of repair. Also, you can argue that the “cure” provision is not an exclusive remedy clause. See Barrack v. Kolea, 651 A. 2d 149, 154 (Pa. 1994). Please note, however, that Defense attorneys take a hard-line view of this defense. See Lorence H. Slutzky, Fully Understanding and Utilizing the Call Back Warranty, *The Construction Lawyer* (Winter 2003 pp. 13-16).

3. Breach of Implied Warranties

With respect to contractors and developers, you should have the opportunity to bring two types of implied warranty claims. See Skylar, Filer and Bird, Implied Duties of Contractors: Wait a Minute, Where is That in My Contract, *The Construction Lawyer* (Summer 2001 pp. 11-45). The first is the implied warranty of habitability and the second is the implied warranty of workmanlike construction. In residential construction, the implied warranty of habitability that accompanies new dwellings is harsh for builders. For example, in Medlin v. FYCO, Inc., 139 N.C. App. 534, 541, 534 S.E.2d 622, 627 (2000), North Carolina Court of Appeals held a builder to “strict liability” for a construction defect. The Court held irrelevant the fact that the builder did not know of the product defect at the time of installation.

The second implied warranty deals with workmanship. In North Carolina, as in many states, it has long been recognized that a contractor impliedly warrants the quality of his work:

It is the duty of the builder to perform his work in a proper and workmanlike manner...This means that the work shall be done in an ordinarily skillful manner, as a skilled workman should do it...There is an implied agreement such skill as is customary will be used. In order to meet this requirement, the law exacts ordinary care and skill only.

Moss v. Best Knitting Mills, 190 N.C. 644, 130 S.E. 635, 637 (1925).

In Cantrell v. Woodhill Enterprises, Inc., the North Carolina Supreme Court set forth the following elements for this claim: (1) a construction contract; (2) failure to perform in a workmanlike way or failure to possess the skills necessary to perform the work; and (3) damage resulting from the failure. 273 N.C. 490, 160 S.E.2d 476 (1968). The contractor’s duty to construct in a workmanlike manner extends to materials used in the construction. Langley v. Helms, 12 N.C. App. 620, 184 S.E.2d 393, 397 (1971). Accordingly, an owner may assert a warranty claim against a contractor for defects in workmanship or materials even though the

contract may not contain an express warranty to that effect. Id. In addition, a contractor is responsible for any actions of his subcontractors either in failing to use good quality materials or to construct in a workmanlike manner, or any negligent conduct on their part, if the general contractor knew or reasonably should have known of those conditions. Lindstrom v. Chestnut, 15 N.C. App. 15, 189 S.E.2d 749, 754 (1972). See also, Vantage View Inc. v. Bali East Development Corp., 421 So.2d 728 (Fla. 4th DCA, 1982) (establishing in Florida a viable cause of action against condominium developer for breach of implied warranties); Drexel Properties, Inc. v. Bay Colony Club Condominium, Inc., 406 So.2d 515 (Fla. 4th DCA), disapproved in part, 620 So.2d 1245 (establishing the rights of condominium unit owners for breach of common law implied warranties by developer/builders In Florida).

Manufacturers are subject to UCC implied warranties for all products they supply to the project. See N.C. Gen. Stat. § 25-2-314. However, manufacturers will argue that owners do not satisfy the definition of a “buyer” under the UCC. See N.C. Gen. Stat. §25-2-103. In addition, manufacturers will argue that the defective product or “good” becomes realty once installed on the project, and that the UCC no longer applies. See N.C. Gen. Stat. Section 25-2-105(1) for a definition of goods. The full extent of these defenses cannot be addressed in this manuscript. However, a simple strategy can be suggested. First argue implied contracts to get around the Privity issues. Also, if you find yourself falling prey to numerous manufacturer warranty defenses such as privity and the like, settle with the builder and go up the chain of distribution through assignments of claims. This worked well for us in the Baypoint vs. Dryvit case. See Board of Directors of the Bay Point Condominiums Assoc., Inc., et al. v. RML Corp., Dryvit Systems, Inc., Bishop Wall Systems, et al. (Circuit Court of Norfolk, VA CL99-475) where we eventually obtained the first verdict against a manufacturer of EIFS. Most lawyers are surprised

to discover that we proceeded as the Developer in that case after settling and receiving an assignment of claims.

4. Negligence Claims and the Economic Loss Rule

A Plaintiff's preference, in any construction defect case, is to assert a negligence claim against the responsible Developer, General Contractor, Subcontractor, Design Professional and Manufacturer. Actionable negligence presupposes the existence of a legal relationship between parties by which the injured party is owed a duty by the other. See Pinnex v. Toomey, 242 N.C. 358, 362, 87 S.E.2d 893, 897 (1955). A duty of care may arise out of a contractual relationship, "the theory being that accompanying every contract is a common law duty to perform with ordinary care, the thing agreed to be done, and that a negligent performance constitutes a tort as well as a breach of contract". See Olympic Products v. Roof Systems, Inc., 88 N.C. App. 315, 363 S.E.2d 367, 371 (1988) (citing Pinnex, 242 N.C. at 362, 87 S.E.2d at 898). Thus, if a defective product is used, the argument can be made against the contractor that the contract has been "negligently performed".

However, recently, in Finley Forest Condominium Assoc, Inc. v. Perry, 163 N.C.App. 735, 594 S.E.2d 227 (2004), the North Carolina Court of Appeals held that a subcontractor owed no duty to a condominium association to waterproof the building. In this case, the Condominium association hired Neuse River Construction, Inc. to replace the roofs on the condominium's buildings. Neuse River hired a subcontractor to install pre-manufactured trusses and to lay plywood over the trusses on the buildings. The subcontractor's contract subjected the subcontractor to penalties for delays, and the subcontractor helped Neuse River in removing weatherproofing rubber and plywood from the roofs. A heavy rain then caused substantial water damage to the buildings. While the Court held Neuse River liable for the damages, based on a six

factor balancing test, the Court did not hold the subcontractor liable because the subcontractor did not owe a duty to the condominium association. The balancing factors included: 1) the extent to which the transaction was intended to affect the other person; 2) the foreseeability of harm to him; 3) the degree of certainty that he suffered the injury; 4) the closeness of the connection between the defendant's conduct and the injury; 5) the moral blame attached to such conduct; and 6) the policy of preventing future harm. The Court held that, when assisting Neuse River, the subcontractor's sole motivation for assisting in the removal was a desire to stay within the time allotted by contract for the installation of the trusses and the subcontractor did not assume a duty to weatherproof the buildings.

Also, in Lynn v. Overlook Development, 328 N.C. 689, 403 S.E.2d 469 (1991), the North Carolina Supreme Court did not hold a building inspector liable to unit owners for issuing a construction permit to an unlicensed contractor. The Court held that the buyers elected to take title and assume occupancy of the townhouse in violation of the law prior to the inspector making a final inspection and issuing a certificate of occupancy. In December 1984, the city issued a construction permit to an unlicensed contractor. In February 1985, the buyers entered into a contract agreeing to buy a townhouse being built by the unlicensed contractor. In August 1985, the buyers moved into the townhouse, and then the building inspector issued a certificate of compliance. Thereafter, the city condemned the townhouse as unfit for human habitation and ordered it demolished at the buyers' expense.

The Court held that even assuming the issuance of the permit to the contractor was negligent, the buyers and the contractor did not enter into their contract until three months later, and the buyers did not take title to the townhouse until eight months later. The Building Code required the contractor to notify the inspector that the work is ready for inspection. The buyers

did not allege that the inspector was notified or that he failed to make any necessary inspections. Furthermore, "plaintiffs elected to take title and assume occupancy of the townhouse in violation of the law before the building inspector had opportunity to make final inspection and issue a certificate of compliance. This act was an intervening, independent cause of plaintiffs' damages. Therefore, the acts or omissions by the city building inspector did not proximately cause the plaintiffs' damages."

In addition, there is ample case law in many jurisdictions, as there is in North Carolina, that a violation of the Building Code constitutes negligence *per se*. See Olympic Products, supra.; See also Lindstrom v. Chesnutt, 15 N.C. App. 15, 189 S.E.2d 749, 754 (1972) (Court held that violation of building code is negligence *per se* and that purpose is "to establish minimum standards, materials, designs, and construction of buildings for the safety of the occupants[.]"); Oates v. JAG, Inc., 314 N.C. 276, 333 S.E.2d 222, 225 (1985); Drum v. Bisaner, 252 N.C. 305, 113 S.E.2d 560 (1960); Sullivan v. Smith, 56 N.C. App. 525, 289 S.E.2d 870, cert. denied, 306 N.C. 392, 294 S.E.2d 220 (1982) and cases cited therein; See also Stone's Throw Condominium Association, Inc. v. Sand Cove Apartments, Inc., 749 So.2d 520 (Fla. 2d DCA, 1999) (holding that a condominium association in Florida has a cause of action to recover economic loss damages from design professionals based on a cause of action for negligence).

Therefore, in any construction defect case, Plaintiffs should seek out Building Code provisions which are applicable to the failed or defective building components. Some jurisdictions such as Virginia and North Carolina have adopted statewide Building Codes. Furthermore, local municipalities and/or counties often adopt additional requirements, which also must be considered. In addition to searching for prescriptive provisions, the Building Code often has performance-based provisions which may be applicable. For example, a contractor

under the Building Code must construct a building which prevents the harmful intrusion of water. If the building leaks, from whatever failed or defective building component, the Building Code has been violated.

As the economic loss rule defense has gained some notoriety in recent years, we have included an entire section on this defense.

5. Negligent Misrepresentation

In a nutshell, this claim can be effective if Plaintiffs can prove that one of the parties involved with the construction defect knew or should have known of the problem, and failed to inform the Plaintiffs. Focused discovery of the manufacturer's file may reveal a past history of problems with the defective component, or perhaps a general contractor that has experienced problems on earlier projects.

The North Carolina Supreme Court has stated that the rules set forth in Restatement (Second) of Torts § 552 (1977), represents the soundest approach to liability for negligent misrepresentation. Raritan River Steel Company v. Cherry, Bekaert & Holland, 322 N.C. 200, 367 S.E.2d 609 (1988). Under the Restatement, as applied by the Supreme Court, a Defendant who (1) during the course of a business, profession or employment, or in any other transaction in which the Defendant has a pecuniary interest, (2) supplies false information for the guidance of others, in their business transaction, (3) is subject to liability for pecuniary loss caused to them, (4) by their justifiable reliance upon the information, (5) if the Defendant fails to exercise reasonable care or competence in obtaining or communicating information. Restatement (Second) of Torts § 552(1) (1977). The Plaintiffs need to prove Defendant's knowledge of reckless falsity. Id.

In accepting the Restatement (Second) of Torts, the Raritan Court rejected three other tests. One of these tests restricted liability to those in privity with the contract, which the court rejected as too restrictive. A test of liability to anyone who was “reasonably foreseeable” was rejected as being too expansive. A third test, which had been applied by the Court of Appeals, was also rejected because it required an assessment of “moral blame” and a policy of preventing future harm, which the Supreme Court thought would be too difficult to apply. See Day and Morris, North Carolina Law of Torts § 27.50, fn. 72.

The issue of negligent misrepresentation is a question for the jury. In Forbes v. Par Ten Group, Inc., 99 N.C. App. 587, 595, 394 S.E.2d 643, 648 (1990), the North Carolina Court of Appeals stated:

[i]t is, in general, a matter of the care and competence that the recipient of the information is entitled to expect in the light of the circumstances and this will vary according to a good many factors. The question is one for the jury, unless the facts are so clear as to permit only one conclusion.

The particulars in which the recipient of information supplied by another is entitled to expect the exercise of care and competence depend upon the character of the information that is supplied. When the information concerns a fact not known to the recipient, he is entitled to expect that the supplier will exercise that care and competence in its ascertainment which the supplier professes to have by engaging it. Thus, the recipient is entitled to expect that such investigations as are necessary will be carefully made and that his informant will have normal business or professional competence to form an intelligent judgment upon the data obtained.

Id. (emphasis omitted).

As negligence cases are not “normally” or “ordinarily susceptible to summary adjudication,” it is rare that a negligent misrepresentation case will be dismissed by means of summary judgment motion. Id. Both a corporation and its agents may be held liable for negligent misrepresentation. A corporation is liable for negligence through the doctrine of respondeat superior if its agents are negligent. Id. “A corporation is liable for the torts and

wrongful acts or omissions of its agents or employees acting within the scope of their authority or the course of their employment.” Raper v. McCrory-McLellan Corp., 259 N.C. 199, 205, 130 S.E.2d 281, 285 (1963).

The following conduct has been held to support a claim for negligent misrepresentation:

(a) Developer of property provided potential builder with information indicating that property was suitable for building and neglected to provide information showing property might not be suitable. Stanford v. Owens, 76 N.C. App. 284, 332 S.E.2d 730, cert. denied, 314 N.C. 670, 336 S.E.2d 402 (1985); and

(b) Soil engineer hired by owner provided negligently prepared soil report to the general contractor. Davidson & Jones v. County of New Hanover, 41 N.C. App. 661, 255 S.E.2d 580, cert. denied, 298 N.C. 295, 259 S.E.2d 911 (1979). See also Howell v. Fisher, 49 N.C. App. 488, 272 S.E.2d 19 (1980), cert. denied, 302 N.C. 218, 408 S.E.2d 198 (1981).

6. Unfair and Deceptive Trade Practices

This statutory action is sui generis, apparently sounding in tort, but neither wholly tortious nor wholly contractual in nature. See Bernard v. Central Carolina Truck Sales, Inc., 68 N.C. App. 228, 230, 314, S.E.2d 582, 584 (1984). A brief explanation of the history of North Carolina’s Unfair and Deceptive Trade Practices Act is helpful to understand that the Act was intended to establish new rights that encourage ethical behavior in the marketplace and provide redress to those wronged by unscrupulous behavior. In the 1960’s, the consumer protection movement became a potent political force. The doctrine of caveat emptor, which had arisen in the days of personal transactions with merchants with whom one had a long-term relationship, obviously was inappropriate for modern consumer transactions.

Consumer protection regulations traditionally had been vested at the federal level with the Federal Trade Commission. Thus, the starting point in any study of this developing area is the 1914 Federal Trade Commission Act (“FTCA”). 15 U.S.C. § 45(a)(1). The key language and core concepts of “unfairness,” “deception,” and methods of “competition” and their relationship with “commerce” or “business” are found in Title 15 § 45(a)(1) of the United States Code as follows: “Unfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce are declared unlawful.” *Id.* Unfortunately, the FTCA was of little consolation to the typical victim of unscrupulous practices because it was construed to vest enforcement solely with the Federal Trade Commission and granted no private right of action to individuals. Individual consumers simply were unprotected because, when they brought traditional common law statutory claims against unscrupulous practitioners, the claims were often defeated by a barrage of effective technical defenses. Accordingly, the Federal Trade Commission encouraged States to adopt legislation similar to the FTCA, which are commonly referred to as “little FTCA Acts,” since they are identical to Section 5 of the FTCA. See Richard D. Conner, Cynthia A. Hatfield, Carmen J. Stuart, Unfair and Deceptive Trade Practices in Construction Litigation and Arbitration, 40 S.C. L. Rev. 977, 979 (1980).

In 1967, the North Carolina legislature, with the support of then Attorney General Robert Morgan, passed the initial version of N.C. Gen. Stat. § 75-1.1. The North Carolina Unfair and Deceptive Trade Practices Act adopted language identical to that contained in the FTCA as to unfair methods of competition and unfair and deceptive acts. See N.C. Gen. Stat. § 75-1.1(a). Using federal precedents which are applicable to state causes of action under the North Carolina Unfair and Deceptive Trade Practices Act, Lindner v. Durham Hoisery Mills, 761 F.2d 162 (4th Cir. 1985); Johnson v. Phoenix Mut. Life Ins. Co., 300 N.C. 247, 266 S.E.2d 610 (1980), Courts

applying North Carolina law have recognized the broad remedial sweep of the Unfair and Deceptive Trade Practices Act. As is demonstrated below, the Act has been interpreted so as not to be laden with the numerous pitfalls that plague traditional common law claims.

A. Wide Breadth of the Unfair and Deceptive Trade Practices Act

The traditional common law statutory claims that combated unfair and deceptive business acts have often required a multitude of onerous elements and were subject to numerous defenses. The North Carolina Supreme Court has identified these pitfalls as the legislative purpose behind North Carolina's "little FTC Act:"

Such legislation was needed because common law remedies have proven often ineffective. Tort actions for deceit in cases of misrepresentation involve proof of scienter as an essential element and were subject to the defenses of "puffing." Proof of actionable fraud involved a heavy burden of proof, including a showing of intent to deceive. Actions alleging breach of express and implied warranties in contracts also entailed burdensome elements of proof. A contract action for rescission or restitution might be impeded by the parol evidence rule where a form contract disclaimed oral representations made in the course of a sale. Use of a product after discovery of a defect or misrepresentation might constitute an affirmation of the contract. Any delay in notifying a seller of an intention to rescind by foreclosing an action for rescission.

Marshall v. Miller, 302 N.C. 539, 543, 276 S.E.2d 397,400 (1981).

In order to combat this inequity, our courts have broadly construed the Act on a case-by-case basis. In Johnson v. Phoenix Mut. Life Ins. Co., 300 N.C. at 247, 266 S.E.2d at 621, the North Carolina Supreme Court stated, "the broad language of the statute indicates that the scope of its concept and application is not limited to precise acts and practices which can be readily cataloged."

B. Three Factor Analysis

North Carolina Courts apply a three factor analysis when determining the sufficiency of an unfair trade practices claim. First, there must be a practice, act, or representation that falls

within the definition of “unfair” or “deceptive.” Our courts generally have described a practice as “unfair” when it offends established public policy as well as when the practice is immoral, unethical, oppressive, unscrupulous, or substantially injurious to consumers. Johnson v. Phoenix Mut. Life Ins. Co., 300 N.C. at 263, 263 S.2d at 621. An act is “deceptive” if it has the capacity or tendency to deceive. Id. at 265, 263 S.E.2d at 622.

Second, the act or practice must have an impact on the marketplace. Usually, an act has been found to impact the marketplace either because it was part of a larger pattern, or because the act was so strongly against public policy that the court’s failure to redress the behavior threatened consumers in general. See Conner, Unfair and Deceptive Trade Practices in Construction Litigation and Arbitration, 40 S.C. L. Rev. at 93. In light of numerous court rulings, Defendants cannot claim that construction contracts do not fall within the “in or affecting commerce” requirement. See Love v. Keith, 95 N.C. App. 549, 239 S.E.2d 674 (1989); Quate v. Caudle, 95 N.C. App. 80, 381 S.E. 2d 842, cert. denied, 325 N.C. 709, 388 S.E.2d 462 (1989).

Third, and finally, North Carolina courts require that the act or practice have an adverse impact on the aggrieved individual or entity in the form of actual damages. See Miller v. Ensley, 88 N.C. App. 686, 691, 365 S.E.2d 11, 14 (1988).

C. Deceptive Acts

The concept of deception relative to N.C. Gen. Stat. § 75-1.1 is quite broad. See Noel L. Allen, North Carolina Unfair Business Practice, § 19.01.

Deception can be best understood as a continuum ranging from outright fraud (a *per se* violation of Section 75-1.1) to statutory misrepresentation (misrepresentation made illegal by statute without regard to intent of the representor. Misrepresentation, constructive fraud, negligent misrepresentation and representations having only the capacity or tendency to deceive though literally true also qualify as deception).

Relying on decisions interpreting the FTCA, the North Carolina Supreme Court has held that an act is deceptive if it has “the capacity or tendency to deceive.” Johnson v. Phoenix Mutual Life Insurance Company, 300 N.C. 247, 266, 266 S.E.2d 610, 629 (1980). To be actionable, representations need not be affirmative, but may also be an omission. See Winant v. Bostic, 5 F.3d 767 (4th Cir. 1993) (developer’s omissions of material facts concerning permits was found to be an unfair and deceptive trade practice).

D. Unfair Acts

The North Carolina Supreme Court has approved the following definition of “unfair:”

While an act or practice which is unfair may also be deceptive, or vice versa, it need not be so for there to be violation of the Act...The concept of unfairness is broader than and includes the concept of “deception.” A practice is unfair when it offends established public policy as well as when the practice is immoral, unethical, oppressive, or unscrupulous or substantially injurious to consumers...A party is guilty of an unfair act or practice when it engages in conduct which amounts to an inequitable assertion of its power or position.

Johnson v. Phoenix Mut. Life Ins. Co., 300 N.C. at 263-64, 266 S.E.2d at 621-22.

Thus, it is clear that unfairness is far broader than “deception” and encompasses more actions than those which have a “tendency or capacity to deceive.” These actions have included intentional torts (Love v. Pressley, 34 N.C. App. 503, 239, S.E.2d 574 (1977), cert. denied, 299 N.C. 441, 241 S.E.2d 843 (1978); coercion (Wilder v. Squires, 68 N.C. App. 310, 315 S.E.2d 63, cert. denied, 311 N.C. 769, 321 S.E.2d 158 (1984); and conspiracy (Pedwell v. First Union National Bank of North Carolina, 51 N.C. App. 236, 275 S.E.2d 565 (1981)).

E. Treble Damages and Attorney’s Fees

If a Defendant violates the Unfair and Deceptive Trade Practices Act, treble damages must be awarded. N.C. Gen. Stat. § 75-16; Bhatti v. Buckland, 328 N.C. 240, 243, 400 S.E.2d

440, 442 (1991); Kewaunee Scientific Corp. v. Pegram, 130 N.C. App. 576, 580, 503 S.E.2d 417, 420 (1998).

The Court has the discretion to award a party its reasonable attorney's fees in an Unfair and Deceptive Trade Practices action upon a finding by the presiding judge that: (1) The Defendant has willfully engaged in the act or practice, and there was an unwarranted refusal by the Defendant to fully resolve the matter which constitutes the basis of such suit; or (2) the Plaintiff knew, or should have known, the action was frivolous and malicious. N.C. Gen. Stat. § 75-16.1.

F. Few Defenses

Very few defenses are available under the Unfair and Deceptive Trade Practices Act. Scienter is not an element, and it is not necessary to show fraud, bad faith, or intentional deception. Overstreet v. Brookland, 52 N.C. App. at 444, 279 S.E.2d at 1. Nor is it necessary that actual deception has occurred, but only that the action has a tendency or capacity to deceive. See Bailey v. Lebeau, 318 N.C. 411, 348 S.E.2d 524 (1986); Forbes v. Par Ten Group, Inc., 99 N.C. App. 587, 394 S.E.2d 643 (1990); Love v. Keith, 95 N.C. App. 549, 383 S.E.2d 674 (1989). It is irrelevant whether the Defendants made their representations negligently and in good faith, and in ignorance of their falsity, and without intent to mislead. See Marshall v. Miller, 302 N.C. 539, 276 S.E.2d at 397; Forbes v. Par Ten Group, Inc., 99 N.C. App. at 601, 394 S.E.2d at 651. In fact, even truthful statements may be deceptive if they have the capacity or tendency to deceive. Pearce v. American Defender Life Ins. Co., 316 N.C. 461, 471, 343 S.E.2d 174, 180 (1986). When dealing with unfairness, actual misstatements are not required because a technically accurate representation may, in some circumstances, be considered to have a

tendency to deceive. See Davidson v. Knauff Ins. Agency, Inc., 93 N.C. App. 20, 376 S.E.2d 488, disc. rev. denied, 324 N.C. 577, 381 S.E.2d 772 (1980).

Claims for unfair and deceptive trade practices in construction defect claims, as with any litigation, can be potent given the broad scope of the statute as well as the availability of treble damages and attorney's fees. The key is proving knowledge of the defective product prior to installation.

7. Fraud

Plaintiffs may find recourse for construction defect damage as a result of defective construction through a fraud claim. However, an owner/Plaintiff is only entitled to recover for fraud when the following elements are established: (1) false representation or concealment of a material fact; (2) reasonably calculated to deceive; (3) made with the intent to deceive; (4) which does, in fact, deceive; and (5) resulting in damage to the injured party. See Terry v. Terry, 302 N.C. 77, 273 S.E.2d 674, 677 (1981). See also, Winant v. Bostic, 5 F3d 767 (4th Cir. 1993). In Winant, Plaintiff focused on the developer's failure to follow permit formalities as well as their refusal to construct what they promised in obtaining a multi-million dollar verdict.

8. Homeowner vs. Board and Association

Sometimes it becomes necessary for the condominium owner to sue the Board of Directors. This situation can arise when the Board is controlled by the Developer or is negligent in its actions. Thus, actions for construction defects can be pursued through the use of shareholder derivative actions when the Developer controls the Board and refuses to allow the Association to prosecute actions against the Developer and others.

Second, with respect to damage caused by the failure of the Association to maintain the common areas, a member may sue the Association and its Board under a variety of theories,

including breach of fiduciary duties, breach of the duties of loyalty and due care, negligence and breach of contract. The primary issue in these cases is whether the business judgment rule will insulate the Board from liability. See Steven S. Weil presentation at the 25th Annual CAI Law Seminar, “Recent Trends in the Business Judgment Rule and Other Standards of Review.”

In some instances, an association may sue a unit owner to comply with condominium restrictions. For example, in Laurel Park Villas Homeowners Ass’n, Inc. v. Hodges, 82 N.C.App. 141, 345 S.E.2d 464 (1986), a condominium homeowners’ association sought to enjoin a condominium owner from further violation of the association’s restrictions or for the owner to vacate. After the unit owner purchased a condominium, a complaint was made against the owner for violating the restrictions by having his minor child living with him on the premises, for parking his pickup in the common parking lot and by playing his stereo too loud. The Court held that the association lacked standing because the restrictions that the association sought to enforce were unrecorded. Therefore, the Court held that the restrictions were unenforceable and the association lacked standing to sue in its own name to enforce the restrictions.

9. Homeowner vs. Homeowners’ Insurance Carrier

This topic is relevant but not directly on point for this Seminar. However, this manuscript (but probably not the actual presentation) will provide some basics in order to emphasize some strategies. The standard HO3 homeowners insurance policy covers leaks that are “sudden and accidental” or result from wind blown rain. Mold contamination resulting from such leaks is an “ensuing loss.” However, insurance carriers are now seeking to exclude mold coverage or place

caps on the amount to be paid on mold claims.¹⁰ Undoubtedly, Plaintiffs' attorneys will challenge the enforceability of these caps.

Mold lawsuits against the homeowners' insurance carrier focus on the misconduct of representatives of the insurance carrier. The misconduct may be as simple as failing to pay a covered claim (breach of contract) to purposely delaying settlement of a valid claim while knowing the mold infestation worsens by the day. Depending on the circumstances, homeowners may have the following causes of action against the insurance carrier: 1) breach of contract, 2) consumer fraud (or unfair and deceptive trade practices), 3) bad faith, 4) negligence; and/or 5) injunctive relief.

A. Breach of Contract

The homeowners insurance policy is a contract between the homeowner and the insurer. The elements of this cause of action are: (a) a contract; (b) a breach; (c) causation; and (d) damages. When the insurer fails to perform its contractual obligation, it subjects itself to a breach of contract claim. A typical scenario occurs when the insurer denies a claim for water damage or mold damage which it is obligated to pay under the terms of the policy. Additionally, if the insurer fails to make a decision whether to pay a claim within a reasonable period of time, the insurer may have breached the insurance contract.

B. Consumer Fraud

Most states have laws that protect consumers against fraud, unfair claims practices, unfair and deceptive trade practices, and unfair competition. Therefore, Plaintiffs should consider whether the acts or omissions of the insurance carrier have run afoul of their state's consumer fraud laws. For example, did the adjuster misrepresent pertinent facts or insurance policy

¹⁰ For example, North Carolina policies now contain a \$5,000 cap; Virginia policies contain a \$2,500 cap.

provisions relating to the coverage at issue? Did the adjuster fail to effectuate a prompt, fair, and equitable settlement of Plaintiffs' claim in which liability had become reasonably clear? Any unfair or deceptive act or omission on the part of the insurer's representatives that resulted in damages could constitute grounds for bringing a consumer fraud action.

C. Bad Faith

Bad faith claims may be grounded in statute or the common law. Statutory claims may be based upon Chapter 75 (Unfair and Deceptive Trade Practices) or Chapter 58 (Unfair Claims Practices). N.C. Gen. Stat. § 58-63-15(11) contains a statutory list of unfair claims settlement practices. Furthermore, a violation of § 58-63-15(11) is an Unfair and Deceptive Trade Practice as a matter of law. Gray v. North Carolina Insurance Underwriting Assoc., 352 N.C. 61, 529 S.E.2d, reh'g denied, 352 N.C. 599, 544 S.E.2d 771 (2000). Thus, treble damages and attorney's fees are available for statutory bad faith claims.

Plaintiffs may also bring common law bad faith claims and seek punitive damages. In a common law claim, a North Carolina insurer has a duty to act in good faith, and may deny claims so long as it is based on an honest disagreement or an innocent mistake. Lovell v. Nationwide Mutual Ins. Co., 108 N.C. App. 416, 424 S.E.2d 181, aff'd in part, disc rev improvidently allowed in part, 334 N.C. 682, 435 S.E.2d 71 (1993) (per curiam). In order to recover punitive damages in a common law bad faith claim, a Plaintiff must establish (1) a refusal to pay after recognition of a valid claim; (2) bad faith; and (3) aggravating or outrageous conduct. Id. at 420.

Thus, an example of grounds for a bad faith claim is an insurer's groundless refusal to pay an insurance claim. However, ordinary negligence or mistake is not enough. Bad faith can trigger punitive damages, and juries often do not hesitate to punish bad faith insurers. In the Ballard v. Fire Ins. Exchange case, the jury was appalled at the bad faith exercised by adjusters

for two different insurance companies, which grossly mishandled the insured's mold claim. All of you are aware of the award in Ballard, and this topic will be addressed by other speakers. We simply wish to emphasize that it is important to document the substance of every contact with adjusters, in the unfortunate event that the adjuster exercises bad faith. This documentation could prove to be valuable evidence supporting your claims of bad faith.

D. Negligence

Negligence is a common law tort. The elements of negligence are: 1) duty, 2) breach of duty, 3) proximate cause, and 4) damages. Plaintiffs must prove that the insurer was under some duty and that the insurer breached that duty. Plaintiffs must also prove that the damages they sustained were a directly caused by the breach of duty. An example would be that the adjuster was under a duty to fully investigate and remediate Plaintiffs' claim after being notified of mold contamination in the Plaintiffs' home. Plaintiffs should also consider the negligent conduct of others who are under the control or supervision of the insurance carrier. They may be acting as agents of the carrier. One possible scenario is where the carrier directs and supervises the work of one of its "preferred remediators." If the remediators are negligent in performing the remediation of mold, the negligence may pass to the carrier, since the remediators were acting as agents of the principal, the insurance carrier.

V. COMMON DEFENSES ASSERTED BY CONTRACTORS IN RESPONSE TO PLAINTIFFS' CLAIMS

1. Breach of Contract Defenses

The contractor's grounds for summary judgment or directed verdict on an owner's breach of contract claim vary depending on the specific contractual relationship between the parties in each case. As discussed in the Plaintiffs' claims section of this paper, construction contracts often provide express representations of quality. Without proof that the construction failed to

comply with those express representations, owners should not be able to prevail on their breach of contract claims.

Similarly, when an owner hires a general contractor to construct a project in accordance with plans provided by the owner or an architect retained by the owner, the general contractor cannot as a matter of law be held liable for any damages arising from his required compliance with those plans:

[W]hen a contractor is required to and does comply with plans and specifications prepared by the owner or the owner's architect, the contractor will not be liable for the consequences of defects in the plans and specifications.

Burke County Public Schools Board of Education v. Juno Construction Co., 50 N.C. App. 238, 273 S.E.2d 504, 506-07 (1981), review allowed, 302 N.C. 396, 279 S.E.2d 350, review dismissed as improvidently granted, 304 N.C. 187, 282 S.E.2d 778 (1981).

Moreover, the defense will argue that the contractor may face liability if he does not comply with the architect's plans, even if they were defective. Id. at 507 ("Where the contractor does not comply with the plans and specifications provided by the owner, notwithstanding the fact that they are defective, the contractor proceeds at his peril, assuming the risk of any deviations from the plans and guaranteeing the suitability of the work."). Accordingly, if a general contractor is required to follow plans provided by the owner and those plans call for use of particular product or material, then the contractor will argue that it cannot be held liable for defects resulting from the required use of the product or material.

2. Breach of Express Warranty Defenses

Owners advancing breach of express warranty claims must reply upon written warranties, as generally oral representations may not be relied upon to alter the terms of the parties' written contract. See Clifford v. River Bend Plantation, Inc., 312 N.C. 460, 464, 323 S.E.2d 23, 25 (1984). Under North Carolina law, "[t]he parol evidence rule excludes prior or contemporaneous

oral arguments which are inconsistent with a written contract if the written contract contains the complete agreement of the parties.” Tar River Cable TV, Inc. v. Standard Theatre Supply Co., 62 N.C. App. 61, 302 S.E.2d 458, 460 (1983). In cases involving a written construction contract, both the North Carolina Court of Appeals and the Supreme Court have held that the parol evidence rule excludes evidence of oral statements or representations concerning the construction projects at issue. See e.g., Dixon v. Sedgefield Realty Co., 42 N.C. App. 650, 257 S.E.2d 466, 468 (1979) (noting that “parol testimony of prior or contemporaneous negotiations or conversations inconsistent with the writing, or which tend to substitute a new and different contract from the **one** evidenced by the writing, is incompetent”), review denied, 298 N.C. 567, 261 S.E.2d 121 (1979); Robbins v. C.W. Myers Trading Post, Inc., 253 N.C. 474, 117 S.E.2d 438 (1960) (finding error in the admission of alleged oral promises to use “good materials” and “first class materials” because “the parties are presumed to have inserted in the contract all provisions by which they intend to be bound”).

In addition, a contract may contain a **merger clause** which expressly excludes any oral representations made prior to the execution of the contract. North Carolina Courts have dismissed warranty claims based on oral assurances in the absence of fraud in the inducement. See Clifford v. River Bend Plantation, Inc., 312 N.C. at 464, 323 S.E.2d at 25.

Accordingly, without a written warranty apart from the parties’ contract, general contractors will argue that they are entitled to judgment as a matter of law on homeowners’ express warranty claims.

We typically look closely at the document in question and find a sentence or two that resembles a warranty or representation of quality. From those provisions, we show how the parol evidence explains, supplements and clarifies the meaning of the contract provisions and

thus the parol evidence rule will not prevent the testimony. This becomes more difficult when merger clauses are involved. If we are unable to find anything in the contract, we try to present clear and convincing evidence of a modification or novation, which presents separate and distinct issues that must be closely examined before such arguments are made.

Contractors often present owners with a written one-year limited warranty agreement. The language of those warranty documents generally limits the responsibility of the general contractor to repairing latent defects discovered during a one-year warranty period often beginning from the date of substantial completion. If the owner does not inform the general contractor of the alleged problems that are the subject of the defective material within the requisite time period, the general contractor will argue that, in accordance with the plain language of the parties' express warranty agreement, the material-related complaints are not the responsibility of the general contractor. See e.g., Moore, 1998 WL 2371283 at 5 (affirming a grant of summary judgment based on a limited one-year warranty that "was effective to bar as untimely any claims for breach of express or implied warranties" that arose outside of the one-year warranty period). See also, Plymouth Pointe Condominium Ass'n v. Delcor Homes-Plymouth Pointe, Ltd., et al.¹¹

3. Defenses to Implied Warranty Claims

If done at the time of contracting, the implied warranty of habitability can be disclaimed. See Griffin v. Wheeler-Leonard & Co., Inc., 290 N.C. 185, 225 S.E.2d 557 (1976). However, clear and unambiguous language, reflecting that the parties fully intended such result, must be

¹¹ In Plymouth Pointe, Not Reported in N.W.2d, 2003 WL 22439654 (Mich.App. 2003), the Court held that a limited warranty of only one year was not "unconscionable." In this case, a condominium association sued a contractor for certain building defects and alleged that a limited warranty of only one year was "unconscionable." The Court stated, "Parties to a contract are free to establish a contractual limitations period which is shorter than the applicable statutory limitations period. ... Hence, there is nothing inherently unenforceable about the one-year limitations period. The Court further stated that it presumed the contractor did not have a monopoly on condominium construction. Thus, the buyer still had a purchasing choice."

used to effectuate such a waiver. Griffin at 202, 225 S.E.2d at 568; Bass v. Pinnacle Custom Homes, Inc., 163 N.C. App. 171, 173, 592 S.E.2d 606, 607-08 (2004).

In Bass, the North Carolina Court of Appeals held that the following language unambiguously demonstrated that both parties intended to waive all other warranties, including the implied warranty of habitability:

THIS IS AN EXPRESS LIMITED WARRANTY OFFERED BY YOUR BUILDER. To the extent possible under the law of your state, all other warranties, express or implied, including but not limited to any implied warranty of habitability, are hereby disclaimed and waived. No one can add to or vary the terms of this Warranty, orally or in writing.

Bass at 173, 592 S.E. at 607-08.

The Griffin Court held that the following language was insufficient to accomplish a waiver of the implied warranty:

Buyer hereby acknowledges that he has inspected the above described property, that no representations or inducements have been made other than those expressed herein, and that this contract contains the entire agreement between all parties hereto.

290 N.C. 185, 202, 225 S.E.2d 557, 567 (1976).

In a more recent case, the following language was at issue:

[o]ther than the Expressed Warranties contained herein, there are no other warranties expressed or implied including Implied Warranty of Merchantability or Implied Warranty for Particular Purpose, which implied warranties are specifically excluded.

Brevorka v. Wolfe Const., Inc., 155 N.C. App. 353, 354, 573 S.E.2d 656, 657 (2002).

The majority opinion from the Court of Appeals held that such language was sufficient to waive the implied warranty of habitability. Id. at 358, 573 S.E.2d at 660. Chief Judges Eagles dissented from the majority opinion because he concluded that the language at issue did not clearly and unambiguously show that both parties intended to exclude the implied warranty of

habitability or workmanlike quality of construction. Id. at 361, 573 S.E.2d at 661. The North Carolina Supreme Court agreed with Chief Judge Eagles and reversed the Brevorka majority in a per curiam opinion for the reasons stated in Chief Judge Eagles' dissent. Brevorka v. Wolfe Const., Inc., 357 N.C. 566, 597 S.E.2d 671 (2003).

4. Defense to Claims for Negligence: The Economic Loss Rule

A. Introduction

In its simplest application, the “economic loss rule” precludes the parties to a construction project from recovering purely economic losses - typically contract damages - from other parties with whom they have no “privity of contract” (direct contractual relationship). Stated another way, “purely economic losses are not ordinarily recoverable under tort law.” Chicopee, Inc. v. Sims Metal Works, Inc., 98 N.C. App. 423, 432, 391 S.E.2d 211, 217 (1990). Thus, a plaintiff who asserts the bald allegation of negligence, or some other tort, against a contractor, subcontractor, or manufacturer over a defective building component faces dismissal by the Court pursuant to the economic loss rule. There is ample case law pertaining to the rule, its exceptions, and the seemingly endless variety of situations to which it might apply. However, this paper briefly discusses the situation where a building component on a project is defective and the owner seeks to sue the general contractor, subcontractor, and manufacturer of the failed component, under a negligence or tort theory. Negligence claims are much preferred by plaintiffs from an evidentiary standpoint. Asserting claims with the broad elements of duty, breach, proximate cause and damages is preferable to the encumbrances associated with specific violations of contract provisions, specific warranties with limited durations, etc. Indeed, courts have stated that one of the primary reasons for the rule is to prevent contract law from “drowning in a sea of tort.” East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986).

B. Overview of the Economic Loss Rule

i. Origins of the Rule:

The economic loss rule has its origin in product liability cases. Under the common law, lack of privity of contract was a bar to an action for negligence. See e.g., Feinman, Economic Negligence, Liability of Professionals and Businesses to Third Parties for Economic Loss § 2.2.1 (1995). The requirement of privity was eventually discarded, however, to allow recovery for personal injuries and property damage caused by the negligence of another. Macpherson v. Buick Motor Co., 111 N.E. 1050 (N.Y. 1916). To limit the potential liability for negligence, the courts created a new defense – the economic loss rule. The rationale for the rule was described as preserving “the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and thereby encourages citizens to avoid causing physical harm to others. Seeley v. White Motor Co., 403 P.2d 145 (Cal. 1965).

Two product liability cases decided in 1965 reflect opposing views toward the recovery of economic loss in tort actions. In the first case, the Supreme Court of New Jersey permitted a consumer to bring an action seeking solely economic losses directly against the manufacturer of a defective product, despite a lack of privity. Santor v. A&M Karagheusian, Inc., 207 A.2d 305 (N.J. 1965). The consumer sued the manufacturer for breach of an implied warranty of reasonable fitness for defective carpet that the consumer had purchased from a third-party seller. The New Jersey court acknowledged that tort liability applied principally to personal injury or property damage, but held that the manufacturer’s responsibility should be no different where the damage was to the product itself.

In the second case, the Supreme Court of California rejected the New Jersey court's rationale and stated that economic losses could not be recovered in a tort action. Seeley, supra. In this case, the purchaser of a defective truck sued the manufacturer for breach of express warranty and strict tort liability, seeking repair damages, the purchase price, and lost profits. Although the court affirmed the contract claim, it rejected the tort claim. The California court distinguished between the types of damages that are recoverable for breach of contract. If the only breach is a breach of a duty assumed solely by contract, the economic loss rule will bar recovery of purely economic losses in a tort action.

The U.S. Supreme Court has approved the application of the economic loss rule in product liability cases. The Court referred to the California case as the majority view and noted that contract law should preclude tort liability if a defective product causes purely economic loss; otherwise, "contract law would drown in a sea of tort." East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858 (1986). The Court also acknowledged, however, that the line of cases following the New Jersey court's decision raised legitimate questions about restricting liability in all economic loss cases.

ii. Definition of Economic Loss:

Given the foregoing, what precisely are "economic losses?" Economic losses are damages that are purely pecuniary losses without any personal injury or physical damage to other property. Economic losses have been defined as "damages for inadequate value, costs of repair and replacement of the defective product, or consequent loss of profits – without any claim of personal injury or damage to other property . . . as well as the diminution in the value of the product because it is inferior in quality and does not work for the general purposes for which it was manufactured and sold." Moorman Mfg. Co. v. National Tank Co., 435 N.E.2d 443 (Ill.

1982). Economic losses are generally considered contract-type damages – they amount to disappointed economic expectations (the loss of the benefit of the bargain of the contract) and not harm from personal injury or property damage. Sensenbrenner v. Rust, Orling & Neale, Architects, Inc., 374 S.E.2d 55 (Va. 1988). In construction, economic losses may be delay damages, See Berschauer/Phillips Const. Co. v. Seattle School Dist. No. 1, 881 P.2d 986 (Wash. 1994), the cost to repair faulty work, See Stuart v. Coldwell Banker Commercial Group, Inc., 745 P.2d 1284 (Wash. 1987), the cost of extra work necessitated by defective design, lost profits, or other financial expenses. See also, Casa Clara Condominium Ass’n, Inc. v. Charley Toppino and Sons, Inc.;¹² and Direblatt v. Osmose, Inc., et al.¹³

C. Inception of the Doctrine: Ports Authority and Other Cases

The origin of the economic loss rule in North Carolina can be traced to North Carolina State Ports Authority v. Lloyd A. Fry Roofing Co., 294 N.C. 73, 240 S.E.2d 345 (1978) (rev’d on other grounds). In Ports Authority, the Plaintiff state agency contracted with a general contractor for the construction of a shed and a warehouse. Id. at 75, 240 S.E.2d at 347. The general contractor then hired a roofing subcontractor to construct a roof on the buildings as well as another subcontractor to manufacture and supply the materials to be used in the construction of the roofs. Id. The state agency brought suit against the general contractor, roofing

¹² In Casa Clara Condominium Ass’n, Inc. v Charley Toppino and Sons, Inc., 620 So.2d 1244 (FL. 1993), the Court held that contract principles are more appropriate than tort principles for recovering economic loss without an accompanying physical injury or property damage. In this case, a supplier supplied concrete used in building condominiums and single-family homes. Some of the concrete allegedly contained a high content of salt causing it to crack and break apart. The homeowners sued numerous defendants including the supplier for negligence and strict products liability. The circuit court dismissed all counts against the supplier, pursuant to its finding that the economic loss rule prohibits tort recovery when a product damages itself, thereby causing economic loss, but fails to cause personal injury or damage to property other than itself.

¹³ In Direblatt v. Osmose, Inc., et al., Not Reported in F.Supp.2d, 2001 WL 197941 (D.Mass), the United States District Court, applying Massachusetts law, held that the economic loss rule barred a negligence cause of action when trustees of a condominium complex initiated a negligence claim against a defendant on account of damages caused by deterioration of roofs in the condominium buildings.

subcontractor, and the other subcontractor after the roofs experienced leaking problems. Id. The trial court granted Rule 12(b)(6) Motions filed by the general contractor and the roofing subcontractor, finding that any such claims were barred by the statute of limitations. Id. at 78-79, 240 S.E.2d at 348-49. The Court of Appeals reversed with respect to the negligence claim against the general contractor, finding that such claim was not barred by the statute of limitations because the exact date on which it expired could not be determined from the pleadings. Id. at 79, 240 S.E.2d at 349.

The Court began its analysis of the State's negligence claim against the general contractor by stating, "[o]rdinarily, a breach of contract does not give rise to a tort action by the promisee against the promisor." Id. at 81, 240 S.E.2d at 350. The Court then recognized four (4) non-exclusive categories of cases that were not encompassed by this general rule: (1) the injury was to the person or property of someone other than the promisee, (2) the injury was a personal injury suffered by the promisee or was damage to the property of the promisee other than the property which was the subject of the contract, (3) the promisor was charged by law, as a matter of public policy, with the duty to use care in the safeguarding of the property from harm, such as a common carrier, innkeeper, or other bailee, and (4) the promisor willfully caused the injury or there was a conversion of the subject property by the promisor. Id. at 82, 240 S.E.2d at 350-51.

In Oates v. JAG, Inc., 314 N.C. 276, 277, 333 S.E.2d 222, 223-224 (1985), plaintiff purchased a home originally built by defendant for the seller. After moving into the house, plaintiff discovered numerous defects in the construction of the home. Accordingly, plaintiff brought suit against the defendant alleging negligent construction. Defendant/builder moved to dismiss on the grounds that no contractual relationship existed between it and plaintiff. Not unexpectedly, the trial court granted defendant's motion. The North Carolina Supreme Court

reversed, however, and allowed plaintiff's complaint to proceed against the builder, in tort, even though plaintiff's losses were purely economic. As the Oates case noted:

Existence of a contract may incontrovertibly establish that the parties owed a duty to each other to use reasonable care in the performance of the contract, but it is not an exclusive test to the existence of that duty. Whether a defendant's duty to use reasonable care extends to a plaintiff not a party to the contract is determined by whether that plaintiff and defendant are in a relationship in which the defendant has a duty imposed by law to avoid harm to the plaintiff.

Id. at 279, 333 S.E.2d at 225 (quoting Navajo Circle, Inc. v. Development Concepts Corp., 373 So. 2d 689, 691 (Fla. 2nd Dist. Ct. App. 1979)).

Several years later, in Warfield v. Hicks, 91 N.C. App. 1, 370 S.E.2d 689 (1988), the plaintiffs sued their contractor in contract and in tort arising out of the contractor's use of beetle-infested interior beams in the construction of their home. The Court of Appeals affirmed dismissal of the negligence claim finding that it did not fit any of the "exceptions in which a promisor might be held liable in tort for damages proximately caused by a negligent or willful act or omission in the course of performance of his contract." Id. at 10, 370 S.E.2d at 694.

The Warfield case attempted to distinguish the Oates decision as follows:

[i]n Oates, the Court did recognize, ... that such a cause of action exists in favor of an owner who is not the original purchaser. However, nothing in that decision suggests an intent to overrule the Court's earlier holding ...with respect to the claims by the initial purchaser. We therefore presume that the Court intended to leave that holding intact, and to merely recognize a means of redress for those purchasers who suffer economic loss or damage from the improper construction but who, because not in privity with the builder, have no basis for recovery in contract or warranty.

Id.

In Spillman v. American Homes of Mocksville, Inc., 108 N.C. App. 63, 422 S.E.2d 740 (1992), the North Carolina Court of Appeals was again faced with plaintiffs who claimed tort damages resulting from the defendant's allegedly negligent construction and installation of a mobile home. After finding that the negligence claim was "premised upon the allegation that

defendant's failure to properly perform the terms of the contract between the parties resulted in damage to the mobile home which is the subject matter of the contract," Id. at 65, 422 S.E.2d at 741, the court held that the tort claim was deficient as a matter of law:

[A] tort action does not lie against a party to a contract who simply fails to properly perform the terms of the contract, even if that failure to properly perform was due to the negligent or intentional conduct of that party, when the injury resulting from the breach is damage to the subject matter of the contract. It is the law of contract and not the law of negligence which defines the obligations and remedies of the parties in such a situation.

Id. at 65, 422 S.E.2d at 741-42 (citations omitted).

Similarly, that same court found that a plaintiff who had entered into a contract for the construction of a pool was not entitled to assert a negligence claim for the allegedly improper construction of the pool. Mason v. Yontz, 102 N.C. App. 817, 403 S.E.2d 536, 537-38 (1991).

In Gregory v. Atrium Door and Window Co., 106 N.C. App. 142, 415 S.E.2d 574, 575 (1992), the plaintiffs contracted with Defendant James Burris to build a residence. Plaintiffs purchased doors manufactured by Defendant Atrium Door and Window Company. These doors did not function properly and were deteriorating, i.e., causing injury to themselves. On appeal, the issue was whether plaintiffs could assert a claim against the manufacturer of the doors for breach of an implied warranty involving only economic loss to the doors, despite the lack of privity. The Court of Appeals determined that such a claim was not available since the damage alleged was purely economic loss.

In Reece v. Homette Corp., 110 N.C. App. 462, 429 S.E.2d 768 (1993), the plaintiffs purchased a mobile home manufactured by the defendant. Four years after the defendant delivered the mobile home to the plaintiffs, the plaintiffs filed a complaint seeking relief for damage to their mobile home, alleging *inter alia* that the defendants negligently designed, manufactured, and misrepresented the mobile home. Because the entire home was the product

sold by the defendants, the Court determined that these tort claims would be barred by the economic loss rule, since the plaintiffs sought recovery only for damage to the product sold by the defendant:

Here, plaintiffs' claims seek recovery only for damage to the mobile home, the very product manufactured by defendant. This claim is substantially different from a factual situation where the manufactured product causes physical injury to a person or to property other than the manufactured product itself.

Id. at 466, 429 S.E.2d at 770.

In Moore v. Coachman Industries, Inc., 129 N.C. App. 389, 499 S.E.3d 772, (1998), defendant, Coachman Industries, manufactured the recreational vehicle sold to the plaintiffs which incorporated an electrical power converter manufactured by Defendant, Magne Tek. The recreational vehicle and all of its contents were destroyed by a fire caused by the defective power converter. The Court of Appeals found that the economic loss rule applied, because the "defect in the product damag[ed] the actual product." Id. at 402, 499 S.E.3d at 780. Accordingly, the Moore plaintiffs could not even bring a claim in tort for personal property contained in the vehicle and destroyed by the fire.

Thus the issue becomes: are the damages asserted by the homeowners against these parties simply "economic loss?" Courts have construed "economic loss" to mean damage to the product caused by the product itself. See Nudelman v. J.A. Booe Bldg. Contractor, Inc., 156 N.C.App. 427, 577 S.E.2d 717 (2003). Recently, two federal opinions, Wilson v. Dryvit Systems, Inc., 206 F. Supp.2d 749 (E.D.N.C. 2002) and Higginbotham v. Dryvit Systems, Inc., No. 1:01CV00424, 2003 U.S. District Lexis 4530 (M.D.N.C. 2003), have held that the economic loss rule in North Carolina bars tort claims against manufacturers of products incorporated into a structure that cause damage to other parts of the structure, because once incorporated the product becomes a part of the structure. Therefore, a window that leaks and damages the framing is

simply the house damaging itself, which is purely economic loss. Therefore, the issue is whether the defective windows and defectively constructed foundation walls are damaging *other* parts of the house, or are they simply causing damage to the “product itself,” the house?

D. Fighting the Economic Loss Doctrine

i. Lord and Privity

In Lord v. Customized Consulting Specialty, Inc., the North Carolina Court of Appeals refused to dismiss a negligence claim asserted by a homeowner against a subcontractor because there was no contract between the homeowner and subcontractor. 643 S.E.2d 28, 33 (2007). This holding is consistent with the statement of the general rule by the Ports Authority Court that a breach of contract does not give rise to a tort action *by the promisee against the promisor*.

In Lord, Plaintiff homeowner brought a negligence claim against a subcontractor for damages resulting from its design and manufacture of defective trusses. Lord at 29. At trial, the subcontractor moved for a Directed Verdict, arguing that the negligence claim was barred by the economic loss rule. Id. at 30. The Motion was denied and the Court of Appeals affirmed when it held,

the (subcontractor) had a duty to use reasonable care in performing its promise to provide reliable trusses to (the general contractor) for use in the construction of the (homeowner’s) residence. Because there was no contract between the (homeowner) and the (subcontractor), we further find that the economic loss rule does not apply and therefore does not operate to bar the (homeowner’s) negligence claims.

Lord at 33.

Thus, Plaintiff’s lawyers should always immediately determine whether there was privity of contract between their client and any party seeking to dismiss a negligence claim based upon the economic loss doctrine.

ii. The Economic Loss Rule May Only Apply to Product Liability Actions

A second question for any Plaintiff's lawyer to ask is whether the negligence claim under attack is a product liability action. If the claim is not a product liability action, you may have another attack that we have been working on and debating with defense attorneys who are authoring papers on this topic. In short, the defense will not agree with the attack, but acknowledge that the same is viable and worrisome to them.

In Ellis-Don Const., Inc. v. HKS, Inc., the Plaintiff general contractor entered into a contractor with the State of North Carolina for the construction of the two hospitals in the University of North Carolina health care system. 353 F.Supp.2d 603, 604 (M.D.N.C. 2004). The State entered into a contract with an entity to design and manage the construction process. Id. at 605. This managing entity then hired CRZ, an architect. Id. The dispute at issue was a negligence claim by the general contractor against the architect. Id. The architect Defendant filed a Rule 12(b)(6) Motion to Dismiss based upon the economic loss rule. Id. In denying such Motion, the Court stated as follows:

CRZ argues that North Carolina's economic loss doctrine has expanded beyond its traditional realm of products liability and sales of goods to preclude Plaintiff's tort claim. The court disagrees. The economic loss doctrine, first articulated by the California Supreme Court in Seely v. White Motor Co., 63 Cal.2d 9, 45 Cal.Rptr. 17, 403 P.2d 145 (1965), and adopted by the United States Supreme Court in East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 106 S.Ct. 2295, 90 L.Ed.2d 865 (1986), was conceived of as a means by which to confine products liability in tort to damages for personal injury and injury to property other than the goods sold, and leave to contract law the question of liability for purely economic losses. This approach was, and remains, firmly rooted in traditional concepts of warranty and contract law, and operates to "keep products liability and contract law in separate spheres and to maintain a realistic limitation on damages" in products liability cases. East River, 476 U.S. at 871, 106 S.Ct. 2295. In North Carolina, the economic loss doctrine limits the types of damages that a purchaser of a product may recover against the seller or manufacturer of the product through a negligence action. The purchaser cannot use claims of negligence to recover

'purely economic losses' caused by the product's failure to meet expectations. Instead, the purchaser must use contract law, including the Uniform Commercial Code (UCC). Higginbotham v. Dryvit Sys., Inc., 2003 WL 1528483, 3, 2003 U.S. Dist. LEXIS 4530, 8 (M.D.N.C.2003) (citing Wilson v. Dryvit Sys., Inc., 206 F.Supp.2d 749, 753 (E.D.N.C.2002); Moore v. Coachmen Indus., Inc., 129 N.C. App. 389, 401, 499 S.E.2d 772 (1998); and Reece v. Hometette Corp., 110 N.C. App. 462, 466-67, 429 S.E.2d 768 (1993)).

CRZ explores at length the 'roots' and 'flowering' of North Carolina's economic loss rule in support of its motion to dismiss, but it appears to be harvesting the wrong field in attempting to use the rule as a bar to Plaintiff's tort claim. The economic loss rule poses no obstacle to Plaintiff's claim. As noted, **North Carolina's economic loss rule bars claims in tort for purely economic losses in the sale of goods covered by contract law, including the UCC. It does not limit tort actions that arise in the absence of a contract, nor is there any indication that the courts of North Carolina have expanded the rule beyond its traditional role in products liability cases...**

CRZ cites some broad statements of the economic loss rule that proclaim that 'the economic loss doctrine prohibits recovery for economic loss in tort,' Land v. Tall House Bldg. Co., 602 S.E.2d 1, 4 (N.C. App. 2004)...**Such statements are made, however, in cases deciding issues of products liability in which the transaction giving rise to the dispute was governed by the law of contracts. Furthermore, all of the cases cited within such cases also address issues of products liability arising under contracts for the sale of goods.** See *id.* (citing Moore, 129 N.C. App. at 401, 499 S.E.2d 772); see also 2000 Watermark Ass'n, Inc. v. Celotex Corp., 784 F.2d 1183, 1185 (4th Cir.1986), and cases cited therein. Such a broad statement of the economic loss rule is entirely appropriate within the confines of those cases, as it is indisputably true that the rule operates to preclude recovery in tort for purely economic damages when a contract or the UCC operates to allocate the risk of such damages. **That does not mean, however, that the doctrine has expanded to preclude all claims in tort for economic damages in the absence of a contract, or, more narrowly, outside the products liability context.** The economic loss rule, even as stated in the cases cited by CRZ, in no way undermines or overturns the twenty-five years of case law recognizing the type of tort claim Plaintiff brings here. Compare Davidson, 41 N.C. App. 661, 255 S.E.2d 580 with North Carolina State Ports Auth. v. Lloyd A. Fry Roofing Co., 294 N.C. 73, 240 S.E.2d 345 (1978); Energy Investors Fund, L.P. v. Metric Constructors, Inc., 351 N.C. 331, 525 S.E.2d 441 (2000); and Kaleel Builders, Inc. v. Ashby, 161 N.C. App. 34, 587 S.E.2d 470 (2003).

Ellis-Don at 606-07.

In Lord, the North Carolina Court of Appeals cited Ellis-Don as persuasive authority when it wrote,

[m]oreover, though not controlling, we are persuaded by a federal court's holding that North Carolina's economic loss rule “does not limit tort actions that arise in the absence of a contract,” but “[t]he privity requirement does, in some cases, preclude action in tort in the absence of a contractual relationship.” Ellis-Don Constr., Inc. v. HKS, Inc., 353 F.Supp.2d 603, 606 (M.D.N.C.2004). Ellis-Don repudiated the idea that the economic loss doctrine prohibits recovery for any and all economic loss in tort; rather, the court reasoned that the doctrine has not “**expanded to preclude all claims in tort for economic damages in the absence of a contract, or, more narrowly, outside the products liability context.**” Id. The court further reasoned that “[t]he economic loss rule ... in no way undermines or overturns the twenty-five years of case law recognizing [a tort claim for negligence from the breach of the duty of care].” Id. We agree with the reasoning in Ellis-Don and its holding that “[North Carolina] state law has been consistent in recognizing [this] type of claim ..., and this court does not find ... the state court of appeals' decision in Tall House Bldg. Co. to be to the contrary.”

Lord at 32.

Thus, based upon the language in Lord and Ellis-Don, Plaintiff's lawyers have an argument that the economic loss rule is limited to product liability and UCC cases.

iii. Negligence Per Se and the North Carolina Building Code

The third category of cases which are not subject to the economic loss rule under Ports Authority are those where the promisor is charged by law, as a matter of public policy, with safeguarding the subject matter property. 294 N.C. at 81, 240 S.E.2d at 350-51. The authors of this manuscript believe a viable argument exists that contractors are charged with a legal duty, as a matter of public policy, to conduct their construction activities in accordance with the North Carolina Building Code as “a violation of the North Carolina Building Code constitutes negligence per se because the Code is a statute to promote the safety of others. Lassiter v. Cecil, 145 N.C.App. 679, 684, 551 S.E.2d 220, 223 (2001) *citing* Lamm v. Bissette Realty, 327 N.C. 412, 415, 395 S.E.2d 112, 114 (1990). The authors further believe that any attempt to contract away the duty to comply with the Code would be unenforceable as a matter of law because it would be contrary to public policy.

iv. Requirement That The Damaged Property Be The Subject Of The Contract

The second category of cases not subject to the economic loss rule as referenced in Ports Authority are those in which damage occurs property of the promisee, “other than the property which was the subject of the contract.” 294 N.C. at 81, 240 S.E.2d at 350. Thus, the issue arises as to what constitutes property that is not the subject of the contract. As with many issues concerning the economic loss rule, the Courts have reached conflicting results. In Land v. Tall House Bldg. Co., the Plaintiff homeowner sued the general contractor, Tall House, for construction defects including water intrusion associated with the application of direct exterior finish systems (“DEFS”). 165 N.C. App. 880, 881, 602 S.E.2d 1, 2 (2004). Tall House filed a Third-Party Complaint against Dryvit, the manufacturer of the DEFS as well as Southern Synthetic, the party which applied the DEFS. Id. Plaintiff and Tall House settled and Plaintiff assigned all claims, rights, and causes of action to Tall House. Id. Tall House, standing in the homeowner’s shoes, then brought claims for indemnity and contribution against Dryvit and the trial court granted Dryvit’s Summary Judgment Motion on said claims. Id.

The Court of Appeals held that since the homeowner could not sue Tall House in tort because of the economic loss rule, Tall House could not seek contribution from Dryvit as the parties could not be joint tortfeasors in a contract action. Id. at 883, 602 S.E.2d at 3.

More importantly, the Court held that Tall House could not sue Dryvit for indemnity because of the economic loss rule. In support of its holding, the Court stated that the home did not constitute “other property” from the DEFS because DEFS was an “integral component” of the Plaintiff’s house. Id. at 884, 602 S.E.2d at 4. In support thereof, the Court cited precedent stating, “when a component part of a product or system injures the rest of the product or the system, only economic loss has occurred.” Id. The Eastern District of North Carolina reached

the same result under almost identical facts in Wilson v. Dryvit Systems, Inc., 206 F. Supp.2d 749 (E.D.N.C. 2002).

The “other property” issue was the focus of the Court’s opinion in Indemnity Ins. Co. of North America v. American Eurocopter LLC, 2005 WL 1610653 (M.D.N.C. 2005) (not reported in F. Supp.2d). In American Eurocopter, a helicopter owned by Duke University Medical Center crashed and Duke’s insurance company brought claims against the party from Duke purchased the helicopter as well as a party that installed a gearbox during a repair to the helicopter. The Court ruled that the helicopter was the subject matter of the contract between Duke and the seller of the helicopter and therefore held that the economic loss rule barred a negligence claim against the seller. However, the Court allowed a negligence claim to proceed against the repair contractor, apparently on the basis that the gearbox was installed into a pre-existing product and therefore the subject matter of the contract was the gearbox.

The authors of this Manuscript believe that the Tall House and Wilson Courts incorrectly determined what constitutes “other property” for purposes of the economic loss rule. In any event, the “other property” argument may be advantageous in renovation projects to existing structures under American Eurocopter.

v. Public Policy: Protection of the Homeowner

In any case representing a homeowner involving the economic loss rule, the following language should be cited to demonstrate the public policy considerations regarding protecting homeowners:

[w]e must be realistic. The ordinary purchaser of a home is not qualified to determine when or where a defect exists. Yet, the purchaser makes the biggest and most important investment in his or her life and, more times than not, on a limited budget. The purchaser can ill afford to suddenly find a latent defect in his or her home that completely destroys the family's budget and have no remedy for recourse. This happens too often. The careless work of contractors, who in the

past have been insulated from liability, must cease or they must accept financial responsibility for their negligence. In our judgment, building contractors should be held to the general standard of reasonable care for the protection of anyone who may foreseeably be endangered by their negligence.

Oates v. Jag, Inc., 314 N.C. 276, 280-281, 333 S.E.2d 222, 225 - 226 (1985); Lord at 32-33.

vi. Argument for a Homeowner's Exception

Based upon the above-cited language in Oates and Lord, an argument can be made for a homeowner's exception to the economic loss rule. This would, of course, require the reversal of almost twenty-five (25) years of case law. The basis for this argument comes from the recent Colorado Supreme Court decision in A.C. Excavating v. Yacht Club II Homeowners Assoc., Inc., 114 P.3d 862 (2005). In A.C. Excavating, a Homeowners Association sued the developer, general contractor, and several subcontractors for negligence in the construction of the townhomes. Id. at 864. After settling with the general contractor and developer, the subcontractors filed a Motion for Summary Judgment on the Association's negligence claim based upon the economic loss rule. Id. The trial court granted the Motion, the Court of Appeals reversed, and the Supreme Court upheld the ruling of the Court of Appeals. Id.

The Supreme Court provided the following summary of the economic loss rule under Colorado law:

The economic loss rule is intended to maintain the sometimes blurred boundary between tort law and contract law. Our formulation of the economic loss rule is that a party suffering only economic loss from the breach of an express or implied contractual duty may not assert a tort claim for such a breach absent an independent duty of care under tort law. In distinguishing between a tort obligation and a contract obligation, it is essential to discern the source of the party's duty. Contract obligations arise from promises the parties have made to each other, while tort obligations generally arise from duties imposed by law to protect citizens from risk of physical harm or damage to their personal property. Where there exists a duty of care independent of any contractual obligations, the economic loss rule has no application and does not bar a plaintiff's tort claim because the claim is based on a recognized independent duty of care and thus falls outside the scope of the economic loss rule.

Id. at 865-866 (internal citations omitted).

The Court then proceeded to analyze the relationship between homeowners and contractors to determine whether a duty of care existed independent of any potential contractual obligations. The Court cited precedent listing the following factors as relevant to this inquiry: (1) the risk involved, (2) the foreseeability and likelihood of injury as weighed against the social utility of the defendant's conduct, (3) the magnitude of the burden of guarding against injury or harm, and (4) the consequences of placing the burden upon the defendant. Id. at 868; Taco Bell, Inc. v. Lannon, 744 P.2d 43 (Colo.1987). The Court then applied these factors to the construction context as follows:

Subcontractors are in as good or better position as general contractors to know whether their work is being properly performed because subcontractors will actually be performing the work. General contractors, on the other hand, are more involved in the area of management: estimating and bidding; negotiating contracts of labor, materials, equipment, and services; and scheduling, coordinating, managing, and supervising the work of its subcontractors. In short, employing the Taco Bell factors does not result in significant distinction between subcontractors and general contractors or other builders in general. Therefore, the law in Colorado is and has been since 1978 that subcontractors and other builders are under an independent tort duty to act without negligence in the construction of homes.

Id.

Although unlikely to succeed, an argument may be made for a homeowner's exception under North Carolina law based upon the above-quoted language from Oates and Lord.

5. Negligent Misrepresentation Defenses

The North Carolina Court of Appeals has examined the requirements for recovery under a negligent misrepresentation claim in the context of a real estate transaction:

Plaintiff's alternative claim for negligent misrepresentation also fails. In Powell v. Wold, 88 N. C. App. 61, 67, 362 S.E.2d 796, 799 (1987), this court stated

North Carolina has adopted the Restatement of Torts definition and requirements for negligent misrepresentation:

One who in the course of his business or profession supplies information for the guidance of others in their business transactions is subject to liability for harm caused to them by their reliance upon information if;

(a) He fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting; and

(b) The harm is suffered;

(i) By the person or one of the class of persons for whose guidance the information was supplied; and

(ii) Because of his justifiable reliance upon it in a transaction in which it was intended to influence his conduct or in a transaction substantially identical therewith.’

Helms v. Holland, 124 N.C. App. 629, 635, 478 S.E.2d 513, 517 (1996) (quoting Restatement (Second) of Torts § 552 (1977)).

Owners generally cannot present evidence that their general contractor negligently misrepresented the nature of construction defect problems or omitted to disclose the potential for mold – there will be no evidence that the general contractor knew or should have known of the potential problems at the time the project was constructed.

6. Defenses to Unfair and Deceptive Trade Practices Claims

Owners will have difficulty establishing that a general contractor’s construction of a project with water intrusion problems or mold constituted an unfair trade practice, as North Carolina law provides that “[a]n unfair trade practice is one that offends established public policy, is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers.”

Blackwell v. Dorosko, 93 N.C. App. 310, 377 S.E.2d 814, 817-18 (citations omitted), withdrawn

in part on other grounds on rehearing, 95 N.C. App. 637, 383 S.E.2d 670 (1989). Accordingly, “[a] party is guilty of an unfair act or practice [only] when it engages in conduct that amounts to an inequitable assertion of its power or position.” C.F.R. Foods, Inc. v. Randolph Development Co., 107 N.C. App. 584, 421 S.E.2d 386, 389 (citing Libby Hill Seafood, 303 S.E.2d at 569, (affirming a dismissal of an unfair and deceptive trade practice claim based on the Plaintiff’s failure to present evidence of an inequitable assertion of power), rev. denied, 333 N.C. 166, 424 S.E.2d 906 (1992); Love v. Keith, 95 N.C. app. 549, 383 S.E.2d 674, 678 (1978) (noting that coercive tactics constitute an unfair practice), overruled in part on other grounds, Custom Molders, Inc. v. American Yard Products, Inc., 342 N.C. 133, 463 S.E.2d 199 (1995). Use of a defective product can rarely satisfy these legal requirements because a general contractor will never intentionally use defective products.

The North Carolina Court of Appeals examined fraud and unfair and deceptive trade practice claims against a builder in Warfield. In Warfield, a builder knowingly “refused to install ‘heavy hand-hewn beams’ as called for in the original specifications but offered to substitute old beams from a tobacco barn.” 370 S.E.2d at 691. During construction, when the Plaintiffs became aware of the possibility that the beams were infested with beetles, they asked the builder if the beetles would be a problem, and the Defendant assured them that the beetles would not be a problem for them. After closing, the Plaintiffs experienced problems with sawdust and scratching noises caused by an active infestation of beetles. The Plaintiffs then learned that the beetle infestation would cause the home to fail a pest inspection, making it potentially difficult for them or future buyers to obtain financing on the home, and brought suit against the builder for fraud and unfair and deceptive trade practices.

Examining the Plaintiffs' fraud and unfair and deceptive trade practice claims, the court noted that "the Plaintiffs' evidence taken in the most favorable light shows merely that [the builder] made a general, unspecific statement of opinion about the potential future consequences of using beetle-infested beams and [did] not support a reasonable inference that he intended to deceive or mislead the [Plaintiffs]." Id. at 693. The court further noted that the builder's actions "simply [did] not rise to the level of oppressive, unscrupulous, or deceptive conduct which would constitute an unfair or deceptive act or practice." Id. Finding the evidence unable to support the elements required to recover on the claims of fraud and unfair and deceptive trade practices, the North Carolina Court of Appeals held that these claims should not have been submitted to the jury.

Another obstacle to an Unfair and Deceptive Trade Practices claim is the existence of a contract between the owner and contractor. In this regard, a simple breach of contract does not qualify as an unfair and deceptive trade practice absent some type of egregious or aggravating circumstances. Poor v. Hill, 138 N.C. App. 19, 28, 530 S.E.2d 838, 844 (2000); Norman Owen Trucking v. Morkoski, 131 N.C. App. 168, 177, 506 S.E.2d 267, 273 (1998). Thus, Plaintiffs must identify sufficient egregious or aggravating circumstances to present a valid Unfair and Deceptive Trade practices claim when the parties have entered into a contract.

A favorable Plaintiff's case concerning this standard is Becker v. Graber Builders, Inc., 149 N.C. App. 787, 561 S.E.2d 905 (2002) where the Court denied a Rule 12(b)(6) Motion and found the Plaintiff adequately pled a Chapter 75 claim by alleging, "Defendant's actions and misrepresentations were in or affecting commerce, constitute unfair and deceptive trade practices, and caused her damages in excess of \$10,000.00. Plaintiff re-alleges the circumstances

surrounding Defendant's failure to install the second septic tank system and to procure the appropriate building permit.” *Id.* at 794, 561 S.E.2d at 911.

7. Defenses to Fraud Claims

North Carolina Civil Procedure Rule 9(b) requires that fraud be alleged with particularity, which requires allegations concerning time, place and content of the fraudulent representation, identity of the person making the representation, and what was obtained as a result of the fraudulent acts or representations. Terry v. Terry, 302 N.C. 77, 85, 273 S.E.2d 674, 678 (1981).

Plaintiffs “bear the burden of proving all elements of a cause of action for fraud in their forecast of evidence.” Johnson v. Beverly-Hanks & Associates, Inc., 328 N.C. 202, 400 S.E.2d 38, 42 (1991). Owners often cannot prove a number of the elements of their fraud claims against general contractors because pursuant to North Carolina law,

[t]o make out a case of actionable fraud, [Plaintiffs] must show that (1) [the Defendant] made a representation relating to some material past or existing fact; (2) the representation was false; (3) [the Defendant] knew it was false or made it recklessly and as a positive assertion; (4) [the Defendant] made the representation with the intention that it be acted upon by the [Plaintiffs]; (5) [the Plaintiffs] reasonably relied upon the representation and acted upon it; and (6) they suffered injury.

Warfield, 370 S.E.2d at 693.

For example, owners often cannot present any evidence that the general contractor knowingly made a false statement concerning the construction defect, mold or water intrusion problem, or that builders and others in the local and national construction industry did not and could not have known of the problems at the time the project was constructed.

In addition, and importantly, Plaintiffs alleging fraud must prove an intent to deceive. Myers & Chapman, Inc. v. Thomas G. Evans, Inc., 323 N.C. 559, 374 S.E.2d 385 (1988).

Owners generally cannot prove that the general contractors made any statement with the specific intent to defraud:

Without the element of intent to deceive, the required scienter for fraud is not present. The term “scienter” embraces both knowledge and an intent to deceive, manipulate or defraud.

Myers & Chapman, Inc. v. Thomas G. Evans, Inc., 323 N.C. 559, 374 S.E.2d 385, 391 (1988).

Moreover, the North Carolina Supreme Court has specifically disavowed “cases [that] omit the essential element of the intent to deceive in a definition of fraud.”

VI. COMMON DEFENSES RAISED BY MANUFACTURERS

1. Breach of Contract Defenses

This is typically not a viable claim for owner/Plaintiffs in water intrusion or mold cases because of the lack of contractual privity. Rarely does an owner/Plaintiff have a contract with the manufacturer that supplied a defective component or material that caused water intrusion or mold. Thus, owner/Plaintiffs must look to other legal theories to proceed against manufacturers. We always argue an implied contract and point to the relationship between the manufacturer, distributor, installer and general contractor. In most cases, we have to get an assignment of this claim from the General Contractor. Then, the contract can be implied. See Board of Directors of the Bay Point Condominiums Assoc., Inc., et al. v. RML Corp., Dryvit Systems, Inc., Bishop Wall Systems, et al. (Circuit Court of Norfolk, VA CL99-475).

2. Breach of Express Warranty Defenses

Manufacturers often issue an express warranty that is intended to be delivered to the owners. There is often an issue of fact as to whether the owner ever received that warranty. However, it is not uncommon for the general contractor or responsible subcontractor to not apply for or obtain a readily available express warranty from the manufacturer. That issue of fact is immaterial, however, because regardless of whether they received the warranty, Plaintiffs typically cannot establish a claim for breach of express warranty.

Initially, Plaintiffs' express warranty claims often fail by the terms of the express warranty. The typical express warranty issued by manufacturers provides that "[N]o warranty whatsoever is made for damage caused in whole or in part by defective or improper workmanship by the subcontractor." Often, the manufacturer will have ample evidence of an installation deficiency that caused the problem or defect.

In addition, manufacturer warranties typically limit Plaintiffs' remedy to the cost of the materials. This amount is often modest, particularly when labor and installation changes are not included. This type of damage limitation is authorized by the Uniform Commercial Code. See Billings v. Joseph Harris Co., 290 N.C. 502, 226 S.E.2d 321 (1976).

Finally, manufacturers often argue that an express warranty claim under the UCC requires evidence that (a) the seller made specific affirmations or promises that were the "basis of the bargain" between the seller and buyer, and (b) the buyer relied on those affirmations or promises in deciding to purchase the product. As N.C.G.S. § 25-2-313 provides:

- (A) Express warranties by the seller are created as follows:

(1) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.

(2) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.

(3) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

N.C. Gen. Stat. § 25-2-313(1) (1999) (emphasis added); Westover Products Inc. v. Gateway Roofing, Co., Inc., 94 N.C. App. 63, 72, 380 S.E.2d 369, 375 (1989) (reliance is a central aspect of “basis of the bargain”).

Of course, manufacturers will argue that no representations or actions were taken by it which was a “basis of the bargain” in Plaintiffs’ discussions on the project.

We typically include in our pleadings an assertion that the Warranty fails for its essential purpose because of its severe limitations. In other word, supplying a bad product for another bad product makes the warranty worthless and thus, the limitations in the warranty as to what the manufacturer is required to do should be disregarded.

3. Breach of Implied Warranties Defenses

Manufacturers argue that warranties are creatures of statute, necessarily limited to their enabling language. The Uniform Commercial Code does not recognize Plaintiffs as having received any warranties from a manufacturer merely by having constructed a project utilizing their particular defective product. See N.C. Gen. Stat. §§ 25-2-313-318.

Initially, warranties may be made only by a “seller” to a “buyer” as part of a contract for sale. See N.C. Gen. Stat. § 25-2-313-315. While it is typically easy to establish that a manufacturer was the “seller” of the defective product, as defined by N.C. Gen. Stat. § 25-2-

103(1)(d), it is more difficult to fit the typical project/owner into the statutory definition of buyer. A “buyer” is defined as “a person who buys or contracts to buy goods.” N.C. Gen. Stat. § 25-2-103(1)(a). Defendants often argue that Plaintiffs are not “buyers” under that definition. Defendants also frequently argue that Plaintiffs do not qualify as “buyers” by operation of N.C. Gen. Stat. § 25-2-318. While it is often undisputed that Plaintiffs paid the contractor to construct the project, Defendants argue that the project is not a “good” as defined by the UCC:

[Goods are defined as] all things (including specially manufactured goods) which are movable at the time of identification to the contract for sale other than money in which the price is to be paid, investment securities (article 8) and things in action. ‘Goods’ also includes the unborn young animals and growing crops and other identified things attached to realty as described in the section on goods to be severed from realty.

N.C. Gen. Stat. § 25-2-105(1).

Defendants argue that Plaintiffs cannot receive an implied warranty from a manufacturer under the UCC because a construction project is not a “good.”

With respect to privity issues, we often seek to have a contract implied by reason of the distribution and installation of the product. For example, in Bay Point, the Court implied a contract between the manufacturer and the general contractor and thus avoided the privity requirement.

4. Manufacturer’s Defense to Claim of Negligence:

Please see the discussion of the economic loss rule in the previous section of this paper.

5. Negligent Misrepresentation Defenses

As discussed in prior sections of this paper, to prove negligent misrepresentation, Plaintiffs must show that a manufacturer (a) knew and intended that Plaintiffs would rely on its opinions, (b) supplied false information to Plaintiffs for their guidance in business transactions; and (c) failed to exercise reasonable care or competence in obtaining that information. Plaintiffs

must also prove that (d) Plaintiffs justifiably relied on the information and suffered pecuniary loss proximately caused by this reliance. See Helms v. Holland, 124 N.C. App. 629, 478 S.E.2d 513 (1996) (citing Restatement (Second) of Torts § 552).

Manufacturers argue that Helms demonstrates the necessity of proof regarding justifiable reliance and proximate causation. In Helms, purchasers of property brought a negligent misrepresentation claim against their broker for failure to disclose that the county health department would not approve the property for use as a family care facility. The trial court granted summary judgment in Defendant's favor. The Court of Appeals affirmed, holding that the Plaintiffs did not reasonably rely on any alleged misinformation because Plaintiffs were already in the business of operating family care facilities and Plaintiffs clearly knew, by experience and by the contract's very terms, that they should make inspections of the property prior to closing to ensure compliance with state inspection guidelines. The Court concluded that "Plaintiffs reliance upon this information was unreasonable and therefore [the negligent misrepresentation] claim must fail. Justifiable reliance is an essential element of . . . negligent misrepresentation." Id. at 635, 478 S.E.2d at 517.

Manufacturers argue that Alva v. Cloninger, 51 N.C. App. 602, 277 S.E.2d 535 (1981), demonstrates the necessity of proof regarding justifiable reliance and proximate causation. In Alva, the purchasers of a home sued their appraiser for economic loss suffered by their purchase of a house with serious structural defects. The appraiser had failed to uncover these defects prior to their purchase. The trial court granted a directed verdict in Defendants favor, but the Court of Appeals reversed. The Court found that there was specific evidence that "warrants an inference that Plaintiffs actually relied upon the Defendant's appraisal report to [bank] and that Defendant's failure to discover and disclose the alleged defects in the house was a proximate

cause of Plaintiffs' injury." Id. at 611, 277 S.E.2d at 541. The Plaintiffs had testified that his purchase contract was conditioned upon obtaining financing, that absent financing the contract was null, and that financing was conditioned upon the appraisal report. A bank officer also testified that indeed, any repair work recommended in the appraisal report would have to be done or the bank would have denied the loan application. See Id.

In summary, a manufacturer will vigorously attack Plaintiff's claims for negligent misrepresentation unless the Plaintiff can point to specific representations or information from the manufacturer upon which Plaintiff "justifiably relied." This is often difficult, especially when the owner/Plaintiff had little or no dealings with the manufacturer.

6. Unfair and Deceptive Trade Practices Defenses

Manufacturers will argue that under North Carolina law, the requirement of justifiable reliance is the same in unfair and deceptive trade practices as in negligent misrepresentation. See Helms, 124 N.C. App. at 635-36, 478 S.E.2d at 517-18 (dismissing Chapter 75 and negligent misrepresentation claims for lack of justifiable reliance); Libby Hill Seafood Restaurants, Inc. v. Owens, 62 N.C. App. 695, 700-01, 303 S.E.2d 565, 569 (1983).

Manufacturers will also be prepared to rebut the argument that representations made to the construction industry or to the general public about their allegedly defective product through advertising or some other means, are sufficient to satisfy the justifiable reliance argument. Indeed, manufacturer's product advertisements are frequently not aimed towards owners; but rather, for design professionals. Manufacturers will also disagree that any reliance by unidentified design professionals is sufficient. Plaintiffs would be borrowing a federal securities law concept if they make this argument. See Basic v. Levinson, 485 U.S. 224 (1988) (enunciating the "fraud on the market" theory). In federal securities law, "fraud on the market"

is an exception to the general rule that a Plaintiff must prove direct reliance on a material omission or misstatement in order to hold a Defendant liable, under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10(b)(5) promulgated thereunder, for material misrepresentations or omissions in connection with the sale of stock. Id. at 230-31, 241-50. Rather, a victim who relied upon a security's market price as an accurate reflection of the security's worth has established a presumption of reliance on the original misstatement and need not show actual reliance in order to make a prima facie case of securities fraud. Id.

Manufacturers also argue that a "fraud on the market" theory cannot apply to a situation where representations made by a manufacturer affected different users of its products differently, so that the effect of any alleged misrepresentations is a fact specific determination. Moreover, construction defect cases are not a federal securities case. Plaintiffs are bound by the common law definition of reliance. Under the law, Plaintiffs must show affirmative evidence that they in fact relied upon specific misrepresentations made to Plaintiffs by the manufacturers of the allegedly defective material. However, See Rowan County Bd. Of Educ. V. U.S. Gypsum Co., 103 N.C. App. 288, 407 S.E.2d 860 (1991) (Court allowed fraud claim against manufacturer).

Manufacturers will also argue another reason why Plaintiffs' unfair and deceptive trade practices claims should fail is that the claim is essentially an ordinary breach of warranty claim recast into a claim for treble damages and attorneys' fees. Under North Carolina law, evidence of breach of warranty is insufficient to support an unfair trade practices claim. See Whitehurst v. Crisp R.V. Center, Inc., 86 N.C. App. 521, 526-27, 358 S.E.2d 542, 546 (1987). Moreover, a Chapter 75 must be dismissed in the absence of facts to establish "substantial aggravating circumstances" surrounding Defendant's actions. See Ace Chemical Corp. v. DSI Transports, Inc., 446 S.E.2d 100, 115 N.C. App. 237 (1994); Terry's Floor Fashions v. Georgia-Pacific

Corp., 1998 WL 1107771, 36 UCC Rep. Serv. 2d 680 (E.D.N.C. 1998). Defendants will also contend that marketing and selling an allegedly defective product is simply not enough to support an unfair trade practices claim, even when it is alleged that Defendant knew the product was defective and misrepresented the characteristics of the product. See Russell v. Baity, 95 N.C. App. 422, 426, 383 S.E.2d 217, 220 (1989); Warren v. Guttanit, Inc., 69 N.C. App. 103, 317 S.E.2d 5 (1984); Terry's Floor Fashions, supra. Manufacturers will always argue that Plaintiffs have failed to allege, much less establish, the required presence of substantial aggravating circumstances. See Bartolomeo v. S.B. Thomas, Inc., 889 F.2d 530, 535 (4th Cir.1989) ("Plaintiff must show substantial aggravating circumstances attending the breach to recover under the Act [for unfair trade practices] . . .").

Warren discusses the concept of substantial aggravating circumstances where the claim is based on breach of representations in a written warranty. In Warren, the manufacturer of a roofing product allegedly promised that the roof would not leak. Plaintiff in that case obtained brochures about the roofing produce which read, "Simply translated, GUTTANIT means "not a drop of water" or "weather proof." GUTTANIT is our brand of corrugated asphalt roofing and siding that has our 25 year warranty against leakage and backs it up." Plaintiff decided to use the roofing product. Defendant said that it could not offer a warranty unless the product was applied by a specific individual, whom Plaintiff used to install the roof. The roof leaked. Defendant claimed that the roof leaked because the materials were installed improperly and that the roof was too flat to allow water to run off. See Id. at 104, 317 S.E.2d at 8. Plaintiff filed claims for breach of warranties and unfair trade practices. The basis for the unfair trade practices claim was that the representations of Defendant Guttanit's agents concerning its roofing product, were fraudulent. See Id. at 116, 317 S.E.2d at 14. The trial court also found that Defendant Guttanit

breached express and implied warranties of fitness. See Id. at 106, 317 S.E.2d at 8. The trial court found that the roofing materials, not the installation, were defective. See Id. Yet the trial court also found that the facts did not give rise to an unfair trade practices claim. The Court of Appeals affirmed, even though almost all factual issues were found in Plaintiffs' favor. See Id. at 116, 317 S.E.2d at 14.

The Court of Appeals reached a similar result in Russell. In Russell, a breach of warranty case involving a water stove system, the Defendants had stated in a written contract that the stove "would meet state and local codes." A jury found that Defendants breached implied and express warranties created by the written contract because the stove did not meet the applicable codes. The Court held that, while the evidence was clearly sufficient to support a finding that Defendants breached express and implied warranties, mere breach of warranty alone did not support a claim for unfair and deceptive trade practices. Russell, 95 N.C. App. at 426, 383 S.E.2d at 220.

Terry's Floor Fashions, supra, is yet another case manufacturer's argue demonstrates that the mere breach of warranty, even if proved, does not constitute unfair or deceptive trade practices. In Terry's Floor Fashions, Plaintiff was a seller and installer of vinyl flooring. The Plaintiff sued the manufacturer of a plywood underlayment for such flooring alleging negligence, breach of warranty, and unfair and deceptive trade practices. Before purchasing the plywood underlayment, Plaintiff specifically inquired whether the underlayment would conform to its needs, particularly whether the underlayment would cause discoloration of vinyl flooring. Defendant informed Plaintiff that the underlayment would meet its needs and would not cause discoloration. Plaintiff sought damages for unfair and deceptive trade practices based on Defendant's allegedly deliberate misrepresentations about the traits and qualities of its products.

Plaintiff claimed that Defendant knew or should have known its product was unsuitable for its intended use. Plaintiff argued that Defendant deceptively induced Plaintiff to enter into the contract for purchase of the plywood underlayment by making false representations about its product's characteristics.

The federal court, applying North Carolina law, dismissed the unfair and deceptive trade practices claim on the basis that the facts supporting Plaintiffs' unfair trade practices claims were indistinguishable from those of Plaintiffs' breach of warranty claims. Terry's Floor Fashions, 1998 WL 1107771 at 8-9. The court also found that Plaintiff did not assert any additional facts to demonstrate substantial aggravating circumstances as required by North Carolina law. See Id.; See also Bartolomeo v. S.B. Thomas, Inc., 889 F.2d 530, 535 (4th Cir. 1989) ("Plaintiff must show substantial aggravating circumstances attending the breach to recover under the Act [for unfair trade practices][.]"); Branch Banking and Trust Co. v. Thompson, 107 N.C. App. 53, 62, 418 S.E.2d 694, 700 (1992) (Defendant's breach of promissory note and loan agreement was not an "aggravating circumstance" for purposes of Plaintiffs' unfair trade practice claim.).

Thus, manufacturers will argue that Terry' Floor Fashions makes clear that selling a defective product without more does not support a claim for unfair and deceptive trade practices, even if the manufacturer knows of prior product failures.

7. Fraud Defenses

A manufacturer's defense to a fraud claim will focus on the lack of representations made directly to the Plaintiffs with the intent to deceive. As with all fraud actions, establishing an intent to deceive is often difficult. Whitlock v. Duke University, 829 F.2d 1340, 1342 (4th Cir. 1987) (in order for Defendant to prevail as a matter of law, it need not negate every element of fraud – if Defendant effectively refutes even one element, summary judgment is proper).

Further, manufacturers will argue that the failure of a manufacturer to warn a Plaintiff about the known defective nature of a product does not rise to the level of fraud. N.C. Gen. Stat. § 99B-1 defines a products liability action to include any action brought for, or on account of personal injury, death or property damage caused by, or resulting from, the manufacture; construction; design; formulation; development of standards; preparation; processing; assembly; testing; listing; certifying; warning; instruction; marketing; selling; advertising; packaging or labeling of product.

N.C. Gen. Stat. § 99B-5 codifies claims based on inadequate warnings or instructions. It requires proof that a manufacturer or seller acted unreasonably in not providing a warning or instruction, and that the failure to provide the warning or instruction was the proximate cause of the harm, and either: (1) when the product left control of the manufacturer, it knew or should have known that the product posed a substantial risk of harm to a reasonably foreseeable user or consumer and the manufacturer failed to take reasonable steps to give adequate warning or instruction, or failed to take other reasonable action. N.C. Gen. Stat. § 99B-5; See also Corprew v. Geigy Chemical Corp., 271 N.C. 485, 157 S.E.2d 98 (1967); Smith v. Selcon Products, Inc., 96 N.C. App. 151, 385 S.E.2d 173 (1989), rev. denied, 326 N.C. 598, 393 S.E.2d 883 (1990); Wells v. French Broad Elec. Membership Corp., 68 N.C. App. 410, 315 S.E.2d 316, rev. denied, 312 N.C. 498, 322 S.E.2d 565 (1984); Lee v. Crest Chemical Co., 583 F. Supp. 131, 133 (M.D.N.C. 1984).

Thus, manufacturers will argue that a failure to warn claim is expressly contemplated by North Carolina statute. Therefore, a manufacturer's failure to disclose known problems with a product does not support a claim for fraud. Of course, success in this regard should remove the potential for punitive damages or an award of attorneys' fees.

8. Product Liability Defenses Available to Manufacturers¹⁴

North Carolina's Product Liability Act (N.C. Gen. Stat. Chap. 99B-1 *et seq.*) covers "all actions brought on account of, caused by or resulting from the manufacture, construction, design, formulation, development of standard, preparation, processing, assembly, testing, listing, certifying, warning, instructing, marketing, selling, advertising, packaging or labeling of any product." N.C. Gen. Stat. Section 99B-1(3).

North Carolina's Product Liability Act provides that a manufacturer is not liable in a product liability action if alteration or modification of the product is a proximate cause of the injury or damage:

(a) No manufacturer or seller of a product shall be held liable in any product liability action where a proximate cause of the personal injury, death or damage to property was either an alteration or modification of the product by a party other than the manufacturer or seller, which alteration or modification occurred after the product left the control of such manufacturer . . .

(b) For the purposes of this section, alteration or modification includes changes in design, formula, function, or use of the product form that originally designed, tested or intended by the manufacturer . . .

N.C. Gen. Stat. § 99B-3; Rich v. Shaw, 98 N.C. App. 489, 391 S.E.2d 220 (1990).

In Rich, the trial court held that the manufacturer of a trenching machine was not liable for Plaintiffs' injuries where a safety guard had been removed after the machine left the manufacturer's control. The Court of Appeals affirmed, writing,

When, as here, the forecast of evidence demonstrates that a proximate cause of Plaintiffs' injury was the modification or alteration of the machine by a party other than the manufacturer after it left the control of the manufacturer; and that

¹⁴ A full discussion of the North Carolina Products Liability Statute is beyond the scope of this paper. A discussion of the more common defenses is included (Section 99B-3-Alteration or Modification of Product, and Section 99-B-4-Knowledge or Reasonable Care).

the alteration of the machine was contrary to the instructions of the manufacturer and done without its express consent, then G.S., Section 99B-3 bars recovery from the manufacturer.

Id. at 492, 391 S.E.2d 223.

Rich suggests that a product manufacturer is not liable when the manufacturer's products were not installed in accordance with the manufacturer's instructions or were impermissibly modified from the original design. See Id.

Section 99B-3(a) also provides that the modifications and alterations that are the subject of the 99B defenses must be a proximate cause of damage. See Id. In Rich, the Court found that had the missing belt guard still been in place, Plaintiff would not have injured himself. The court reasoned that the removal of the belt guard was a proximate cause of Plaintiffs' injuries; hence the manufacturer of the product could not be held liable. Rich, 98 N.C. App. at 492, 98 S.E.2d 222-23.

Thus, manufacturers will carefully seek to establish that the general contractor and subcontractor did not follow the applicable installation specifications of the manufacturer and that any deviations caused the problems with the product.

In a similar vein, N.C. Gen. Stat. § 99B-4(1) provides that the manufacturer of a product is not liable if (a) the product was used contrary to express and adequate instructions or warnings delivered with, appearing on, or attached to the product, and (b) the user should have known of the instructions in the exercise of reasonable care. Manufacturers will also seek to establish that the general contractor and subcontractors violated this provision of the statute as well.

VII. APPLICABLE STATUTES OF LIMITATION AND REPOSE

Claims asserted in construction defects cases are not only governed by several differing statutes of limitations, but also by the applicable statutes of repose. Each of these will be

discussed below, in the context of the typical claims asserted by Plaintiffs in construction defect cases.

1. Statutes of Limitations and Repose

A. Plaintiffs' Claims for Breach of Contract, Non-UCC Implied Warranties, Express Warranties and Negligence

Sections 1-52(1), (5), and (16) and 1-50 of the North Carolina General Statutes govern the statute of limitations applicable for claims of breach of contract, breach of non-UCC implied warranties, express warranties, and negligence in a typical construction defects case. Section 1-52(16) encompasses all of these claims and states:

Unless otherwise provided by statute, for personal injury or physical damage to claimant's property, the cause of action, except in causes of actions referred to in G.S. 1-15(c), shall not accrue until bodily harm to the claimant or physical damage to his property becomes apparent or ought reasonably to have become apparent to the claimant, whichever event first occurs. Provided that no cause of action shall accrue more than 10 years from the last act or omission of the Defendant giving rise to the cause of action.

N.C. Gen. Stat. § 1-52(16).

Section 1-50(f) modifies § 1-52, and states as follows:

This subdivision prescribes an outside limitation of six years from the later of the specific last act or omission or substantial completion, within which the limitations prescribed by G.S. 1-52 and 1-53 continue to run. For purposes of the three-year limitation described by G.S. 1-52, a cause of action based upon or arising out of the defective or unsafe condition of an improvement to real property shall not accrue until the injury, loss, defect or damage becomes apparent or ought reasonably to have become apparent to the claimant. However, as provided in this subdivision, no action may be brought more than six years from the later of the specific last act or omission or substantial completion.

N.C. Gen. Stat. § 1-50(a)(5)(f).

The North Carolina Supreme Court has recognized, with specific reference to § 1-52, that “these statutes modify the sometimes harsh common law rule by protecting a potential Plaintiff in the case of a latent injury by providing that a cause of action does not accrue until the injured

party becomes aware or should reasonably have become aware of the existence of the injury.” Pembee Mfg. Corp. v. Cape Fear Constr. Co., Inc., 313 N.C. 488, 493, 329 S.E.2d 350, 354 (1985). In Pembee the Court held that the statute of limitations began to run when the Plaintiff first knew of the existence of leaks in the roof, even though the Plaintiff was not aware of the extent of the damage. Pembee, however also provided that a Plaintiff is not required to be a “construction expert.” It is the rare water intrusion case that involved a simple roof leak.

The Court of Appeals reached a similar conclusion in Bonestell v. North Topsail Shores Condominiums, Inc., 103 N.C. App. 219, 405 S.E.2d 222 (1991) and Haywood St. Redevelopment Corp., Inc. v. Harry S. Peterson Co., Inc., 120 N.C. App. 832, 463 S.E.2d 564 (1995), rev. denied, 342 N.C. 655, 467 S.E.2d 712 (1996) (Plaintiff knew water was leaking into the building when water proofing was applied to concrete in 1987, but did not file claim until 1992, and was thus barred by the statute of limitations). The courts have also held, however, that the mere suspicion of a problem will not start the statute of limitations under N.C.G.S. § 1-52(16).

In Bonestell v. North Topsail Shores Condominiums, Inc., 103 N.C. App. 219, 405 S.E.2d 222 (1991), the Court of Appeals held that a condominium association and unit owner’s claim was barred by the six-year statute of repose. The association and owner did not discover the absence of fire stops between their condominium units and the buildings until 1988, but the units were completed in 1980. By 1981, the condominium-owners had discovered that improper ventilation resulted in moisture retention and damage to the interior walls and carpet, and they filed negligent construction claims against the contractor in 1986. However, in 1988, the owners learned that the contractor had also failed to install fire stops between the units or buildings, and amended their complaint to add an allegation concerning the fire stops. The Court held that

N.C.G.S. § 1-50(5) precludes initiation of an action beyond six years from the completion of an improvement to real property, even if the defect was not discovered until after the six-year period expired. The Court held that the fire stop claim was barred by the statute of repose because it did not relate back to the filing of the original complaint. The original claim against [the contractor] was based entirely on moisture problems and water damage allegedly caused by negligent construction of the units' common areas. Therefore, since the units were completed in 1980, the plaintiffs were barred from amending their complaint by the statute of repose.

In Bryant v. Don Galloway Homes, Inc., 147 N.C.App. 655, 556 S.E.2d 597 (2001), the Court held that the statute of repose begins to run from the date a certificate of occupancy is issued. In this case, the homeowners did not buy their home until December 4, 1992, but the builder received a certificate of occupancy on November 25, 1991. Therefore, the plaintiff's claim against the builder was barred by the statute of limitations since the plaintiff did not file suit until November 25, 1998. The Court also noted that even though the builder attempted to repair the floor of the residence in August 1994, this was not the builder's last act or omission as contemplated by the statute of repose in G.S. 1- 50(a)(5). *See also* Ocean Winds Corp. of Johns Island v. Lane.¹⁵ *See also* Monson v. Paramount Homes, Inc., 133 N.C. App. 235, 515 S/E/2d 445 (1999).

¹⁵ In Ocean Winds Corp. of Johns Island v. Lane, 347 S.C. 416, 556 S.E.2d 377(2001), the Supreme Court of South Carolina ruled that the statute of repose began running against a manufacturer in 1986 when its windows were installed at a Seabrook Island condominium project — not up to four years later, as each individual unit got a certificate of occupancy. In this case, Ocean Winds Corporation developed a condominium project on Seabrook Island. The condo windows were installed by Dec. 2, 1986. Certificates of Occupancy for individual units were issued between June 1987 and May 1991. In April 1997, a condo owners group sued Ocean Winds for water damage and other structural problems. In February 2000 Ocean Winds sued Andersen Windows, the manufacturer and supplier, seeking indemnification for any damages it might have to pay. The suit against Andersen brought the statute of repose into play. S.C. Code Ann. Sect. 15-3-640 states in part: "No actions to recover damages based upon or arising out of the defective or unsafe condition of an improvement to real property may be brought more than 13 years after substantial completion of such an improvement." Ocean Winds argued the statutory repose period did not begin to run until certificates of occupancy were issued for the individual units. The Court held that the date the windows were installed was the date they were "substantially completed" which began the running of the statute of repose.

Although the courts analysis has been very rigid under the statute of repose, their analysis is often more yielding as to when the statute of limitations accrues. Decisions have stated the obvious that homeowners are not required to be “construction experts” in determining when the statute accrues. Thus, simply observing a problem will not typically cause accrual of the statute. See, Howell v. City of Lumberton, 144 N.C. App. 695, 548 S.E.2d 835 (2001). The homeowner must actually observe damage or be informed that the situation constitutes a defect. Swain v. Preston Falls, 156 N.C. App. 357, 576 S.E.2d 699 (2003). However, claims against a manufacturer begin to run upon the purchase by the subcontractor of the defective component.¹⁶

In Nolan v. Paramount Homes, Inc., 133 N.C. App. 73, 518 S.E.2d 789 (1999), even though the builder worked for ten months to correct punch list items, the court held that the six year statute of repose ran from the date of substantial completion rather than from the time the contractor finished the punch list work.

In Quail Hollow East Condominium Ass’n v. Donald J. Scholz Company, 47 N.C. App. 518, 268 S.E.2d 12 (1980), a condominium association brought an action against an architect and contractor for damages allegedly resulting from a substandard underground water pipe system serving the condominium complex. The Court stated that under N.C.G.S. § 1-50(5), which sets an outside limit on the right to sue, an action must be brought within six years after construction is completed. However, except the statute is not applicable “to any person in actual possession and control as owner, tenant or otherwise, of the improvement at the time the defective and unsafe condition of such improvement constitutes the proximate cause of the injury for which it

¹⁶ Cacha v. Monaco, Inc. 147 N.C. App. 21 554 S.E.2d 388 (2001) in suit where contractor installed defective component, six year statute begin to run as to the homeowner when the subcontractor purchased the component, not when the homeowner moved in or when substantial completion of the house was obtained.

is proposed to bring an action.” The Court held that the plaintiffs discovered the defect on October 9, 1974 and brought the action on June 13, 1977.

In both Wilson v. McLeod Oil Co., Inc., 327 N.C. 491, 398 S.E.2d 586 (1990) and Crawford v. Boyette, 121 N.C. App. 67, 464 S.E.2d 301 (1995), the Courts concluded that even though the Plaintiffs, respectively, could smell gasoline and benzene in their water, and in Crawford even stopped using the water for cooking and drinking upon the advice of the Wake County Health Department, the statute of limitations did not begin to run until the date the Plaintiffs received official notification of the contamination of their water. Obviously, the facts of each given case need to be carefully analyzed to determine whether the defect or damage is latent or patent, the extent of what the Plaintiffs know about the defect or damage to the structure, and when they knew that information.

B. Claims of Negligent Misrepresentation and Fraud Claims

N.C. Gen. Stat. § 1-52(9) specifies the applicable statute of limitations for claims arising from negligent misrepresentation and fraud. The statute states that “the cause of action should not be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud or [misrepresentation].” N.C. Gen. Stat. § 1-52(9). A claim for negligent misrepresentation does not accrue until two (2) events occur: (1) the claimant discovers (or had a reasonable opportunity to discover) the misrepresentation, and (2) the claimant suffers harm because of that misrepresentation. See Barger v. McCoy, Hillard and Parks, 346 N.C. 650, 488 S.E.2d 215 (1997). Similarly, a cause of action for fraud accrues at the time the fraud is discovered or should have been discovered with reasonable diligence. Nash v. Motorola Communications and Elec., Inc., 96 N.C. App. 329, 385 S.E.2d 537 (1989), aff’d, 328 N.C. 267, 400 S.E.2d 36 (1991).

C. Breach of UCC Implied Warranties Claims

If the Plaintiff has asserted specific breaches of the implied warranties that arise under the Uniform Commercial Code as a matter of law, such claims are governed by the statute of limitations set forth in N.C. Gen. Stat. § 25-2-725, which states:

(1) An action for breach of any contract for sale must be commenced within four years after the cause of action has accrued. By the original agreement the parties may reduce the period of limitation to not less than one year but may not extend it.

(2) A cause of action accrues when the breach occurs, regardless of the aggrieved party's lack of knowledge of the breach. A breach of warranty occurs when tender of delivery is made, except that where a warranty explicitly extends to future performance of the goods and discovery of the breach must await the time of such performance the cause of action accrues when the breach is or should have been discovered.

Id.

D. Unfair and Deceptive Trade Practices Claims

The statute of limitations governing a claim for unfair and deceptive trade practices is set forth in N.C. Gen. Stat. § 75-16.2, which states that “any civil action brought under this Chapter to enforce the provisions thereof shall be barred unless commenced within four years after the cause of action accrues.” Id. The determination of when the statute of limitations begins to accrue for a Chapter 75-1.1 claim has been held to depend upon the nature of the 75-1.1 claim. In Hand v. Ace Hardware Corp., No. 4:92CV00454 (M.D.N.C. 1995), the court stated:

[i]f an action for unfair and fraudulent trade practices is based on fraud, the action does not accrue until discovery of the fraud. Nash v. Motorola Communications and Elec., Inc., 96 N.C. App. 329, 331, 385 S.E.2d 537, 538 (1989), aff'd, 328 N.C. 267, 400 S.E.2d 36 (1991). In contrast, if an action under § 75-1.1 more closely resembles an action for breach of contract, the statute of limitations begins to run on the date of the termination of the contract. See Ring Drug Co. v. Carolina Medicorp Enter., Inc., 96 N.C. App. 277, 281, 385 S.E.2d 801, 804 (1989).

Id. at 10-11.

In Hand, the court noted that the claim for unfair and deceptive trade practices arose from the same “factual scenario” as the fraudulent misrepresentation, and therefore the court determined that the discovery rule with regard to claims for fraud was to be utilized for determining the date of accrual of the 75-1.1 claim. Id. at 11. See also, Liner v. DiCresce, 905 F. Supp. 280 (M.D.N.C. 1994).

Therefore, the facts of each given case will determine when the claim for unfair and deceptive trade practices begins to accrue. Because most construction defects claims are governed by the statute of limitations that sets forth that the claim accrues upon discovery of the damage or defect, presumably the statute of limitations with regard to the claim for unfair and deceptive trade practices for a construction defects claim would also arise from the date of discovery of the defect or damage. Similarly, if the unfair and deceptive claim is based upon misrepresentations or fraud, presumably the statute of limitations will begin to run upon the date of discovery of the misrepresentation or fraud. Obviously, such determination will have to be made on a case by case basis.

VIII. THE VIABILITY OF CLASS ACTIONS IN CONDOMINIUM CASES

1. Introduction and Overview

Class actions are a legal mechanism for claims which, being too numerous or inefficient to bring them individually before a court, may be pursued together in a unified action. They are designed to make efficient use of judicial resources and ensure that inconsistent verdicts do not result from identical questions being presented in multiple lawsuits. Crow v. Citicorp Acceptance Co., 319 N.C. 274, 354 S.E.2d 459 (1987). “If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued.” N.C. Gen. Stat. §

1A-1, Rule 23 (a); Crow at 277; 354 S.E.2d at 463. Despite recent attacks and abuses, there is a significant public policy interest in allowing cases to be brought as class actions because, class actions historically:

1. Avoid inconsistent results regarding the same legal or factual questions;
2. Serve to most efficiently utilize scarce judicial resources;
3. Allow swift and uniform application of law to common facts;
4. Allow swift and uniform application of judicial decisions to common claims;
5. Allow swift and uniform application of settlement/judgment proceeds;
6. Allow creation of a single, cogent and final plan for resolution of claims; and
7. Ensure access to the judicial system for claims which by themselves may not economically be feasible to prosecute.

Simply put, the cases that should be turned into class actions are those that clearly would provide for the efficient, consistent and equitable administration of justice.

Indeed, “[o]ur Rule 23 should receive a liberal construction, and it should not be loaded down with arbitrary and technical restrictions...The rule has as its objectives ‘the efficient resolution of the claims or liabilities of many individuals in a single action’ and ‘the elimination of repetitious litigation and possible inconsistent adjudication involving common questions, related events, or requests for similar relief.’” Crow at 274, 354 S.E.2d 459 (1987) (quoting English v. Holden Beach Realty Corp., 41 N.C. App. 1, 9, 254 S.E.2d 223, 230-31 (1979) (overruled on other grounds). Merits of the case are not to be considered. Maffei v. Alert Cable Television of North Carolina, Inc., 75 N.C. App. 473, 331 S.E.2d 188 (1985), rev’d on other grounds, 316 N.C. 615, 342 S.E.2d 867 (1986).

Whether a “class” exists under Rule 23(a) is a question of law. Crow at 281, 354 S.E.2d at 464. When a Court is considering a Motion for Class Certification, it must “determine whether

the allegations of the complaint, taken as true and viewed in the light most favorable to the plaintiffs, support the conclusion that the named and unnamed plaintiffs comprise a ‘class’ within the meaning of Rule 23(a).” *Id.* In determining whether a “class” exists, North Carolina Courts often require that a “common question of law and fact” exists among the named and unnamed class members. Nobles v. First Carolina Communications, Inc., 108 N.C. App. 127, 423 S.E.2d 312 (1992) *citing* Crow; See also English. This has been determined to mean that a proper consideration in the determination of class certification is whether each of the putative class members has an interest in either the same issue of law or of fact, and that issue predominates over issues affecting only individual class members. *Id.* A class presumptively exists when the named and unnamed members each have an interest in either the same issue of law or fact, and that issue predominates over issues affecting only individual class members. Crow at 280; 354 S.E.2d at 464.

2. Certification Requirements under North Carolina Law

A. Summary of Certification Requirements

Under North Carolina Law, in order to meet certain prerequisites for bringing a class action, the trial court must determine whether the party seeking certification has met its burden of showing three (3) prerequisites: (1) that a class exists, (2) that the named class representatives will fairly and adequately represent the interests of all members of the class, and (3) that the proposed class members are so numerous that it is impractical to bring them all before the court. See generally Faulkenbury v. Teachers' and State Employees' Retirement System of North Carolina, 345 N.C. 683, 483 S.E.2d 422 (1997). Rendered down, this means that Plaintiffs and the potential class members must meet the following requirements:

- **COMMONALITY:** Common question of law or fact predominating over individual issues;

- **NUMEROSITY:** Potential Plaintiffs are sufficiently numerous as to make it impractical to bring them all before the Court;
- **TYPICALITY/ADEQUACY OF REPRESENTATION:** Class Representatives must fairly and adequately represent the interest of the class; and
- **SUPERIORITY OF CLASS ACTION:** Class Action should be a superior method of adjudicating the claims at bar.

B. Commonality

Under North Carolina law, a class exists where “each of the members has an interest in either the same issue of law or of fact, and that issue predominates over issues affecting only individual class members. Crow at 277, 354 S.E.2d at 462. To justify class certification this Court need only find that the class members have at least one common question of law or fact and that said question predominates over all issues affecting individual class members. Id.

It is important to note that the standard of having the common question of law or fact is much looser than the prior standard of “community of interest,” which was expressly rejected by the Crow Court, which wrote:

[w]hen each class member shared a jural relationship with each of the other members, they were deemed to have a ‘community of interest’ sufficient to justify the prosecution of a class action on behalf of them. The class action device was not permitted where potential class members shared only (1) a parallel relationship to the opposing party, e.g., separate contracts with the same defendant, or (2) an interest in the same issue of law or fact, but without any overlap in the circumstances of their respective cases.

Id. at 278, 319 S.E.2d at 463.

C. Numerosity

North Carolina’s Rule 23 requires that the “persons constituting a class are so numerous as to make it impracticable to bring them all before the court[.]” English at 6, 254 S.E.2d at 229. It is not necessary that they demonstrate the impossibility of joining class members, but

they must demonstrate substantial difficulty or inconvenience in joining all members of the class. There can be no firm rule for determining when a class is so numerous that joinder of all parties is impractical. The number is not dependant upon any arbitrary limit, but rather under the circumstances of each case. Crow at 283, 354 S.E.2d at 466. A party seeking certification need not allege in the certification motion the exact number of proposed class members or their identities. See Newberg on Class Actions § 3.05 (3rd ed.1992). There is no hard and fast formula for determining what is a “numerous” class; the number is not dependent upon any arbitrary limit but rather upon circumstances of each case. English at 6, 254 S.E.2d at 229.

D. Typicality and Adequacy of Representation

Under North Carolina Law, the named representatives “must establish that they will fairly and adequately represent the interest of all members of the class.” Crow at 282, 354 S.E.2d at 465; English at 10, 254 S.E.2d at 187. In addition, “[t]he named representatives must establish that they will fairly and adequately represent the interests of all members of the class” and that “there is no conflict of interest between them and the members of the members of the class who are not named parties, so that the interests of the unnamed class members will be adequately and fairly protected.” Crow at 282, 354 S.E.2d at 465. Further, “the named parties must also have a genuine personal interest, not a mere technical interest, in the outcome of this action.” Id. at 283, 354 S.E.2d at 465; English at 7, 254 S.E.2d at 230. Plaintiffs have the burden of showing that the representatives are members of the class and that the interests of absent class members will be adequately protected; it must not appear that there is a conflict of interest between the members of the class who are not parties and those members who are representing the class as parties; this requirement is not necessarily one of numbers, but is

dependent on the adequacy and vigor with which those parties will protect the interests of the class. English at 7, 254 S.E.2d at 230.

Typicality and adequacy of representation are intertwined in North Carolina's analysis of these criteria. "[T]he class representatives within this jurisdiction also must establish that they will adequately represent those outside of the jurisdiction." Crow at 283, 354 S.E.2d at 465; English, 41 N.C. App. at 6, 254 S.E.2d at 229.

The Court stated in In Re American Medical Systems, Inc.:

Typicality determines whether a sufficient relationship exists between the injury to the named plaintiff and the conduct affecting the class, so that the court may properly attribute a collective nature to the challenged conduct. In other words, when such a relationship is shown, a plaintiff's injury arises from or is directly related to a wrong to a class, and that wrong includes the wrong to the plaintiff. Thus, a plaintiff's claim is typical if it arises from the same event or practice or course of conduct that gives rise to the claims of other class members, and if his or her claims are based on the same legal theory. A necessary consequence of the typicality requirement is that the representative's interests will be aligned with those of the represented group, and in pursuing his own claims; the named plaintiff will also advance the interests of the class members.

75 F.3d 1069, 1082 (C.A. 6 1996).

E. Superiority of Class Action as Method of Adjudication

In Crow, the Court stated: "the decision whether a class action is superior to other available methods for the adjudication of this controversy continues to be a matter left up to the trial court's discretion." 319 N.C. at 284, 354 S.E.2d at 466. The Court continued, "[c]lass actions should be permitted where they are likely to serve useful purposes such as preventing a multiplicity of lawsuits or inconsistent results...As we have indicated, the trial court has broad discretion in this regard and is not limited to consideration of matters expressly set forth in Rule 23 or in this opinion." Id.

“Some proper considerations include, but are not limited to, the amount of recovery compared to the cost of administration of the lawsuit, ‘the interest of members of the class in individually controlling the prosecution or defense of separate actions,’ ‘the extent and nature of any litigation concerning the controversy already commenced by or against members of the class,’ ‘the desirability or undesirability of concentrating the litigation of the claims in the particular forum,’ and ‘the difficulties likely to be encountered in the management of a class action.” Maffi v. Alter Cable T.V. of North Carolina, Inc., 75 N.C. App. 473, 331 S.E.2d 188 (1985).

F. Application of Class Action Requirements to Defect Cases

After reviewing the reported cases, the author has concluded that defective product class actions are generally acceptable in certain instances, but when the case centers on defects in construction, class certification is rarely allowed. For construction defects, if the defect is a single consistent issue, such as a problem with the foundation of the building or if property rights are violated then perhaps a class action may be certified, but if it is improper flashing of windows and doors, the proof is too individualized and the courts have routinely refused certification. Interestingly, claims against a Condominium Board for failure to maintain common elements can be certified.

The June 2006 North Carolina Bar Association’s Construction Law section newsletter, called the Change Order, includes an article written by Stephanie U. Roberts, titled “Tips for Successful Defense of Construction-Based Class Actions.” NCBA, Change Order Vol. 20, No3, June 2006). In this article, Ms. Roberts focuses on defending manufacturers of building materials in class action litigation. She reports that the defense bar focuses on: venue/removal options; third-party practice; investigation in order to demonstrate differences in the putative

class member's cases; and provides insight and case law to include in a Brief in Opposition to Class Certification. You can find this article by visiting the Construction law section's website at: <http://construction.ncbar.org/Newsletters+/Newsletters/default.aspx>. Most of these strategies are also employed by the defense counsel who represent contractors and other construction participants and this is an excellent secondary source that should be read by anyone involved in a construction based class action in North Carolina.

G. Selected Cases: Class Actions in Construction Defect Disputes

1. Welcome v. Arvida Community Sales, Inc., 2004 WL 234029 (Fla Cir. Ct., 2004). Class Action not certified for three hundred (300) James Island Homeowners who had defective stucco, improper flashings and gaps between the floor and bottom of the exterior walls. The Court found that the requirements were not met and that "This case is far too complicated and individualized to permit class treatment."

2. Hicks v. Kaufman & Broad Home Corp., 89 Cal. App 4th 908 (2001). Homeowners brought causes of action for strict liability, negligence, and breach of express and implied warranties against developer and general contractor seeking to recover the cost of repairing or replacing defective concrete foundations under their homes. The concrete was constructed using Fibermesh, a polypropylene product, rather than wire mesh. According to the Plaintiffs, the mesh allowed for wider cracks than is typical and permitted moisture, dirt and insects to invade the homes. The trial court denied the motion for class certification. On appeal, the Court reversed as to express and implied warranties.

3. Marcuse v. Del Webb Communities, Inc., 163 P.3d 462 (2007). Carry over from a class action surrounding a community of homes that were built with defective unsleeved, underslab domestic water copper plumbing lines.

4. Shuette v. Beazer Homes Holdings Corp., 121 Nev. 837, 124 P.3d 530 (2005). Homeowners Class Action, which had been certified in a haphazard way on Plaintiffs' claims of breach of express and implied warranties, negligence and negligent misrepresentation. The case proceeded to trial and the Plaintiffs prevailed on negligence and negligent misrepresentations but lost on the warranty claims. The award was \$7,885,500. The lawyers were awarded fees in the amount of \$2,033,406. Because the class was found to have been comparatively negligent, the judgment was entered for 93% of the verdict. The Supreme Court of Nevada zealously reversed and found the class certification to be inappropriate. The Court followed California precedent and found single family construction defect cases to be ill-suited for class action treatment.

5. Smith v. Glen Cove Apartments Condominiums Master Assoc. Inc., 847 So.2d 1107 (2003). Plaintiffs filed a class action complaint against condominium association and lessors for failure to maintain roofs on condominium buildings and moved for class certification. The Trial court entered a non-final order denying the motion and the Plaintiffs appealed. The District Court of Appeal reversed and directed the trial court to certify the class and held that: (1) separate joinder of potential class members would have been impracticable; (2) allegations that defendant violated a statutory duty or was negligent in its failure to maintain roofs causing damages to tenants and members of class were common to all potential class members; (3) representatives' claims were typical of each potential member of the class; and (4) representatives were able to adequately represent the interests of the proposed class of one hundred (100) condominium tenants.

6. Zehnder v. Ginsburg & Ginsburg Architects, 678 N.Y.S.2d 376, 254 A.D.2d 284 (1998). Condominium Owners class action for construction defects related to the design of their units was certified and then the certification was found improper by the appellate court.

7. Henriques v. Archstone Smith Operating Trust, No. 02-21697 (Cir. Ct. Miami- Dade County Jan. 6, 2003). Class action “seeking damages and injunctive relief against Defendants for exposing Harbour House South residents to toxic mold growing inside their apartments and in the building’s common areas” was certified.

8. Lienhart v. Dryvit Systems, Inc., 255 F.3d 138 (4th Circuit, 2001), wherein the 4th Circuit decertified a class action against Dryvit (by the same judge that authored the Wilson Decision!) stating the homeowner’s injuries could have just have easily have been caused by builders and subcontractor applicators that installed the defective cladding.

IX. CASE OVERVIEW AND LEGAL STRATEGY

Typically, these cases are referred to us by dozens of community association lawyers and community association managers. Our first conversation typically begins with the lawyer or manager describing a recent call from the Board’s President, who has been confronted by a group of angry owners who believe that their homes are water and mold infested disasters or plagued by some other type of serious construction defect. The President is in disbelief and cannot imagine that the horror stories are true. Instead, the President believes that the ringleader is out to cause trouble and that the community association lawyer needs to come up with a simple solution by tomorrow. The lawyer simply cannot deliver, as these issues are among the most complex any practitioner or litigation attorney can deal with. That’s why we get a call.

When confronted with a Board member in denial, who has just been accosted by an angry unit owner, the Board’s attorney, Community Association Manager and the Plaintiff’s attorney must act concurrently. The Board’s attorney and the Manager will gather documents and obtain basic information and deliver the same to the litigation attorney. The litigation attorney will review the same and then evaluate the case, determine the fee arrangement and begin preparing

two (2) sets of Reports. The litigation attorney needs to be direct in order to gather the necessary information but must also understand the reasons why the information may not be easily obtained. Each of the three (3) groups you are dealing with (the Board, Board's attorney and Property Manager) are worried about this process and are afraid that they may have made a mistake or simply cannot afford to pay your hourly rate. They don't want to tell you what they could have done and will spend an inordinate amount of time defending their actions or inaction. You have to understand this reluctance and appreciate the legitimacy of their concerns but you have a job to do, and must be direct and forceful. Unless they have dealt with you in the past, you will not be trusted. Understand this, and raise difficult questions and issues all along the way and try to cut your initial bills if possible. Assume you are not hearing the whole story and evaluate the case as if you will have to accept the same on a contingency basis.

This initial process is summarized as follows:

Ask these questions, gather the following documents and begin preparing the following Reports:

1. Identify all the "players" and all of their pertinent employees.
 - A. From this begin preparing a "Player's Report", which eventually will be a trial preparation source. In order to undertake proper trial strategy, you must understand what each person's potential testimony will be and how this fits into the overall presentation packages by each Defendant and witness. You begin this process on Day 1 and continue to update this Report at every stage of the litigation. Eventually, this Report, along with the Document Outline, will be used to: schedule and prepare for depositions, prepare written discovery and responses to discovery, and finally it will serve as a primary source for Direct Testimony and Cross-Examination Outlines. This process will force you to learn: who is important and who is not and who is a friend and who is a foe and who can be both (everyone on some issue). Knowledge is key so make sure you get a clear understanding about who knew what, when, why and how from the outset. If you overlook anyone, you will be surprised and surprises are very dangerous when you are on a contingency fee. Assumptions can only be made.

- B. Include in the Report the role the person played and how this role changed over time. Include a list of the major meetings the person attended and whether his/her positions were adopted or trumped by others. Can you put this person in a position of saying: I told them so, but they didn't listen? When you identify the major documents, note in your Players Report whether they had possession of the same.
 - C. Later on in the process, when you identify the specific factual issues in the case, identify in your Players Report what position each player will take on each specific issue.
 - D. Assess credibility. Find out whether this person was or remains in denial, is an alarmist, is emotional (hotheads are treated differently from others in depositions and mediation).
 - E. Focus on insurance. Who has what insurance and what amounts?
 - F. Focus on assets. We hire people to help us with this.
 - G. As this Report continues to develop, it can be altered in to an Issue Report, where specific issues are outlined and all players and documents are combined.
2. Defect questions
- A. What are the issues?
 - B. Accumulate pictures, reports and all documents that relate to the problems.
 - C. Speak with an expert and gage the amount in controversy and the data they need to evaluate the issues.
3. Mold questions
- A. What exactly has been discovered?
 - B. How long has it been around?
 - C. Who discovered it?
 - D. How long has the Board known about it?
 - E. Is it in common areas or limited common areas?
 - F. Have any inspections/tests been performed on the mold?

4. Water questions
 - A. What is the source of water intrusion that is feeding the mold?
 - B. Who discovered it?
 - C. How long has the Board known about it?
 - D. Is it in common or limited common areas?
 - E. How long has any Member known about it?
 - F. Have any inspections/tests been performed on the area?
 - G. Was the source caused by original construction? If not, what caused the water intrusion?
5. What maintenance has been performed?
6. What repairs have been performed?
7. How old are the units?
8. What insurance is available and have they been notified of a claim?
9. Who are the potentially responsible persons?
10. Who are the potential Plaintiffs?
11. Gather every document that you can.
 - A. Condo docs
 - B. Plans, Plats, Specs, Contracts
 - C. Submittals to all relevant agencies and if it is relevant, meeting minutes for each governmental authority
 - D. Pictures, videos, parts of the structure
 - E. Letters and memos
12. Determine when you must file suit by calculating the date(s) the Statutes of Repose and Limitations run.

Gather everything and begin a Document Outline, which is also an ongoing updated report. Basically, try to summarize all important documents and indicate the witnesses who will be confronted with the same. This will be used in preparing for depositions, written discovery, drafting the Pre-Trial Order, and testimony/cross examination outlines. We usually begin by breaking the documents into categories and then placing the documents in chronological order within each category. I like to have three ring binders tabbed, labeled, and indexed for easy access.

When reviewing the documents, take the time to flag the documents with color coded “Post-it” notes. We use Pink for documents that are protected from discovery, Blue for documents that go into the Document Outline and Green for Exhibits. A paralegal can use these tabs to begin preparing your Document Outline after you place the documents into red wells that are marked by the “category”, such as “Contracts, Plans and Specifications” or “Letters, Memos and Meeting Minutes”. The lawyer fills in the “Comments” and “Witnesses” columns.

Once you have basic information (you will never have the time to prepare your reports until after you are retained), you should instruct the Community Association lawyer or the Property Manager to:

1. Notify all insurance companies of the water intrusion damage and mold.
2. Begin their/your search for water intrusion and mold experts. As for Mold experts, a Certified Industrial Hygienist (CIH) or the like should be immediately consulted and queried on how to mitigate damages and prevent mold exposure and growth. A forensic engineer will also be necessary. Costs for a matrix analysis (described below) must be demanded.
3. All sick owners should be directed to a medical professional.

Simply put, the Community Association lawyer or property manager needs to immediately call in those who deal with these problems all the time and can provide a

professional opinion about what is needed to take care of the property and people. This will serve three (3) purposes. First, it puts a plan of attack into play that will look good when the case is tried. Your client will be able to testify: “we were overwhelmed; we called the experts and followed directions.” Second, it gives you, the potential litigation attorney two important things, information and time. You will learn the true scope of the problem during this time period while you conduct investigations about scope of repair, standing issues, potential Defendants, collection issues and the like. After you gather and receive all this information, you can decide whether you will accept the case, and, if so, under what fee arrangement. Third, regardless of whether you accept the case, the client will have gathered enough information to make informed decisions on how best to proceed. Also, if you turn down the case, then the data will be readily available for another attorney to review and hopefully help the client.

PLEASE, PLEASE, PLEASE, make sure that you and your client have a clear understanding about one point in particular- **Spoliation of Evidence** - which must be on the forefront of your mind. All activities should be memorialized in many ways, including photographs and video. The potentially responsible parties and insurance companies should be notified prior to any destruction of potential evidence. It’s not a perfect world and your admonitions about this will fade in the mind of your clients over time, but keep on them. They (and you) simply cannot afford to be sloppy with so much at stake.

The next steps you take will be based upon the circumstances of your case. This takes more analysis, which begins with a general overview of the Construction Defect, Water Intrusion and Mold Multi-Family Litigation Wars.

1. Initial Considerations for a Litigation Attorney

A. Introduction and Overview

When we meet with a potential client for the first time, we initially focus on size, defenses and “collectability”. Simply put, we typically work on a contingency or hybrid fee arrangement and therefore we are often sharing the risk of litigation. Our willingness to accept risk is directly proportional to the size of the potential verdict and the chance the case could settle. Our willingness to accept small cases is related in some part to the absence of potential defenses. Thus, when you see a Plaintiffs’ lawyer prosecuting a smaller case, you can assume the attorney thinks it is a “lay down.”

B. Statutes of Limitation and Repose

Of course, you should not waste the Associations’ money on cases that they will lose.

With respect to defenses, the typical focus is limitation periods. We generally steer away from Statute of Repose cases but will fight a Statute of Limitation defense to the death. The case law dealing with Statutes of Repose issues are simply too harsh and unbending to risk a lot of time and expense. There are exceptions, of course. For example, we are beginning to push the “control exception” found in many Statutes in cases where the developer had control of the homeowner’s association at a time when it knew that the common areas had problems. See N.C. Gen. Stat. § 1-50(a)(5)d (“[t]he limitation prescribed by this subdivision shall not be asserted as a defense by any person in actual possession or control, as owner, tenant or otherwise, of the improvement at the time the defective or unsafe condition constitutes the proximate cause of the injury or death for which it is proposed to bring an action, in the event such person in actual possession or control either knew, or ought reasonably to have known, of the defective or unsafe condition.”).

C. Mitigation of Damages, Failure to Maintain, and Likeability

We have found other “defenses” such as failure to perform maintenance and mitigation to actually hurt the defense in many cases. Unless the Plaintiffs are arrogantly rich and acted in a brazen manner because of their financial ability, which allowed them to be unconcerned about the costs of repair, our jury research indicates that these defenses can really backfire. However, with wealthy owners, these defenses can have a profound effect, especially if the jury does not like the Plaintiffs. As an aside, we learned in the Pepper¹⁷ trial that the jury actually considered the Peppers’ wealth and decided, as a person, that they liked the Peppers and wanted to help them regardless of the Peppers’ ability to shoulder the loss. Thus, wealth is an issue but “likeability” is the determining factor. If the jury does not like the Plaintiffs, then this is a great way to let them set out their resentment in an indirect manner.

D. The Hurricane Defense

Causation is fact intensive and must always be considered. In a coastal environment, we sometimes face the “hurricane defense,” i.e. “these problems were caused by six hurricanes, not my clients little flashing mistake.” Nobody seems to know how successful the defense will be because all the close cases have settled. We can report that the Pepper jury and the Judge in Baypoint v. Dryvit¹⁸ appeared unconcerned with the storm evidence. Those cases are likely not dispositive on the effectiveness of the issue, however, because the hurricane exposure was relatively light in both instances.

E. Insurance Coverage and Collectability

¹⁷ Pepper v. Lancaster Homes, Inc., Sto Corp., et al. (New Hanover County Superior Court, 96 CVS 3992)

¹⁸ Board of Directors of the Bay Point Condominiums Assoc., Inc., et al. v. RML Corp., Dryvit Systems, Inc., Bishop Wall Systems, et al. (Circuit Court of Norfolk, VA CL99-475)

The third initial consideration is insurance coverage and Defendant's assets. No Plaintiff can spend a paper judgment so there must be a solvent target or covered claims. This analysis must be made before drafting the Complaint, or Plaintiffs can easily plead themselves out of coverage. Simply put, do your best to plead covered claims and name dates that you know will trigger coverage. Dan Bryson is presenting on this topic so this manuscript will not delve into insurance. I must simply warn you, plead yourself into coverage, not out.

2. Owner's Expectations and Unity

Representing owners in construction cases is very similar to representing parties in domestic disputes. No asset is more important financially and emotionally than one's home. Also, homeowners live with the problems every day and night. When others sleep soundly during rain storms, these Plaintiffs are up, with leaking homes, thinking about why their case is taking so long to resolve. Another difficult feature of construction defect and water intrusion cases is that most owners will never be made whole through the litigation process, unless they also have a personal injury claim for mold illness. Very few claims allow the award of attorneys' fees and, absent physical illness, damages for pain and suffering and other intangible losses are typically unavailable. Punitive and treble damages are rarely covered by insurance and, instead, often must be collected by selling broken down trucks and old equipment. In a nutshell, Owners must start the process knowing that they will rarely be made whole or they will never be made happy (or reasonably unhappy). Instead, these owners, who have likely experienced years of agonizing communications with general contractors, should be told the truth, without sugar coating, so they can make appropriate plans and make decisions with full knowledge of the likelihood of obtaining various verdict amounts.

A Homeowner Association's Board of Directors needs help and the legal team needs to understand this. The Board will be under fire from those whose homes are damaged. However, it is simply imperative that you keep the membership and the Board united in their goal of obtaining as much money as possible to fix their problems. How to spend that money and other thorny issues can be resolved later, but the focus must be on the litigation and everyone needs to help with information and testimony.

We always try to get control of the claims in the hands of the Board. Simply put, although standing issues may require you to file individual claims on behalf of certain individuals in addition to the Board, we like to have the Board control the litigation. This allows us to report directly to one group, who owe the others fiduciary duties. Mediation and negotiation is tough work. It is impossible if you have to get the consent of hundreds or even dozens of people. Instead, we prepare and have executed limited powers of attorney and assignments of claims and proceeds to the Board prior to filing any individual claims.

In this light, it is important to have the Board, Community Association attorney, and Property Manager to begin planning how the association will use the money that they could receive. The local Community Association attorney and Property Manager should look at their bylaws and controlling documents and determine whether revision is needed in order to equitably spend the money to fix everyone's property. We recently saw an imaginative allocation where the controlling documents were revised to give each owner the option of choosing either of two repairs. The first repair required an owner contribution, while the second was repaired from settlement proceeds only. The owners agreed to an HOA waiver if they chose the second option.

3. Communication

Nothing will destroy a relationship or a case as quickly as a failure to communicate. These disputes are not “cookie-cutter” cases. Instead, each case must be thoroughly analyzed as the discovery continues. Your client will prove to be an excellent resource when you prepare responses to the other parties’ position and/or discovery. Further, spoliation of evidence can and will occur unless someone tells a homeowner that the other side must be notified of repairs and be given a chance to examine the project before the process begins. Finally, while you may know that you are working on the case; your client only knows what you tell them. We have used secure websites where we post bulletins that can only be read by our clients by using confidential passwords. Of course, we sanitize these reports because of fear that the other side will somehow get their hands on the material, but our clients at least know what stage the litigation is in, and what is coming up next. In an effort to maintain open communications and good relations, we go to homeowner meetings and meet with our clients face-to-face. These meetings are long and often occur on weekends and holidays, but they are crucial. Anytime you can speak with a group of clients, you have a chance of learning something new and you will always be given the chance to diffuse any dissension in the ranks.

4. Construction Deficiency Experts

The concepts, analyses and opinions required to successfully prove a moisture intrusion (and mold) claim are, by their nature, issues which few jurors (or lawyers) address in their daily lives. As such, these cases are expert driven. In addition, the approach to these cases must be such that you establish the underlying construction defect/moisture intrusion claims before you move into the mold and mildew facets of the case. Your attack with construction defect experts

must be solid before you bring mold experts into the picture since the expertise of a mold specialist can be worthless, unless liability for the moisture intrusion is firmly rooted.

Further, evidentiary issues must weigh heavily in your decisions on whom to hire as an expert. If you are unsuccessful in presenting an alleged expert's opinions to the jury, then you have surely wasted thousands of dollars in time and expert fees. Finally, you must be ever cognizant of the "digestibility" of the concepts, analyses and opinions presented by the expert witness. The greatest expert testimony available will go unheard if the jury is unable to grasp and understand the fundamental concepts being discussed. For this reason, your experts must be prepared to offer their testimony in creative ways to both instruct and persuade the jury (and judge).

Regardless of the various theories that can be asserted against construction participants, and the dryness of scientific analyses, we have found that you can successfully present expert witness testimony. We prefer using Reports for three reasons. First, it focuses the lawyer and expert witness and prevents lapses in memory. Second, it makes a great exhibit at trial and is the most frequently reviewed document in mediations. Our experience indicates that adjusters will not read deposition transcripts but will study experts reports at length. Our job is to convince the adjuster that the case has value and we find expert reports to be more important than anything else we can say or do. Finally, the report is the single best way to respond to discovery requests.

As referenced above, an understandable presentation to a jury is a paramount consideration of every trial lawyer and expert witness. For this reason we have insisted that our experts "give no oral testimony alone". By this, we mean that rather than have an expert witness simply tell a jury (or judge) what the expert saw, the expert should find, remove, save and present physical evidence which illustrates their testimony, stands for their opinions and

propositions, and gives the jury something to hold onto. How wonderfully effective it is to have a construction expert talking about defective flashing while holding a piece of that defective flashing, taken from the residence or project in question, and comparing the defective piece with the correct type of flashing which should have been used. Surely the jury will remember seeing, holding and comparing the “wrong” piece of flashing with the “right” piece.

Bags of mold are also very effective. In a bench trial, we placed bags of mold and insects on the Judge’s bench. We were immediately instructed to remove the evidence from the Court room. Moreover, copious pictures or videos of the residence or project illustrating the defects and damages will get untold use demonstrating to the adjusters, opposing attorneys, and finally, the jury, why the case has merit and value for which your client should recover. Whatever approach you may choose, realize that you are presenting difficult concepts which, at the end of the day, must be credible and persuasive to the jury or judge.

With respect to construction defect issues, our experts must be prepared to present five (5) elements of opinion and fact testimony. We prefer this be set forth in a “matrix” which quickly becomes the most often used and effective document in a case. On the left side of the matrix is the list of issues and deficiencies. Then, for each issue, five topics are discussed. The first topic is set forth as the “Requirements”. The Requirements section includes reference to the State Building Code (establishing negligence *per se* and insurance coverage), manufacturers’ specifications, specific contract provisions, plans, and, if all else fails, the standard of workmanship then prevailing at the time and place of construction.

Next, for each item, the second topic is set for as “What was done” (done wrong) or “deviations from the requirements”. In this instance, the breach of warranty or negligence is specifically delineated. This is accomplished by comparing what was observed at the project or

residence with what should have been done as specified under the “Requirements” section. In this respect, the expert must be well versed in every possible requirement, including the applicable building codes, the applicable manufacturer specifications or instructions, the plans and specifications for the particular project and, of course, the prevailing standard of workmanship for the area in which the project or residence is constructed. Clearly knowing the construction dates, material manufacturers and particular needs of the project location are crucial in determining applicable building codes, applicable instructions and specifications and applicable standards prevailing at the site. You can see that the proper investigation of the requirements and “as built” conditions are very time intensive and critical in forming the foundation of your case.

The third topic is “Damage”. Damage is important for, at least, two reasons. First, damage obviously triggers insurance. Second, damage triggers big verdicts. In this facet of the case, the experts relay to the jury how the conditions found in the “as built” project or residence are negatively impacting the proper function of the same. Again, pictures and physical evidence should be prepared and presented to assist the jury in their understanding of the conditions which your clients are forced to live through and eventually incur substantial costs to repair.

The fourth matrix topic is the “Necessary Repair”. Typically, an engineer will work with a remedial contractor. As this is a typical battle ground, much attention is placed on this topic. Typical attacks include types of repair (i.e., removal vs. replacement), amount of materials needed, unit costs, labor costs, profit, etc. Care must be taken to ensure that the experts, the remedial contractor and the engineering expert agree as to damages, the required repairs, as well as the methods and means to be employed to that end. Additionally, the attorney and the experts should be sure that the agreed upon repairs put the Plaintiffs back to the position they should

have been, owning a properly constructed residence, without affording them what defense counsel loves to call “upgrades.”

Finally, the cost of the repair is established. We have found that breaking out the costs of the repair is especially helpful at mediation because the adjusters can easily tally up the amount of money the Plaintiffs will be seeking to recover from their client, and will be able to quantify the amounts of the total repairs which are the “responsibility of others.”

5. Mold Experts

The topic of expert witnesses for mold is frankly too extensive for this simple presentation. Thus, we will again just provide basics and some elementary strategy. With respect to mold claims, you probably will have, at least, three experts. First, in order to identify the mold in a manner which will satisfy a Motion to exclude¹⁹ your expert, a qualified industrial hygienist or qualified and experienced microbiologist must perform an investigation of the structure as well as the interior air quality of the project. As with any scientific field, the expert must use methodologies and materials that pass muster in that particular field. In addition, the interpretation of the raw data and issuing of opinions should be made cautiously and with due consideration of the accepted arenas of thought and conclusions. Finally, the particular fauna or type of mold present must be ascertained with certainty so that the correct course of action can be followed. In this regard, we have often used the services of qualified microbiologists for the initial threshold testing and investigation as to the presence of mold or mildew. Alternatively, we have also used the services of companies with on-staff industrial hygienists. The primary consideration with the services of either a biologist or industrial hygienist, as stated above, is that

¹⁹ The Supreme Court set forth the North Carolina standard for the admissibility of expert witness testimony in Howerton v. Arai Helmet, 358 N.C. 440, 597 S.E.2d 674 (2004). In Howerton, the Court rejected both the Daubert and Frye approaches and adopted a more lenient standard. See John M. Conley and Scott W. Gaylord, We are Not a Daubert State- But What are We? Scientific Evidence in North Carolina After Howerton, 6 N.C. J. L. & Tech. 289 (Spring 2005).

their methods, materials and analysis are sufficient, complete and generally accepted in the field. Finally, their reports, conclusions and/or opinions must be presented in a manner that clearly identifies the presence (or absence) of harmful mold and a proper repair/remediation process.

After the hygienist has established, as the threshold of your mold claim, the presence of the mold in and affecting the structure and/or interior air quality, a qualified mold remediation contractor must issue a bid for the proper containment and removal of the mold organisms without spreading the infestation to other parts of the structure. This bid is established through coordination with the industrial hygienist as to proper scope and protocol to follow, for example the New York City protocol.

Finally, should personal injury be an issue, a medical doctor with expertise or specialized training in diagnosing and treating mold related ailments must be employed. This doctor must be prepared to discuss the following:

1. The known physical ramifications of exposure to different types of mold, especially those types found by the hygienist at the project;
2. The types of mold present in the project and to which the Plaintiffs have been exposed;
3. The physical ailments presented by the particular Plaintiffs, and how those are congruent with the known effects of the mold found at the project;
4. The treatment which the Plaintiffs require as a result of the exposure to the mold;
5. The long term effects of the mold exposure;
6. Whether this particular Plaintiffs have any particularly acute reactions to mold; and
7. The costs which the Plaintiffs will incur as a result of the mold exposure.

The most critical aspect of the medical expert's testimony is drawing the causal link between the moisture intrusion related presence of mold and the physical injuries which form the basis of the personal injury claim.

As a final word on experts and expert opinions, credibility is everything. To that end, there is no substitute for preparation and attention to detail. Where most experts and the attorneys falter, is by stretching to reach an opinion or to find viable issues. The preliminary evaluation of the potential claims should mitigate this problem by sufficiently establishing the core of your case and therefore the focus of your experts' investigations and analyses. The greatest disservice to your client is to instill them with unrealistic expectations and thus present an unrealistic case by stretching that core and focus. If the core of the case is strong, the preparation of experts complete and the presentation understandable, these cases can be profitable for the attorney and literally, Plaintiffs' saving grace.

6. The Four Stages of Litigation

This litigation is expensive. Thus, when you are assessing the case and are preparing to report to the Board about the costs that will accompany a lawsuit, present the costs in stages. The First stage is the expert work needed to develop a "bullet point list of defects." This is enough to help you prepare your complaint and initial discovery. The Second Stage is the expert reports. For example, obtain a quote from your expert for preparing the Matrix Report described herein. You will use this Report when drafting discovery and taking depositions.

The Third Stage is all the costs necessary to get to mediation. Assume that all your clients will have to be deposed and that all your experts will be deposed. You will probably want to take the opposing experts' depositions and the main "players" from your "Player's Report". As these cases are usually large enough to justify expert involvement in the mediation,

include these costs as well. We try to produce a PowerPoint for the mediation. The Fourth Stage is through trial. Include all your mock-ups, construction costs, and demonstrative exhibits.

7. Issues in Class Action Settlements

If you delve into this area of law, you will eventually find yourself on the wrong end of a class action settlement. Typically this arises when your clients' property has a defective siding, roof or defective window product installed in the units. If this product was the subject of a class action, which settled, then you need to look at the settlement agreement and determine what rights your client lost in the release language. In most instances, this release will likely benefit suppliers and others in the distribution chain. Some settlements are even broader and seek to release contractors and developers. You will need to fight this, or lose your claims.

In one case we handled, our clients were an association of 91 homes that had either of two hardboard sidings installed. Both of these sidings were the subject of class action settlements. One settlement only released the manufacturer and supplier. The other attempted to release the builders and developers. To make matters even worse, our clients did not qualify for settlement proceeds because their siding was not installed in accordance to the manufacturer's application instructions. Thus, we were in the precarious position of having millions of dollars of repair costs with no settlement recovery, but supposedly released our rights against the responsible parties in order to get nothing. One would think this would be easy to escape, but it was quite difficult. Eventually we prevailed using the following strategy.

We employed a "three bites at the apple" approach, which can be used in most situations. First, we went to Alabama, the jurisdiction that approved the class action, and fought several issues, including, 'whether or not our clients were class members,' what was the Court's determination of who received a release, and whether the manufacturer breached the settlement

agreement by failing to give our clients notice as well as failing to send notice to the developer, builder and suppliers. Second, we came back to North Carolina and asked the Court to determine whether the class action settlement would have *res judicata* effect over our clients. This battle required a determination of whether our Plaintiffs were afforded due process if the Settlement Agreement and its release provisions are applied against them. In this regard, we narrowed the issues to three arguments: whether our clients interests were adequately represented by the Class Members; whether we received adequate notice of their inclusion in the Class Action; and third, because of the manufacturer's post-settlement affirmative misrepresentations and omissions, whether the manufacturer was equitably estopped from raising a defense based upon any release in the Class Action Settlement. Finally, we were prepared to assert negligent misrepresentation and unfair and deceptive trade practices claims for post-settlement omissions and misrepresentations by the manufacturer (but never were allowed to do so because the case settled after we defeated the Motion for Summary Judgment in North Carolina).

We have a significant amount of briefs and authorities on this subject and would be willing to share the same with anyone who desires a copy. Simply, send us an e-mail and we will forward the same to you.

8. Settlement Issues in Non-Class Action Cases

As stated above, we focus our cases on achieving a result at mediation. Typically, we give the client incentive to settle at mediation by having a reduced contingency fee prior to mediation and a higher fee after. We try to keep our costs down before mediation and limit Motions. After mediation fails, all gloves must come off and the real risks begin. Thus, we truly are ready to negotiate at mediation and cannot offer the same deal later.

Sometimes, we have to get imaginative in order to settle a case. It is clearly easier to just put a set sum of cash on the table and tell the clients this is what is available, take it or leave it. Because of insurance issues, we now have to consider work in kind. This can be very difficult. Thus, if you are considering a work-in-kind settlement, we suggest the following:

1. Require approval of all plans and specs by your expert.
2. Require approval of the as built conditions.
3. Require an extended express warranty.
4. Require performance bonds.
5. Require a punch-list protocol.

Second, how do you get paid? This is difficult. Our engagement agreements require the work in kind to be valued by an independent engineer and we take our percentage of that value.

Also, Plaintiff's lawyers need to help defense attorneys get coverage for their clients. We try to have a separate meeting with the Defendants and their personal attorneys when possible.

We also will settle and take assignments of claims. This gets around many of the manufacturer defenses set forth above. It worked in Baypoint, and we are not afraid to do it again.

X. ARBITARTE OR LITIGATE, THAT IS THE QUESTION

1. Overview and General Arbitration Principles under NC Law

Arbitration clauses and demands for arbitration are somewhat uncommon issues that must be dealt with in multi-family cases but deserve discussion. The Association's attorney will be intricately involved in the decision to fight arbitration or, if some pressing need or egregious jury trial issue exists (like everyone in the county hates your client), to invoke arbitration. Often arbitration clauses can be found hidden in the many paragraphs of general construction

agreements. In the wake of recent litigation involving such clauses, some drafters are beginning to make arbitration agreements a more prominent part of the larger contract because the parties to these agreements must clearly understand they are subjecting themselves to an arbitration agreement. Further, parties to an arbitration must specify clearly the scope and terms of their agreement to arbitrate. A party cannot be forced to submit to arbitration of any dispute unless he has agreed to do so.

In North Carolina, the determination of whether a dispute is subject to arbitration involves a two-pronged analysis, requiring the Court to ascertain (1) whether the parties have a valid arbitration agreement and (2) whether the specific dispute is covered by that agreement. Raspet v. Buck, 147 N.C. App. 133, 554 S.E.2d 676 (2001); Brevorka v. Wolfe Const. Co., Inc., 155 N.C. App. 353, 356, 573 S.E.2d 656, 658-59 (2003) (rev'd in part on other grounds); Ragan v. Wheat First Sec., Inc., 138 N.C. App. 453, 455, 531 S.E.2d 874, 876, disc. rev. denied, 353 N.C. 268, 546 S.E.2d 129 (2000).

The North Carolina Court of Appeals has addressed the arbitrability of claims based on tortious conduct, unfair and deceptive trade practices, express warranties, negligent misrepresentation, and claims for punitive damages.

In Rodgers Builders v. McQueen, the contract in question stated that all claims or disputes between the parties to the contract "arising out of, or relating to," the Contract Documents or the breach thereof would be resolved through arbitration. 76 N.C. App. 16, 18, 331 S.E.2d 726, 728 (1985). As the project neared completion, a dispute arose over the timeliness of the completion and a failure to pay a draw request. Id. The Plaintiff demanded arbitration of the dispute, which consisted of fraud, unfair and deceptive trade practices, negligent misrepresentation, and punitive damages. Id. at 19, 331 S.E.2d at 728.

The Court held that N.C. Gen. Stat. § 1-567.2(a) allowed the parties to include an arbitration provision in a written contract so long as any controversy subject to the arbitration clause was related to the contract or the failure or refusal to perform the whole or any part thereof. Id. at 23, 331 S.E.2d at 731. Whether or not the parties agreed to submit a particular dispute or claim to arbitration is determined by looking at the language in the agreement to ascertain whether the claims fall within its scope. Id. at 23-24, 331 S.E.2d at 731. Whether a claim falls within the scope of an arbitration clause depends on the relationship of the claim to the subject matter of the arbitration clause, not whether it is characterized as a tort or contract. Id. at 25, 331 S.E.2d at 732. In its analysis the Court concluded that the language of the arbitration clause was sufficiently broad to include all claims which may arise out of or are related to the contract or its breach. Id. Thus, the parties were required to submit their dispute involving fraud, unfair and deceptive trade practices, negligent misrepresentation, and punitive damages to arbitration.

In Brevorka, the Plaintiff brought implied warranty, express warranty, and negligent misrepresentation claims against a builder-vendor. 155 N.C. App. at 355, 573 S.E.2d at 658.²⁰ The builder had supplied a typical “Warranty Package” that we often see in our cases. The Defendant sought to stay the proceedings and compel arbitration based upon the following language in the parties’ limited warranty agreement:

disputes on covered items shall be submitted for arbitration to the American Arbitration Association (AAA) or such other independent arbitration service as may be designated by QBW, for resolution in accordance with the rules and regulations of the AAA or such other service. You must pay the cost of arbitration when filing a claim. Such arbitration shall be a condition precedent to the commencement of any litigation by the homeowner or builder arising out of or connected with the rights and obligations created by this Agreement.

²⁰ The issue in Brevorka concerning the waiver of implied warranties is discussed herein at Section IV.

Id.

In analyzing the first prong, the Court noted that the limited warranty constituted an agreement to arbitrate any disputes or claims arising thereunder. Id. at 357, 573 S.E.2d at 659. The Court also cited numerous cases stating that there is an affirmative duty to read an instrument, or have it read before signing it, and that one who signs a written contract without reading it when able to do so is bound by the contract unless the failure to read is justified by some special circumstances. Id. The Court noted that no evidence of special circumstances was presented. Id.

As for the second prong, the Brevorka Court began its analysis by citing several cases for the proposition that there is a “strong state and federal public policy favoring the settlement of disputes by arbitration” which “requires that the courts resolve any doubts concerning the scope of arbitrable issues in favor of arbitration.” Id. at 357-58, 573 S.E.2d at 659 (internal citations omitted). The Court also favorably reviewed the Court’s analysis in Rodgers and found that there was a “sufficiently strong connection between plaintiffs’ misrepresentation claims and the express warranties set forth in the parties’ agreement to bring the claims within the arbitration provision.” Id. at 360, 573 S.E.2d at 661.

When we look at Warranty packages, such as that at issue in Brevorka, we focus on the Parties to the Agreement and determine whether the person/entity with standing to bring the claim is bound by the agreement. For example, we argue that the HOA is a proper plaintiff in a common element construction defect claim and is not bound by the Warranty package given to an individual unit owner.

In Pineville Forest Homeowners Ass’n v. Portrait Homes Const. Co., 646 S.E.2d 864 (Table), 2007 WL 2034044 (N.C.App), the Court of Appeals recently held that when a trial

court's order denying the defendant's motion to compel arbitration contains neither factual findings nor a determination whether an arbitration agreement exists between the parties, the Court of Appeals is unable to determine the basis of the trial court's judgment. *See also* R.J. Griffin & Co. v. Beach Club II Homeowners Ass'n Inc.²¹

The cases cited above did not, however, discuss whether a personal injury claim would be related to or have a sufficiently strong relationship to an underlying breach of contract claim so as to fall within the scope of an arbitration clause. While the author of this manuscript is not aware of any North Carolina cases that have directly addressed this issue, there is case law in other jurisdictions on this topic.

2. Arbitration Clauses and Personal Injury Claims

The Florida Supreme Court specifically addressed whether the terms of an arbitration provision in a contract for the sale and purchase of a house required the claim for personal injury to be arbitrated. The Court held that such a claim was not arbitrable. Seifert v. U.S. Home Corp., 24 Fla.L.Weekly S 540, 750 So.2d 633, 635 (1999).

In Seifert, the owner of a newly constructed home was killed as a result of construction deficiencies in the house. The deceased's wife sued the contractor alleging claims for strict liability, negligence and breach of express and implied warranties. Defendant moved to compel arbitration invoking the arbitration clause in the construction contract. Defendant's position was

²¹ In R.J. Griffin & Co. v. Beach Club II Homeowners Ass'n Inc., 3 Fed.Appx. 43, 2001 WL 101467 (C.A.4(S.C)), the District Court denied a general contractor's motion to compel arbitration because the homeowner's association was not a party to the contract. A South Carolina homeowners association sued a general contractor for alleged construction defects in a condominium building, and the contractor then sued the association in federal to force arbitration under clauses in the general construction contract and the master deed. The Court stated that the association did not seek a direct benefit from the contract, and the contractor is not a third-party beneficiary of the master deed and is not otherwise entitled to invoke its arbitration clause. The contractor's main argument was that the arbitration clause in the general contract was enforceable against the association through the doctrine of equitable estoppel. The contractor asserted that the association, though not a signatory to the general contract, is equitably estopped from avoiding the contract's arbitration provision. However, the Court held that the association, in asserting its claims, was not seeking a direct benefit from the provisions of the general contract it did not sign, and the doctrine of equitable estoppel could not be used to force the association to arbitrate.

that the arbitration clause mandated that Plaintiff's personal injury claims be arbitrated. The arbitration clause read, "any controversy or claim arising under or related to this agreement or to this property, or with respect to any claim arising by virtue of any representations alleged to have been made by the Seller or Seller's representatives shall be settled and finally determined by mediation or binding arbitration." The Court, in its analysis stated:

[I]t is fair to presume that not every dispute that arises between contracting parties should be subject to arbitration. As the prevailing case law illustrates, even in contracts containing broad arbitration provisions, the determination of whether a particular claim must be submitted to arbitration necessarily depends on the existence of some nexus between the dispute and the contract containing the arbitration clause. Disputes arise in many and varied contexts and the mere coincidence that the parties in dispute have a contractual relationship will ordinarily not be enough to mandate arbitration of the dispute. In other words, the mere fact that the dispute would not have arisen but for the existence of the contract and consequent relationship between the parties is insufficient by itself to transform a dispute into one arising out of or relating to an agreement. For a tort claim to be considered arising out of or relating to an agreement, it must, at a minimum, raise some issue the resolution of which requires reference to or construction of some portion of the contract itself.

Id.

The Court's evaluation looked at whether the tort claim arose from the contract and bore a significant enough relationship to the contract as to mandate application of the arbitration clause. Plaintiff conceded that her claims for breach of contract or of any of the warranties or other rights under the contract were subject to arbitration. However, because the wrongful death claim was predicated upon common law negligence unrelated to the rights and obligation under the contract, Plaintiff argued that the claim was not contemplated by the parties when the contract was made, and therefore should not be subject to arbitration. The Court agreed.

[T]he absence of any mention of the parties' rights in the event of personal injuries or death arising out of any alleged tortious conduct such as that which allegedly occurred in this case creates an ambiguity and uncertainty as to the intent of the parties. Under the well established rule of construction, we are constrained to construe the provisions of the contract against its drafter, U.S.

Home (Defendant) There is nothing within these provisions to indicate that either party intended to include tort claims for personal injuries arising under the common law within the scope of either the contract in general or the arbitration provision in particular. In fact, the only reference to casualties relates solely to damages to the property itself and not to personal injuries suffered by either party as a consequence of the tortious conduct of the other.

Id.

In another Florida case, Plaintiff sued her employer for invasion of privacy, battery and negligence after a fellow employee made numerous offensive sexually-oriented statements to her concerning her physical appearance, groped her and propositioned her. Defendant employer attempted to invoke the arbitration clause in Plaintiff's employment contract which stated, "all disputes, claims and questions regarding the rights and obligations of the parties under the terms of this agreement were to be resolved through arbitration." The Court refused to compel arbitration stating that, "there is nothing in the agreement to indicate that either party intended to include sexual harassment litigation of tort claims for personal injuries arising under the common law within the scope of either the contract in general or the arbitration provision in particular." Boone v. Etkin, 25 Fla.L. Weekly D2275, 771 So.2d 559 (2000).

Louisiana Courts have also faced this issue with a similar result. In one Louisiana case, Plaintiffs purchased a mobile home from Defendants. Subsequent to their purchase, Plaintiffs began to experience trouble with their air conditioner, which had rusted and caused water to accumulate in the duct work of the mobile home. In spite of numerous efforts to correct the problems, the air conditioner continued to leak causing mold and algae to grow in the duct work and insulation. Plaintiffs and their children began to experience respiratory health problems, which they alleged were caused by the mold and algae growth. Plaintiffs also alleged mental anguish and emotional distress. Dennis v. CMH Manufacturing, Inc., 773 So.2d 818, 819, 1999-1626 (La. App. 3 Cir. 11/2/00).

Defendant argued that Plaintiffs agreed to arbitrate all claims when they signed the contract to purchase the mobile home. The arbitration clause read, “any and all claims for liability, damages or expenses arising out of or in connection with the home, the contract, or any warranties, representations, or agreements relating thereto shall be resolved through binding arbitration”.

The Court stated it was clear that the clause covered any and all claims regarding defects in the mobile home, but that:

[A]ny personal injury claim the Plaintiffs might have is not subject to the arbitration agreement contained in the contract...The only disputes subject to arbitration are those arising out of the contract or those disputes which exist between the parties who agree to submit said disputes to arbitration which are existing between them at the time of the agreement to arbitrate...Certainly, a personal injury claim is not a claim arising out of the contract.

The injury suffered by Plaintiffs which gave rise to their personal injury claims clearly arose after signing the contract and did not exist when the contract was signed.

These cases provide insight and guidance on how Courts in different jurisdictions may generally see arbitration clauses as they relate to personal injury. As the Louisiana Court stated, “certainly, a personal injury claim is not a claim arising out of the contract”. Dennis, 773 So.2d at 819. Plaintiffs’ personal injury claims in that case arose subsequent to the signing of the contract, and did not exist at the time the contract was signed.

The North Carolina Court of Appeals stated that, to determine whether a particular dispute or claim is subject to arbitration, it is necessary to look at the language in the agreement and ascertain whether the claims fall within its scope. Whether a claim falls within the scope of an arbitration clause depends on the relationship of the claim to the subject matter of the arbitration clause. The determination of whether a particular claim must be submitted to

arbitration depends on the existence of a nexus between the dispute and the contract containing the arbitration clause.

3. Selection of the Arbitration Company

When faced with an arbitration clause and a personal injury claim, parties must review how the arbitrator is to be selected. It was never anticipated that this company would arbitrate personal injury claims.

A Pennsylvania Court addressed this issue in McDonnell Douglas v. Pennsylvania Power & Light Company, 858 F.2d 825 (1988). This was a case in which a power company issued shares of stock, the issuance of which was governed by a purchase agreement containing an arbitration provision. The arbitration clause stated that if any disagreement arose between the power company and the shareholders, then they would together appoint an independent tax counsel to resolve the dispute. Ultimately a dispute arose, but the basis of the disagreement was bad faith, not valuation.

The Court, while stating that while the parties had agreed to submit some disputes to arbitration, the parties had not agreed to submit questions of whether the power company had acted in good faith. Additionally, the Court stated, “we rely on the plain language of the arbitral clause, and its import within the context of the paragraph”. The fact that parties agreed to choose tax counsel rather than an arbitrator also swayed the Court. “This supports our conclusion that the effect of the clause should be limited to tax law questions and computation disagreements. Had the parties intended to submit all issues regarding good faith to an arbitrator, we do not believe they would have chosen a tax counsel.”

A. Potential Bias in Selection of Arbitration Company

The Federal Arbitration Act, 9 U.S.C. §10 allows for an arbitration award to be vacated if, among other reasons, “there was evident partiality or corruption in the arbitrators,” or “where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.” 9 U.S.C. §10(a)(2) and (3). North Carolina’s Uniform Arbitration Act, N.C.G.S. §1-567, has similar provisions. If the proposed process for selecting the arbiter is one-sided or based toward the drafting party, the Court may consider disqualifying the biased arbiter or the entire clause.

The United States Supreme Court has addressed what is acceptable in terms of bias or partiality on the part of an arbitrator. The Court in this case was addressing the issue of bias of an arbitrator after an award had been rendered and was on appeal, but by implication arbitration service providers failing to meet these criteria are suspect. Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 111 S.Ct. 1647, 114 L.Ed.2d 26 (1991.) The characteristics enumerated by the Court are whether the parties have been informed of the arbitrator’s employment history, whether parties are allowed to make further inquiries into the arbitrators background, whether parties are allowed challenges to the selection of arbitrator, and that the arbitrator must disclose and circumstances which might preclude them from rendering an impartial decision. Additionally, the North Carolina Court of Appeals has stated that, “It is, of course, true that public policy generally requires that arbitrators be impartial and that they have no connection with the parties involved or the subject matter of the dispute.” Thomas v. Howard, 51 N.C. App. 350, 353, 276 S.E.2d 743, 745 (1981). These cases are just two of many; it is common knowledge that a an impartial and unbiased decision maker is prerequisite to effective and useful arbitration.

Therefore it is critical when evaluating an arbitration clause contained within a contract or other written agreement that the intent of the parties be clearly understood and the method by which the arbitration company is selected be completely neutral.²² The simple presence of an arbitration agreement in a written contract does not automatically mean that all subsequent disputes between parties to the contract are therefore subject to the arbitration provision.

²² The parties' intent as to which disputes are to be sent to arbitration is especially critical.