The *Spearin* Doctrine and the Economic Loss Rule in Residential Construction

by Jesse Howard Witt

This column is sponsored by the CBA Construction Law Section.

Residential construction defect litigation can present issues unfamiliar to many contractors and attorneys. This article discusses the limitations of two common defenses, the *Spearin* doctrine and the economic loss rule, and offers practical recommendations for avoiding liability on residential projects.

In a series of decisions over the past six years, the Colorado Supreme Court has clarified that the *Spearin* doctrine and the economic loss rule preclude construction professionals from suing one another in tort for breaching contractual duties. Although these holdings reduce the likelihood that a given construction contract will lead to unanticipated liability, their protections will not always apply in cases involving damage to the home of a third-party consumer. Lawyers who represent builders should recognize the limitations of the *Spearin* doctrine and the economic loss rule to help their clients allocate risk and avoid liability on residential jobs. This article provides an overview of the *Spearin* doctrine and the economic loss rule, as well as practical recommendations for practitioners advising construction professionals.

A Legacy of Homeowner Rights

Anyone who builds in Colorado should know that its courts have a long history of protecting homeowners from defective construction. In 1964, Colorado became the first American jurisdiction to recognize an implied warranty of habitability for houses that were complete at the time of sale.[1] This warranty provides that any new home must comply with the local building code, be built in a workmanlike manner, and be suitable for habitation.[2] The courts have likened the implied warranty of habitability to strict liability, insofar as a homeowner need merely offer proof of a construction defect to establish a developer's liability.[3] In situations where a contractor and developer are closely affiliated, the courts have ruled that the contractor can be sued for breaching the implied warranty of habitability, as well.[4] Although builders routinely attempt to disclaim this warranty in the boilerplate of their sales contracts, such provisions are disfavored, and no reported decision in Colorado has ever upheld such a disclaimer.[5]

In the decades since the adoption of the implied warranty of habitability, Colorado courts have consistently enforced a policy that the builder—not the homeowner—should bear the risks associated with construction defects, reasoning that professionals who have erected and sold many houses are in a much better position to determine the structural condition of a new home than most buyers.[6] Although the protections of the implied warranty of habitability are not available to purchasers of previously owned homes, the Colorado Supreme Court granted relief to such individuals in 1983 with its seminal *Cosmopolitan Homes v. Weller*[7] decision, wherein the Court held that subsequent owners could sue a builder in negligence for la-

Column Editor:

James W. Bain of Benjamin, Bain & Howard, L.L.C., Greenwood Village—(303) 290-6600, jamesbain@bbhlegal.com

About The Author:

This month's article was written by Jesse Howard Witt, a shareholder in the Golden law firm of Benson & Associates PC. Mr. Witt focuses on construction litigation, insurance disputes, and appeals, and he co-wrote an amicus *brief in the* Yacht Club *case discussed in the article. He thanks James W. Bain for his editing and assistance with this article. Mr. Witt welcomes any questions or comments—(720) 898-9680, jesse@jessewitt.com.*

"The term 'economic loss rule' generally refers to the principle that a party cannot sue in tort to recover purely economic damages caused by the breach of a contractual duty."

tent construction defects that manifest before the statute of limitations expires. The Colorado Court of Appeals, meanwhile, has upheld claims for negligence *per se* where building code violations have caused actual property damage.[8] It also has ruled that homeowners can recover damages under the state's consumer protection act where a developer knew or should have known that his construction techniques fell short of advertised quality.[9]

As community living has become commonplace, the courts also have liberally interpreted the Colorado Common Interest Ownership Act and ruled that a homeowner association's ability to institute litigation "in its own name on behalf of itself or two or more unit owners on matters affecting the common interest community" comprises the right to recover damages for construction defects in the units and common elements of a community.[10] Despite several challenges, the courts have steadfastly held that this act confers standing on homeowner associations to assert warranty, tort, and consumer protection claims on behalf of their members in construction defect disputes.[11]

Recent Construction Defect Litigation

The 1990s saw Colorado's population increase by more than 30 percent,[12] and with the influx of new residents came many new builders eager to profit from the increased demand for housing. Unfortunately, not all of these builders were prepared for Colorado's challenging conditions, which can include expansive clay soils, heavy snowfall, high winds, and other challenges. Because of such factors, the boon in construction quickly was followed by a rash of construction defect lawsuits, as buyers demanded repairs to their new homes.

Against this backdrop, a number of contractors unexpectedly found themselves in litigation with homeowners and homeowner associations. Many of these contractors raised the *Spearin* doctrine and the economic loss rule as defenses, asserting that they had complied with the applicable designs and contracts and thereby fulfilled all of their obligations. The courts were not always sympathetic to these arguments, however. When the evidence showed that a contractor had been negligent or had violated the building code, many courts ruled that the contractor could be liable to the homeowner, even if the developer had accepted the quality of the contractor's work or consented to deviations from the code.

The Spearin *Doctrine*

In *United States v. Spearin*,[13] the U.S. Supreme Court ruled that when a developer or owner provides a contractor with a set of plans, the developer impliedly warrants that the plans are adequate for the job.[14] The developer's implied warranty is not overcome by general clauses requiring the contractor to examine the site, review the drawings, or assume responsibility for the work until completion and acceptance.[15] As a result, the developer remains responsible for the consequences of any defects in the plans or specifications.[16]

The case arose after the government hired a contractor, George B. Spearin, to build a dry dock at the Brooklyn Navy Yard in 1905.[17] The government supplied Spearin with plans and specifications that required diversion of a nearby sewer line as part of the project.[18] The plans failed to show a dam in the existing system, however, and the dam caused the diverted section to break under stress.[19] The government insisted that the responsibility for remedying problems in the existing conditions rested with Spearin and annulled his contract when he refused to make repairs at his own expense.[20] The Court disagreed and awarded Spearin damages and lost profits.[21]

Many jurisdictions have adopted the "*Spearin* doctrine" since the Court announced its decision in 1918, expanding it well beyond the realm of government contracts and incorporating it into the common law of many states.[22] The doctrine is not limited to developers, and courts have ruled that a general contractor who supplies plans to a subcontractor provides the same warranty.[23]

In Colorado, litigants often cited *Spearin* in the trial courts, but the case did not appear in a reported decision until 2004, when the Colorado Supreme Court announced *BRW, Inc. v. Dufficy & Sons, Inc.*[24] There, the Court relied on *Spearin* for the propositions that (1) a developer impliedly warrants the adequacy of the plans and specifications it provides to a contractor, and (2) a contractor can sue a developer for economic losses that result from defects in the plans and specifications.[25]

Colorado's Economic Loss Rule

The term "economic loss rule" generally refers to the principle that a party cannot sue in tort to recover purely economic damages caused by the breach of a contractual duty.[26] The rule came into being after American courts began to move away from traditional privity requirements in the 1960s and permit third parties to sue manufacturers in tort over personal injuries.[27] This precedent prompted litigants in breach of contract disputes to assert tort claims, hoping to impose strict liability on manufacturers who had failed to perform their contracts.[28] Although some feared that this evolution would lead to the law of torts swallowing the law of contracts, the California courts formulated a doctrine to maintain the boundary between the two: the economic loss rule.[29]

In *dicta* of *Seely v. White Motor Co.*,[30] the California Supreme Court explained that it was proper for the law to protect consumers from physical injury, but that consumers should bear the risk a given product would not match their economic expectations.[31] Thus, the Court limited negligence claims to damages for physical injuries and held that there could be no recovery in tort for economic loss alone.[32] In subsequent years, numerous other jurisdictions adopted some form of an economic loss rule, many holding that a manufacturer could not be liable for negligence unless a product caused personal injury or damaged some piece of property other than the product itself.[33] The rule first surfaced in Colorado in 1988, when the Colorado Court of Appeals concluded that the economic loss rule prevented a developer from suing a foundation contractor in negligence, where the developer sought lost profits but did not allege physical harm to person or property.[34]

Although many of these early decisions focused on whether the plaintiff had suffered property damage as opposed to eco-

nomic harm, the Colorado Supreme Court declined to follow this rationale when it formally adopted the economic loss rule in 2000. Instead, the Court adopted a variant of the rule that abandoned this often arbitrary distinction in favor of an analysis of the source of a defendant's duty.[35]

In *Town of Alma v. AZCO Construction, Inc.*, the Court held that a party suffering only economic losses from the breach of an express or implied contractual duty cannot assert a tort claim for such a breach, absent an independent duty of care.[36] The case arose from a contract to build improvements to a town's water distribution system.[37] The contract contained a warranty requiring the contractor to remedy any defects in materials or workmanship for one year.[38] After several defects manifested beyond the warranty period, the town and several residents brought suit against the contractor, alleging negligence and breach of contract.[39] The trial court dismissed the negligence allegations based on the economic loss rule, and a jury returned a defense verdict on the contract claim.[40] The Colorado Supreme Court affirmed dismissal of the negligence claim, finding that it represented purely economic losses arising from the breach of a contractual duty.[41] This precluded the claims of both the town and the individuals who were intended third-party beneficiaries of the contract.[42]

To a large extent, the economic loss rule arising from *Town of Alma* serves a purpose similar to that of the *Spearin* doctrine: it enforces the expectancy interests of the parties' promises and allows them to effectively allocate risks and costs during their bargaining.[43] Restricting tort remedies for contractual disputes, like limiting liability for undiscovered design errors, helps contractors define the scope of their rights and responsibilities and thereby bid with confidence on potential jobs. In *BRW*, the Court discussed the interplay of the two doctrines, explaining that a subcontractor could sue a developer in contract for breaching the *Spearin* warranties, but that the economic loss rule would bar the subcontractor's tort claims against other construction professionals on the job.[44] Although this decision may shield contractors from tort liability in many situations, the exceptions to the rule define the bounds of the contractor's liability under both the *Spearin* doctrine and the economic loss rule, and it is here that the construction lawyer's role becomes important.

There is No Excuse for Negligent Homebuilding

Construction lawyers must help their clients recognize that, regardless of what their agreement with a developer says, contractors have an overriding obligation to avoid harming homeowners. Whether this is interpreted as an implied term of their contracts or, more accurately, as duty independent of their contracts, construction professionals must account for this obligation when bidding and working on residential projects, as neither the *Spearin* doctrine nor the economic loss rule will exonerate the negligent construction of someone's home.

Spearin*: No Blanket Immunity for Design Defects*

Although the *Spearin* doctrine can shield a contractor from certain claims by a developer (or shield a subcontractor from certain claims by a general contractor), it does not absolve the contractor of

all liability for damage from design errors. On any type of project—residential, commercial, or public—*Spearin*'s implied warranty of the adequacy of plans applies only to design specifications; it does not affect performance specifications that set forth an objective or standard to be achieved or rely on the contractor to select the means of achieving that objective or standard.[45] Furthermore, even if a developer supplies comprehensive design specifications, the contractor is not justified in "blithely proceeding with its work in the face of obvious and recognized errors"; rather, the contractor has a duty either to take appropriate steps to address obvious defects in the design or demand that the developer take action.[46]

Importantly, although the *Spearin* doctrine can prevent a developer from bringing suit against a contractor, it provides little shelter from the tort claims of consumers. The leading case addressing this distinction is *Hercules Inc. v. United States*,[47] in which manufacturers of Agent Orange sought indemnity from the government for the cost of defending soldiers' personal injury claims.[48] The U.S. Supreme Court acknowledged that, under *Spearin*, the government had warranted that the manufacturers would be able to perform satisfactorily if they followed the specifications provided.[49] Nevertheless, the Court held that "this circumstance alone does not support a further inference that would extend the warranty beyond performance to third-party claims against the contractor," and therefore affirmed dismissal of the manufacturers' indemnity suit.[50] The posture of *Hercules* can be analogized to that of a typical construction defect suit, and its holding suggests that the *Spearin* doctrine may have limited effect where a third-party homeowner sues a contractor for negligent construction.

This is not to say that the *Spearin* doctrine is irrelevant in defending against construction defect claims. A homeowner bringing suit against a contractor still bears the burden of proving a breach in the standard of care; merely demonstrating the existence of a defect is not sufficient to prove that the contractor was negligent.[51] Thus, if the contractor can demonstrate compliance with a developer's plans and specifications, the *Spearin* doctrine might preclude a finding that the contractor was at fault and thereby eliminate a necessary element of the plaintiff's case. Relying on such a defense may be perilous where the facts are disputed, however, because a jury could disagree that the designs were faulty or conclude that an experienced contractor should have recognized any such defects and taken steps to correct them.[52] Lawyers for contractors must remain aware of a crucial distinction: though the *Spearin* doctrine can be an absolute bar against liability to a developer, it may only create an issue of fact as to the claims of a homeowner.

Furthermore, as commentators Bruner and O'Connor note, "Design errors and construction negligence are not mutually exclusive."[53] If it is impossible to apportion liability between design and construction errors, some jurisdictions have ruled that the designer and the contractor can be held jointly and severally liable for repairs.[54] Although the Colorado appellate courts have disfavored this approach in contract disputes among builders, it may have some application in the context of third-party tort claims.[55]

The Economic Loss Rule Does Not Abrogate Independent Duties of Care

The protections of Colorado's economic loss rule are likewise limited when a defendant breaches a duty of care that exists independent of contract.[56] *Town of Alma* discussed three examples where the economic loss rule did not apply to claims against a construction professional, and subsequent decisions suggest that the rule will not restrict causes of action arising under statute or local code.

1. A contract that does not address the standard of care will not limit common law duties: If a contract is silent as to the expected quality of workmanship, the courts may recognize a negligence claim.[57] Unless the contract evinces that the parties negotiated an alternate standard of care, the courts may infer that the contractor was to exercise due care and caution and the necessary degree of skill involved in the job. Although "this duty may not be contractual, the law allows no vacuum and imposes the duty."[58] Similarly, if a contractor undertakes work beyond the scope of a written contract, he or she may be found liable to the developer in negligence for defects in that portion of the job.[59]

2. Fundamental obligations may arise during performance: Every person has a fundamental duty to avoid foreseeable harm, regardless of any contract. Thus, a party who contracts to perform a limited repair still must exercise reasonable care in inspecting the site for obvious dangers; this duty arises independent of contract and therefore is not limited by the economic loss rule.[60] This echoes the sentiment of courts that have refused to interpret *Spearin* to provide a defense to contractors who ignored open and obvious defects in a developer's plans.[61] As the Colorado Supreme Court succinctly held: "Where damage is to be foreseen, there is a duty to act so as to avoid it."[62]

3. Builders have an independent duty to avoid negligent homebuilding: Public policy imposes a duty on all construction professionals to act without negligence in the construction of a home. In *Cosmopolitan Homes*, the Court observed:

> 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.[63]

Based on such considerations, the Court allowed the fourth owners of a home to sue the original developer and contractor in tort for latent defects that manifested after they purchased the property.[64] The Court explained that the existence of a contract between the developer and the original purchaser of the home did not transform the builders' contractual obligations into the measure of their tort liability arising out of their contractual performance.[65] In *Town of Alma*, the Court clarified that the adoption of the economic loss rule was not inconsistent with the holding of *Cosmopolitan Homes*, because a builder's duty to future homeowners exists independent of contract.[66]

Despite this seemingly clear language, parties to residential construction defect cases litigated in the wake of *Town of Alma* continued to debate whether the economic loss rule afforded a defense, and the trial courts reached widely disparate rulings as to whether direct contractual privity was a prerequisite to imposition of the economic loss rule and whether the independent duty of *Cosmopolitan Homes* extended to contractors or was limited to developers.[67] The Colorado Supreme Court answered these questions in a pair of decisions from 2004 and 2005.

In *BRW*, the Court resolved the first question and held that the policies underlying the application of the economic loss rule to commercial parties are unaffected by the absence of direct privity.[68] Addressing a subcontractor's claim for increased costs on a public works project, the Court noted, "Contractual duties arise just as surely from networks of interrelated contracts as from two-party agreements."[69] The Court therefore concluded that the economic loss rule prevented the subcontractor from suing the project's engineer for negligence.[70] Although this holding seemed to bolster the argument that a subcontractor's agreement with a developer might preclude a homeowner's tort claims, the Court rejected this theory several months later.

In *Yacht Club*, a homeowner association brought negligent construction claims against a developer, a general contractor, and various subcontractors.[71] The trial court granted summary judgment for the subcontractors, finding that the association and its members were necessarily third-party beneficiaries of the subcontractors' agreements with the developer, and that the economic loss rule therefore barred any tort claims among them.[72] The Supreme Court ruled that this was error. Weighing the foreseeability of harm from construction defects against the consequences of placing the burden on contractors to avoid such defects, the Court found that subcontractors often are in as good or better a position as developers and general contractors to know whether their work is being properly performed.[73] In substance, the Court's holding recognizes that subcontractors' pivotal role in the homebuilding process gives rise to both an opportunity and a duty to avoid property damage and construction defects.

The Court found further support for its ruling in the general assembly's passage of the Construction Defect Action Reform Acts ("CDARAs") in 2001 and 2003.[74] Given that the Court of Appeals had allowed homeowners to bring negligent construction claims against subcontractors since at least 1978, the Court noted with interest that the legislators did not eliminate this right.[75] Instead, they enacted laws that limit certain construction defect claims against all "construction professionals," while still "preserving adequate rights and remedies for property owners."[76] Rather than grant immunity to subcontractors, the general assembly "has tailored its legislative prescriptions to the principle that subcontractors must act without negligence in the construction of homes."[77]

Independent duties may arise pursuant to local code: The relationship between the CDARAs and local building codes is particularly important for cases filed after 2001, because the acts arguably create a statutory cause of action for actual damages, loss of use of property, personal injury, or wrongful death resultant from the failure to build a structure in compliance with applicable building codes.[78] This

portion of the legislation effectively codifies two Colorado Court of Appeals decisions from the early 1980s: *Iverson v. Solsbery*[79] and *Aetna Casualty & Surety Co. v. Chrissy Fowler Lumber Co*.[80]

In the former decision, the court ruled that a commercial property owner could not recover the cost of correcting code violations under a theory of negligence *per se*, because such costs were not the sort of harm that the code had been enacted to protect against.[81] In the latter decision, the court clarified that negligence *per se* claims were proper if the builder's code violations resulted in actual property damage, because avoidance of such damage was a principal goal of the code.[82] Construction lawyers should advise their clients of claims that could arise under the CDARAs, as the economic loss rule generally cannot limit a statutory cause of action.[83]

Continued Protections For Homeowners

Putting the above decisions and enactments into historical perspective reveals a logical progression from Colorado's early applications of the implied warranty of habitability, which concluded that the superior knowledge of the developer, as compared to the buyer, required that the developer bear the risk that a given house was not built in a workmanlike manner or fit for its intended use.[84] This evolution matches the national trend of maintaining remedies for homeowners, even in jurisdictions that have adopted an economic loss rule that might otherwise preclude tort claims against contractors.[85] Colorado, like Florida and South Carolina, has reached this result in reliance on precedent acknowledging the importance of protecting homeowners.[86] In other jurisdictions, such as California and Nevada, state assemblies have acted to reverse court decisions that had applied an economic loss rule to limit homeowner claims.[87] Although some construction professionals might lament the imposition of liability under these circumstances, they should note that the courts and legislatures are not promulgating a terribly radical concept; they merely have concluded that contractors should remain responsible for their own negligent acts and omissions when a family's home is at risk.

Take Steps to Avoid Liability

No one wants to end up in a lawsuit, and construction lawyers should take special measures to protect their clients from litigation over construction defects. Such cases typically involve costly discovery, implicate numerous parties, and span several years. Subcontractors can be liable to homeowners for their own negligent acts under *Yacht Club*, and they likely will face third-party indemnity claims from the developer even if a homeowner does not name them directly in a lawsuit. For this reason, many practitioners doubt that the *Yacht Club* ruling will cause an overall increase in litigation; subcontractors will be brought into most construction defect suits in one way or another.[88]

Although there is no absolute immunity from such litigation, construction professionals can institute measures before and during the building process to decrease their exposure. With proper advice

from counsel, contractors should continue to bid on residential projects with confident risk allocation.

First and Foremost, Do Not Be Negligent

Above all, a contractor should simply refrain from negligence. This point is more subtle than many contractors may realize, however, and construction lawyers must communicate the ramifications of the independent legal duties that come into play on certain projects. For instance, the fact that a developer accepts or approves substandard work will not prevent an injured third party from suing the contractor in tort.[89] Contractors working on residential projects must recognize that they owe a duty to the eventual homeowner to prevent foreseeable damage, regardless of any directives from the developer or general contractor. Under the economic loss rule and the *Spearin* doctrine, evidence that a contractor complied with his or her contract is relevant to a jury's determination of negligence, but it is not an absolute defense.[90]

Similarly, acceptance by the building inspector does not prove that a contractor's work meets code. Most existing construction in Colorado was built under some version of the Uniform Building Code, which specifically states that "Issuance of a certificate of occupancy shall not be construed as an approval of a violation of the provisions of this code or of other ordinances in the jurisdiction."[91] In analogous situations, Colorado courts have held that evidence of compliance with government regulations is a relevant but not dispositive factor as to whether a product is defective.[92] Given that most building inspectors perform limited inspections, approval by the local building department may not prevent a homeowner from establishing a code violation. Contractors therefore should take steps to adhere to the code at all times, even if a developer or inspector overlooks noncompliant work.

Subcontractors also should be reminded that, if they have signed a typical form contract, they likely have promised to complete all work in compliance with applicable building codes and industry standards, and likely have agreed to indemnify and hold harmless the developer, the architect, and the general contractor from all claims and losses resulting from the performance of their contract.[93] Subcontractors should not, therefore, assume that a developer's verbal directives in the field will exonerate them from liability for work that does not satisfy industry standards or the applicable building code.

Adopt Procedures to Address and Document Problems in the Field

Of course, even the most diligent contractors may face situations where performing quality work is virtually impossible, and their lawyers should advise them to have procedures in place for such circumstances. For example, a developer might supply drainage plans that conflict with the requirements of the project's soils report. The architectural designs might call for construction that is plainly unsuited for a Colorado winter. The materials provided to the contractor might be of poor quality or incorrect dimension. If these

problems are apparent to a reasonably diligent observer, the contractor should not proceed with construction until the issues are resolved.[94] Although *Spearin* should preclude the developer from suing the contractor over such issues, it may not limit the contractor's liability to the eventual homeowner for failing to prevent foreseeable harm.

Trade subcontractors may find themselves in especially precarious situations, as they typically depend on the developer or the general contractor to properly sequence and supervise the other contractors on a project. The plans, for instance, might require the deck subcontractor to install flashing and concrete before the framer attaches the siding. If the siding is installed before the deck subcontractor is called out to the job, however, the deck subcontractor will not be able to perform the work properly without first removing and then replacing portions of the siding. If the general contractor refuses to make the framer perform this additional work, the deck subcontractor then must decide whether to: (1) walk off the job; (2) correct the existing mistakes at his or her expense; or (3) proceed with an improper method and hope that the homeowner does not sue when the deck leaks.

Although these are not enviable options, they are not unheard of in the current environment. Colorado, unlike many of its neighbors, has no statewide body to regulate its builders, and a handful of individuals have seized this as an opportunity to peddle shoddy construction on unsuspecting homebuyers. Because the work of subcontractors frequently depends on the proper sequencing and supervision of other trades, subcontractors in particular must be cautious if an unscrupulous or incompetent developer or general contractor interferes with their ability to produce a quality product.

To minimize liability under such circumstances, detailed documentation often is the most important measure. Construction litigation can drag out for many years, during which time employees disappear and memories fade; contemporaneous records may be the only means of proving a defense when a case goes to trial. Construction lawyers should advise their clients to keep daily journals and document all change orders, directives, requests for information, and other communications with the developer or general contractor. In particular, if a developer or general contractor directs a subcontractor to perform substandard work, the subcontractor should not proceed without written confirmation and a promise of indemnity for any resulting losses.

Some contractors already bring forms to the jobsite that require the developer or general contractor to consent in advance if it appears that the existing conditions will adversely impact their work. Lawyers should review these forms, however, and remind their clients that a developer's acceptance of defective work does not shield the contractor from liability to a third-party consumer. Indeed, a homeowner plaintiff potentially could use such documents to establish that the harm was foreseeable to the contractor or, worse, to argue that the contractor's failure to correct obvious problems indicates a tacit agreement to act in concert with the developer, thereby making both parties jointly and severally liable for the cost of fixing the defects.[95] Given that developers often op-

erate through single-purpose companies with limited assets, contractors should take extra care to avoid circumstances that could result in imposition of joint liability with such an entity.

Promptly Assert Cross-Claims And Designate Nonparties

In addition, contractors' lawyers should evaluate any available cross-claims and nonparty designations as soon as it appears that their clients could be liable to a consumer as the result of a developer's mistakes. In Colorado, claims against construction professionals—a broad term encompassing virtually everyone on a job except the surety—are subject to one of the shortest statutes of limitations in the country.[96] In cases commenced before the first CDARA took effect in August 2001, the statute of limitations for indemnity claims runs from when the physical manifestation of the defect was first discovered, not the date that a settlement or judgment was paid; thus, the right to seek indemnity could expire long before the underlying case resolves.[97] In cases filed after CDARA, parties can seek immediate indemnity or bring suit within ninety days of resolution.[98] In either scenario, the contractor's lawyer should not delay review of potential claims against the developer or other parties.

Counsel also should act quickly to designate any potential nonparties. Colorado generally has abolished the doctrine of common-law indemnity,[99] and the economic loss rule will preclude most tort claims among contracting parties.[100] Thus, if a contractor believes that his or her performance was adversely affected by a poor design or by another contractor's work, a nonparty designation may be the best means of avoiding liability for a disproportionate share of fault. Colorado statute allows the trier of fact to allocate fault to one or more nonparties, but only if the defendant identifies the nonparties by filing a designation within ninety days of the commencement of an action.[101]

Counsel should further note that, in addition to being timely, a nonparty designation must also recite the specific facts that would establish the nonparty's liability; a designation limited to conclusory allegations of fault will be stricken.[102] Returning to the example of a deck subcontractor, a proper nonparty designation by this professional might include a statement of facts, showing that the general contractor's scheduling of other trades was negligent; or feature an expert's affidavit, setting forth reasons the project engineer fell below the standard of care in the original design.[103]

Seek Contractual Indemnity

Naturally, the best opportunity for a lawyer to reduce a client's liability often lies in the drafting of the parties' contracts. If a contractor wishes to limit adverse parties to contractual claims, the contract should clearly recite the standard of care and workmanship, define the contractor's scope of work, and address requests for work outside the original contract. The contractor also may wish to offer an express limited warranty to third-party consumers. Such language can cut both ways, however, and lawyers should be careful not to invite contract claims or unwittingly limit their clients' insurance coverage.[104]

The contract also should expressly warrant that the developer will indemnify the contractor for any losses relating to defects in the plans, materials, sequencing, or supervision. As noted above, Colorado generally has abolished the doctrine of common-law indemnity, and the U.S. Supreme Court has suggested that *Spearin* will offer little relief in such situations.[105] Contractors, therefore, should be careful to preserve a contractual right of indemnity in the event they are found liable in tort to a third-party consumer. Although developers might be reluctant to indemnify a subcontractor in advance for defects in workmanship, some standard contract forms permit the parties to waive all claims between themselves if the developer obtains "all risk" insurance, and this arrangement can effectively limit future litigation.[106]

Conclusion

As one commentator recently observed, "By rejecting tort claims designed to alter the parties' contractual allocation of risks and rewards, the *BRW* decision underscores the singular importance of contract negotiations in the commercial setting."[107] The *Yacht Club* decision teaches that it is equally important to consider the limits of such negotiations when the ultimate harm may fall on parties outside the commercial setting. Contractors should not bid on any project in a vacuum, and the cost of protecting consumers from poor designs and substandard work cannot be ignored. The courts have made clear that homeowners will not bear the cost of cleaning up after negligent builders, and construction lawyers should encourage their clients to adopt policies that discourage shoddy work and limit liability for the mistakes of others.

NOTES

1. *Carpenter v. Donohoe*, 388 P.2d 399, 402 (Colo. 1964). The implied warranty of habitability originated with the English case of *Miller v. Cannon Hill Estates, Ltd.*, [1931] 2 K.B. 113, which recognized that a buyer who contracts on a house while it is still under construction expects that the final product will be fit for human dwelling. Colorado and other American courts later adopted this holding. *See, e.g., Vanderschrier v. Aaron*, 140 N.E.2d 819 (Ohio App. 1957); *Glisan v. Smolenske*, 387 P.2d 260, 263 (Colo. 1963). In *Carpenter*, the Colorado Supreme Court expanded this warranty to include all new homes.

2. *Carpenter, supra* note 1 at 402.

3. *Cosmopolitan Homes, Inc. v. Weller*, 663 P.2d 1041, 1045 and n.6 (Colo. 1983).

4. *Erickson v. Oberlohr*, 749 P.2d 996, 998 (Colo.App. 1987).

5. *Dicta* in *Belt v. Spencer*, 585 P.2d 922, 925 (Colo.App. 1978), suggested that a developer could disclaim this implied warranty by using "clear and unambiguous language," but the Colorado Supreme Court cast doubt on this prospect three years later when it expressly declined to adopt this *dictum* in *Sloat v. Matheny*, 625 P.2d 1031, 1034 (Colo. 1981). Since that time, no reported decision in Colorado has ever upheld a disclaimer of the implied warranty of habitability, and many trial courts have ruled that such disclaimers are void on public policy grounds, even if written in clear and unambiguous language. *E.g.*, Order, *Lakewood Vista at Green Mtn. Ranch Ass'n Inc. v. Foxpointe Vista Phase I Ltd.*, No. 03CV790 (Colo. 1st Dist. Sept. 2004); Order, *Terrace at Columbine II v. Vision Homes, Inc.*, No. 99CV2632, (Colo. 1st Dist. May 2001); Order, *Rusta v. PH Services, LLC*, No. 01CV0772 (Colo. 17th Dist., Jan. 2005) (copies on file with author).

6. *Cosmopolitan Homes*, *supra* note 3 at 1045.

7. *Id.*

8. *Aetna Cas. & Sur. Co. v. Chrissy Fowler Lumber Co.*, 687 P.2d 514 (Colo.App. 1984).

9. *Hoang v. Arbess*, 80 P.3d 863, 870 (Colo. App. 2003), *cert. denied* Dec. 1, 2003, *citing* CRS § 6-1-105 (2002):

> A person engages in a deceptive trade practice when, in the course of such person's business, vocation, or occupation, such person . . . [r]epresents that goods, food, services, or property are of a particular standard, quality, or grade . . . if he knows or should know that they are of another; [or] [f]ails to disclose material information concerning goods, services, or property which information was known at the time of an advertisement or sale if such failure to disclose such information was intended to induce the consumer to enter into a transaction.

10. *Yacht Club II Homeowners Ass'n, Inc. v. A.C. Excavating*, 94 P.3d 1177, 1180 (Colo.App. 2003), *aff'd* 114 P.3d 862 (Colo. 2005).

11. *Heritage Vill. Owners Ass'n, Inc. v. Golden Heritage Investors, Ltd.*, 89 P.3d 513, 515 (Colo.App. 2004); *see also A.C. Excavating v. Yacht Club II Homeowners Ass'n*, 114 P.3d 862, 869 (Colo. 2005) (notwithstanding denial of a petition for *certiorari* on this issue, Supreme Court observed that the Colorado Common Interest Ownership Act "grants homeowners' associations standing to sue on behalf of property owners in such matters as construction defect claims"). For more detailed discussions of the theories underlying a homeowner association's standing to assert implied warranty and negligent construction claims, see Witt, "HOA Standing Revisited: Strategic Considerations in Construction Defect Suits," *Trial Talk* (Dec. 2005/Jan. 2006) at 25-26; *see also* Benson and Witt, "Do Homeowners Associations Receive Implied Warranty of Habitability?" *Colo. Real Est. J.* (July 18, 2001) at 18.

12. U.S. Census Bureau, "Ranking Tables for States: 1990 and 2000," available at http://www.census.gov/population/cen2000/phc-t2/tab01.txt. According to 2000 census data, 15 percent of all Colorado residents live in structures that are less than five years old. U.S. Census Bureau, "Profile of Selected Housing Characteristics: 2000," *American FactFinder*, available at http://factfinder.census.gov/servlet/BasicFactsTable?_lang=en&_vt_name=DEC_2000_SF3_U_DP4&_geo_id=04000US08.

13. *United States v. Spearin*, 248 U.S. 132 (1918).

14. *Id.* at 137.

15. *Id.*

16. *Id.* at 136.

17. *Spearin v. United States*, 1916 WL 1103 (Ct.Cl.).

18. *Spearin*, *supra* note 13 at 134.

19. *Id.*

20. *Id.* at 135.

21. *Id.* at 138.

22. Leaderman, "The *Spearin* Doctrine: It Isn't What It Used To Be," 16:4 *The Construction Lawyer* (Oct. 1996) at 47.

23. *Bradford Builders, Inc. v. Sears, Roebuck & Co.*, 270 F.2d 649, 655 (5th Cir. 1959).

24. *BRW, Inc. v. Dufficy & Sons, Inc.*, 99 P.3d 66, 73 (Colo. 2004).

25. *Id.*

26. Elmore and Crawford, "Defenses in Construction Defect Cases," 23:2 *The Construction Lawyer* (Spring 2003) at 27 and 32.

27. *Town of Alma v. AZCO Constr., Inc.*, 10 P.3d 1256, 1259 (Colo. 2000) (discussing history of the economic loss rule in America).

28. *Id.*

29. *Id.* at 1260, *citing Seely v. White Motor Co.*, 403 P.2d 145 (Cal. 1965).

30. *Seely, supra* note 29.

31. *Id.* at 151.

32. *Id.*

33. *Town of Alma, supra* note 27 at 1261, *citing East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858, 861 (1986).

34. *Jardel Enters., Inc. v. Triconsultants, Inc.*, 770 P.2d 1301, 1304 (Colo.App. 1988). Foreshadowing the rule adopted in *Town of Alma*, the *Jardel* court also relied on the fact that "no duty independent of the contract was breached" in affirming summary judgment for the defendant.

35. *Town of Alma*, *supra* note 27 at 1263; *see also* Lawler, "Independent Duties and Colorado's Economic Loss Rule—Part 1," 35 *The Colorado Lawyer* 17 (Jan. 2006).

36. *Town of Alma, supra* note 27 at 1264.

37. *Id.* at 1258.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* at 1266.

42. *Id.* at 1264 n.12.

43. *Id.* at 1262.

44. *BRW, supra* note 24 at 73.

45. *Blake Constr. Co., Inc. v. United States*, 987 F.2d 743, 745 (Fed.Cir. 1993). *Compare Newcomb v. Schaeffler*, 279 P.2d 409, 411 (Colo. 1955) *with Klipfel v. Neill*, 494 P.2d 115, 117 (Colo.App. 1972). For a critical discussion of attempts to draw a bright-line distinction between design and performance specifications, see Golden and Thomas, "The *Spearin* Doctrine: the False Dichotomy Between Design and Performance Specifications," 25 *Pub. Cont. L.J.* 47 (1995).

46. *Allied Contractors, Inc. v. United States*, 381 F.2d 995, 999 (Ct. Cl. 1967); *see also PCL Constr. Services, Inc. v. United States*, 47 Fed. Cl. 745, 794 (2000); *Mann v. Clowser*, 59 S.E.2d 78, 85 (Va. 1950).

47. *Hercules Inc. v. United States*, 516 U.S. 417, 419 (1996).

48. *Id.*

49. *Id.* at 425.

50. *Id.*

51. *Cosmopolitan Homes, supra* note 3 at 1045.

52. *Park Rise Homeowners Ass'n, Inc. v. Resource Constr. Co.*, No. 04CA91, ___ P.3d ___ (Colo.App. 2006); *Allied Contractors, supra* note 46 at 999; *George B. Gilmore Co. v. Garrett*, 582 So.2d 387, 396 (Miss. 1991).

53. 3 Philip L. Bruner and Patrick J. O'Conner, Jr., *Bruner and O'Conner on Construction Law* § 9:83 (2005).

54. *Id.*, *citing Paine v. Spottiswoode*, 612 A.2d 235 (Me. 1992).

55. *See City of Westminster v. Centric-Jones Constructors*, 100 P.3d 472, 478-79 (Colo.App. 2003) (court rejected use of the "total cost" method in a case where the plaintiff was partially at fault for supplying the contractor with defective designs, but court left unanswered whether this method might be available in situations where "the injured party was not responsible for the added costs"); *see also Park Rise, supra* note 52.

56. *See generally* Lawler, "Independent Duties and Colorado's Economic Loss Rule—Part II," 35 *The Colorado Lawyer* 33 (March 2006).

57. *Town of Alma, supra* note 27 at 1265, *citing Lembke Plumbing & Heating v. Hayutin*, 366 P.2d 673 (Colo. 1961).

58. *Lembke*, *supra* note 57 at 675.

59. *Town of Alma, supra* note 27 at 1262, *citing Consol. Hardwoods, Inc. v. Alexander Concrete Constr. Inc.*, 811 P.2d 440, 443 (Colo.App. 1991) (Colorado Court of Appeals held that a jury could have found that, although a contractor "was not obligated under the contract to compact the soil, it was negligent when it did so"); *see also Grynberg v. Agri Tech, Inc.*, 10 P.3d 1267, 1270 (Colo. 2000), *citing Cooley v. Big Horn Harvestore Systems, Inc.*, 813 P.2d 736, 749 (Colo. 1991) (contractual limitation of liability does not restrict claims based on negligent conduct distinct from conduct necessary to complete contract).

60. *Town of Alma, supra* note 27 at 1265, *citing Metropolitan Gas Repair Serv., Inc. v. Kulik*, 621 P.2d 313, 317 (Colo. 1980). *But see Lewis v. Emil Clayton Plumbing Co.*, 25 P.3d 1254, 1256 (Colo.App. 2000), *cert. denied* June 25, 2001 (under facts similar to *Metropolitan Gas*, Court of Appeals found that plumbing contractor had no duty to inspect property beyond the specific area he was repairing).

61. *See, e.g., Allied Contractors, supra* note 46 at 999.

62. *Metropolitan Gas, supra* note 60 at 317.

63. *Cosmopolitan Homes, supra* note 3 at 1045, *quoting Simmons v. Owens*, 363 So.2d 142, 143 (Fla.App. 1978).

64. *Id.*

65. *Id.* at 1143.

66. *Town of Alma, supra* note 27 at 1266.

67. *Compare, e.g.*, trial court rulings in *Yacht Club, supra* note 10 at 1179 (Colo.App. 2003) *with* Order, *Lakeshore at Hunters Glen Homeowners Ass'n, Inc. v. Lakeshore I Holdings, LLC*, No. 99CV0152 (Colo. 17th Dist. Adams County July 2002) (copies on file with author). *See also* Order Re: the Economic Loss Rule *and* Order Re: Trimark's M.P.S.J., *Fairways Homeowners Ass'n Inc. v. Trimark Communities, LLC*, No. 96CV677 (Colo. 1st Dist. Jefferson County Oct. 2005) (copies on file with author).

68. *BRW, supra* note 24 at 72; conversely, the Colorado Court of Appeals has ruled that the economic loss rule does not prevent the buyer of a new home from from asserting both contract and tort claims against the developer. *Stiff v. BilDen Homes, Inc.*, 88 P.3d 639, 641 (Colo.App. 2003).

69. *BRW, supra* note 24 at 72.

70. *Id.*

71. *Yacht Club, supra* note 11 at 864.

72. *Yacht Club, supra* note 10 at 1179. Although the court acknowledged that existence of a third-party beneficiary relationship could justify imposition of the economic loss rule, establishing such a relationship typically would require proof that the subcontractor and developer intended to confer a direct—not merely an incidental—benefit on the eventual homeowner/consumer. *Concrete Contractors, Inc. v. E.B. Roberts Constr. Co.*, 664 P.2d 722, 725 (Colo. App. 1982), *aff'd* 704 P.2d 859 (Colo. 1985). As the parties' intent generally is a question of fact, a trial court likely could not decide such

an issue on summary judgment, and the subcontractor would therefore have to convince the trier of fact that the homeowner was indeed a direct third-party beneficiary. *East Meadows Co., LLC v. Greeley Irr. Co.*, 66 P.3d 214, 217 (Colo.App. 2003); *Union Rural Elec. Ass'n v. Public Utils. Comm'n*, 661 P.2d 247, 251 n.5 (Colo. 1983).

73. *Yacht Club, supra* note 11 at 868.

74. H.B. 1166, 63d Gen. Assem., 1st Reg. Sess. (Colo. 2001); H.B. 1161, 64th Gen. Assem., 1st Reg. Sess. (Colo. 2003).

75. *Yacht Club, supra* note 11 at 867, *citing Driscoll v. Columbia Realty-Woodland Park Co.*, 590 P.2d 73 (Colo.App. 1978).

76. *Id., citing* CRS §§ 13-20-802 to -804.

77. *Id.* at 870.

78. CRS § 13-20-804 (2005). Under the first Construction Defect Action Reform Act ("CDARA"), this provision applied only to residential construction. The second CDARA, which applies to cases filed after 12:31 P.M. on April 25, 2003, deletes the word "residential" from this section.

79. *Iverson v. Solsbery*, 641 P.2d 314 (Colo. App. 1982).

80. *Aetna Cas. & Sur. Co., supra* note 8.

81. *Iverson, supra* note 79 at 316.

82. *Aetna Casualty & Surety Co., supra* note 8 at 516.

83. Lawler, *supra* note 56 at n.3 ("[b]ecause it is a common law doctrine, the economic loss rule is preempted by statutory duties and remedies."); *see also Comptech Int'l, Inc. v. Milam Commerce Park, Ltd.*, 753 So.2d 1219, 1222 and 1227 (Fla. 1999) (separation of powers doctrine precludes courts from applying economic loss rule to abrogate statutory cause of action for building code violations).

84. *Sloat, supra* note 5 at 1033.

85. Thompson and Dean, "Continued Erosion of the Economic Loss Rule in Construction Litigation by and Against Owners," 25:4 *The Construction Lawyer* 36, 38 (Fall 2005).

86. *Compare Yacht Club, supra* note 10 at 867, *with Kennedy v. Columbia Lumber & Mfg. Co., Inc.*, 384 S.E. 2d 730, 734-36 (S.C. 1988) *and Moransais v. Heathman*, 744 So.2d 973, 983 (Fla. 1999).

87. *See Rosen v. State Farm General Ins. Co.*, 135 Cal.Rptr.2d 361, 367 (Cal. 2003) (recognizing that Cal. Civ. Code §§ 895–945.5 supersedes *Aas v. Superior Court*, 12 P.3d 1125 (Cal. 2000)); *Olson v. Richard*, 89 P.3d 31, 33 (Nev. 2004) (recognizing that Nev. Rev. Stat. 40.600–40.770 supersedes *Calloway v. Reno*, 993 P.2d 1259 (Nev. 2000)).

88. Rebchook, Real Estate, "Homeowners' ability to sue subcontractors stirs debate," *The Rocky Mtn. News* (July 13, 2005) at 4B.

89. *Driscoll, supra* note 75 at 74, *cited with approval in Yacht Club, supra* note 11 at 869.

90. *Tanktech, Inc. v. First Interstate Bank*, 851 P.2d 174, 177 (Colo.App. 1992), *rev'd on other grounds*, 864 P.2d 116 (Colo. 1993); *George B. Gilmore Co., supra* note 52 at 396.

91. Unif. Bldg. Code § 109.1 (1997 ed.).

92. *Blueflame Gas, Inc. v. Van Hoose*, 679 P.2d 579, 590-91 (Colo. 1984).

93. *See, e.g.*, AIA A201 ¶ 11.11.1.

94. *Allied Contractors, supra* note 46 at 1000.

95. *See* Sandgrund, Sullan, and Smith, "Theories of Homebuilder Liability for Subcontractor Negligence—Part I," 34 *The Colorado Lawyer* 69, 71 (June 2005) (discussing joint liability under CRS § 13-21-111.5(4)); *see also Loughridge v. Goodyear Tire and Rubber Co.*, 192 F.Supp.2d 1175, 1186 (D.Colo. 2002) (recognizing that manufacturer of defective product could be jointly liable with seller for negligence and violation of Colorado Consumer Protection Act); *cf. Governors Grove Condo. Ass'n, Inc. v. Hill Dev. Corp.*, 414 A.2d 1177, 1182 (Conn.Super. 1980) (recognizing homeowner association's cause of action for civil conspiracy against developer and contractor).

96. *See* Sandgrund and Sullan, "Statutes of Limitations and Repose in Construction Defect Cases—Part I," 33 *The Colorado Lawyer* 73 (May 2004).

97. *Nelson, Haley, Patterson & Quirk, Inc. v. Garney Cos., Inc.*, 781 P.2d 153, 155 (Colo.App. 1989).

98 *CLPF-Parkridge One, L.P. v. Harwell Investments, Inc.*, 105 P.3d 658, 662-63 (Colo. 2005).

99. *Brochner v. Western Ins. Co.*, 724 P.2d 1293, 1299 (Colo. 1986).

100. *BRW, supra* note 24 at 74.

101. CRS § 13-21-111.5(3)(b).

102. *Redden v. SCI Colorado Funeral Services, Inc.*, 38 P.3d 75, 80 (Colo. 2001)

103. *See id.* (although CRS § 13-21-111.5(3)(b) only requires a certificate of review in cases involving licensed health care professionals, a court might still require expert testimony if a nonparty designation alleges professional negligence).

104. Although Colorado law is unsettled on this point, some have argued that contractors' commercial general liability policies provide coverage for tort claims but not for breach of contract claims. This can create difficulties in defending lawsuits alleging alternative theories of relief. *See* Wielinski, "Negligence, Breach of Contract, and the Economic Loss Rule: Dilemma for Insurance Defense Counsel in Construction Defect Litigation?" *Construct!* (Spring 2004) at 14. Notably, at least one court has shown reluctance to apply Colorado's economic loss rule to limit insurance coverage for construction defects. *Commercial Union Ins. Co. v. Roxborough Vill. Joint Venture*, 944 F.Supp. 827, 832 (D.Colo. 1996).

105. *Hercules, supra* note 47 at 425.

106. *See* 1C Cathy Stricklin Krendl and J. David Arkell, *Colorado Methods of Practice* § 56.14 (4th ed. 1997).

107. Phelan, "Avoiding Tort Liability in Design, Construction, and Inspection of Commercial Projects," 34 *The Colorado Lawyer* 81 (Jan. 2005). ■

Colorado Lawyers Committee Holds Annual Luncheon

The Colorado Lawyers Committee ("CLC") held its 27th Annual Luncheon on May 24, 2006. The keynote speaker was Hiroshi Motomura, Kenan Distinguished Professor of Law and Associate Dean for Faculty Affairs at the University of North Carolina School of Law.

The CLC congratulates the following awards recipients:

- **Gale T. Miller,** of Davis Graham & Stubbs LLP—Outstanding Sustained Contribution Award recipient
- **Kelly/Haglund/Garnsey+Kahn LLC**—2005 Law Firm of the Year
- **Kristin L. Mix,** of Snell & Wilmer L.L.P, and **Tarek F.M. Saad,** of Morrison & Foerster LLP—2005 Individual of the Year Award recipients.

The CLC offers special thanks to this year's Gold Sponsors: Arnold & Porter LLP; Davis Graham & Stubbs LLP; Faegre & Benson LLP; Hale Friesen, LLP; Isaacson Rosenbaum P.C.; Morrison & Foerster LLP; Musgrave & Theis LLP; and Reilly Pozner & Connelly LLP.

http://www.coloradolawyerscommittee.org

Miller (left) displays his award, presented at the 2006 CLC Luncheon.