CASE STUDY PREPARED FROM ORIGINAL PUBLISHED OPINION

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Beacon Residential Community Association v. Skidmore, Owings & Merrill LLP (7/3/14)

Construction Defect; Architect's Duty of Care in Absence of Privity

A homeowners association on behalf of its members sued a condominium developer and various other parties over construction design defects that allegedly make the homes unsafe and uninhabitable for significant portions of the year. Two defendants were architectural firms, which allegedly designed the homes in a negligent manner but did not make the final decisions regarding how the homes would be built. The trial court sustained a demurrer in favor of the defendant architectural firms, reasoning that an architect who makes recommendations but not final decisions on construction owes no duty of care to future homeowners with whom it has no contractual relationship. The Court of Appeal reversed, concluding that an architect owes a duty of care to homeowners in these circumstances, both under the common law and under the Right to Repair Act (Civ. Code, § 895 et seq.).

The California Supreme Court took the case on review. It recited the facts that Skidmore, Owings & Merrill LLP (SOM) and HKS, Inc. (collectively defendants) provided architectural and engineering services for The Beacon residential condominiums, a collection of 595 condominium units and associated common areas located in San Francisco (the Project). Although the units were initially rented out for two years after construction, defendants provided their services knowing that the finished construction would be sold as condominiums. A condominium association was formed, and the condominium's conditions, covenants, and restrictions were recorded, before construction commenced.

The homeowners association, plaintiff Beacon Residential Community Association (Association), sued several parties involved in the construction of those condominiums, including several business entities designated as the original owners and developers of the condominium, as well as SOM and HKS, with whom the owners and developers contracted for architectural services. SOM and HKS were the only architects on the Project. Plaintiff alleged that negligent architectural design work performed by defendants resulted in several defects, including extensive water infiltration, inadequate fire separations, structural cracks, and other safety hazards. One of the principal defects is "solar heat gain," which made the condominium units uninhabitable and unsafe during certain periods due to high temperatures. Plaintiff alleged that the solar heat gain is due to defendants' approval, contrary to state and

local building codes, of less expensive, substandard windows and a building design that lacked adequate ventilation.

According to the complaint, defendants "provided architectural and engineering services" for the Project that "included, but were not limited to, architecture, landscape architecture, civil engineering, mechanical engineering, structural engineering, soils engineering and electrical engineering, as well as construction administration and construction contract management." Defendants were paid more than $5 million for their work on the Project. In addition to "providing original design services at the outset" of the Project, defendants played an active role throughout the construction process, coordinating efforts of the design and construction teams, conducting weekly site visits and inspections, recommending design revisions as needed, and monitoring compliance with design plans.

Justice Liu wrote that this case is concerned solely with the first element of negligence, the duty of care. Whether a duty of care exists in a particular case is a question of law to be resolved by the court. The Justices would consider whether design professionals owe a duty of care to a homeowners association and its members in the absence of privity. There is authority for the imposition of liability where there is no privity and where the only foreseeable risk is of damage to tangible property. (*Biakanja v Irving* (1958) 49 Cal.2d 647) In *Biakanja*, the high court held that a notary public who negligently drafted a will was liable to the intended beneficiary of the will. That opinion explained that "the determination whether in a specific case the

defendant will be held liable to a third person not in privity is a matter of policy and involves the balancing of various factors, among which are the extent to which the transaction was intended to affect the plaintiff, the foreseeability of harm to him, the degree of certainty that the plaintiff suffered injury, the closeness of the connection between the defendant's conduct and the injury suffered, the moral blame attached to the defendant's conduct, and the policy of preventing future harm."

The declining significance of privity has found its way into construction law as noted in *Aas v. Superior Court* (2000) 24 Cal.4th 627: "Formerly, after a builder had completed a structure and the purchaser had accepted it, the builder was not liable to a third party for damages suffered because of the work's condition, even though the builder was negligent. Having already held that the manufacturers of defective ladders, elevators, and tires could be liable to persons not in contractual privity with them yet foreseeably injured by their products, the Court applied the same rule to someone responsible for part of a house, i.e., a defective railing (*Hale v. Depaoli* (1948) 33 Cal.2d 228).

The court in *Stewart v Cox* (1961) 55 Cal.2d 857, applied the *Biakanja* factors to determine the scope of the duty of care: "Here it was obvious that the pool for which Cox provided the gunite work was intended for the plaintiffs and that property damage to them — and possibly to some of their neighbors — was foreseeable in the event the work was so negligently done as to permit water to escape.

It is clear that the transaction between the pool subcontractor and Cox was intended to specially affect plaintiffs. There is no doubt that plaintiffs suffered serious damage, and the court found, supported by ample evidence, that the injury was caused by Cox's negligence. Under all the circumstances Cox should not be exempted from liability if negligence on his part was the proximate cause of the damage to plaintiffs." (*Stewart*, at p. 863.)

Courts have applied these third party liability principles to architects. In *Montijo v. Swift* (1963) 219 Cal.App.2d 351, the plaintiff sued an architect after falling and injuring herself on a stairway at a bus depot that she alleged had been negligently designed with an inadequate handrail. Relying in part on *Stewart*, and *Hale v. Depaoli*, the court said: "Under the existing status of the law, an architect who plans and supervises construction work, as an independent contractor, is under a duty to exercise ordinary care in the course thereof for the protection of any person who foreseeably and with reasonable certainty may be injured by his failure to do so, even though such injury may occur after his work has been accepted by the person engaging his services." (*Montijo*, at p. 353.)

Architect liability to third parties has not been confined to personal injury; it also extends to property damage. The Court of Appeal in *Cooper v. Jevne* (1976) 56 Cal.App.3d 860, recognized such liability to condominium purchasers where an architectural firm "prepared and furnished to the builder-seller . . . architectural drawings and plans and specifications for the construction and other

improvements within the . . . project and acted as supervising architects in the construction of the buildings within the project." Applying the *Biakanja* factors, *Cooper* held on demurrer that "the architects' duty of reasonable care in the performance of their professional services is logically owed to those who purchased the allegedly defectively designed and built condominiums . . . . The architects must have known that the condominiums they designed and whose construction they supervised were built by [the builder-seller] for sale to the public and that purchasers of these condominiums would be the ones who would suffer economically, if not bodily, from any negligence by the architects in the performance of their professional services." (*Cooper* at p. 869.)

As noted, *Biakanja* set forth a list of factors that inform whether a duty of care exists between a plaintiff and defendant in the absence of privity and the application of these factors necessarily depends on the circumstances of each case. The Justices noted it is possible to derive general rules that govern common scenarios. An example is the high court's decision in *Bily v Arthur Young & Co.* (1992) 3 Cal.4th 370, limiting the duty of care owed by auditing firms to nonclient third parties. *Bily* involved a suit brought by investors in a computer company against the accounting firm that the company had hired to conduct an audit and issue audit reports and financial statements. The plaintiffs claimed that the accounting firm, Arthur Young & Company, had committed negligence in conducting the audit and reporting a $69,000 operating profit rather than the company's actual loss of more than $3 million. The computer company eventually filed

for bankruptcy, and its investors lost money. They sued, claiming injury from reliance on Arthur Young's allegedly negligent audit.

The Justices held that an auditor generally owes no duty of care to its client's investors. In so holding, they recognized the important "public watchdog function" of auditors but sought to set a reasonable limit on their potential liability for professional negligence given the vast range of foreseeable third party users of audit reports. "Viewing the problem . . . in light of the *Biakanja* factors," the court in *Bily* focused on "three central concerns. First, "given the secondary 'watchdog' role of the auditor, the complexity of the professional opinions rendered in audit reports, and the difficult and potentially tenuous causal relationships between audit reports and economic losses from investment and credit decisions, the auditor exposed to negligence claims from all foreseeable third parties faces potential liability far out of proportion to its fault."

In addition, the court noted a mismatch between the auditor's "secondary" role in the financial reporting process and the "primary" role attributed to the auditor as the cause of economic loss in a negligence suit by a third party. Because "the auditor may never have been aware of the existence, let alone the nature or scope, of the third party transaction that resulted in the claim", and because "the ultimate decision to lend or invest is often based on numerous business factors that have little to do with the audit report," the auditor's conduct lacks a sufficiently " 'close connection' " to the loss of loaned or invested funds to justify recognition of a duty of care to

third parties. In this context, "the spectre of multibillion-dollar professional liability . . . is distinctly out of proportion to: (1) the fault of the auditor . . . ; and (2) the connection between the auditor's conduct and the third party's injury . . . ." (*Bily*, at p. 402.)

Second, *Bily* emphasized that unlike ordinary consumers in product liability cases, "the generally more sophisticated class of plaintiffs in auditor liability cases (e.g., business lenders and investors) permits the effective use of contract rather than tort liability to control and adjust the relevant risks through 'private ordering' . . . ." (*Bily*, *supra*, 3 Cal.4th at p. 398.) "For example, a third party might expend its own resources to verify the client's financial statements or selected portions of them that were particularly material to its transaction with the client. Or it might commission its own audit or investigation, thus establishing privity between itself and an auditor or investigator to whom it could look for protection. In addition, it might bargain with the client for special security or improved terms in a credit or investment transaction. Finally, the third party could . . . insist that an audit be conducted on its behalf or establish direct communications with the auditor with respect to its transaction with the client." "As a matter of economic and social policy, third parties should be encouraged to rely on their own prudence, diligence, and contracting power, as well as other informational tools. This kind of self-reliance promotes sound investment and credit practices and discourages the careless use of monetary resources. If, instead, third parties are simply permitted to recover from the auditor for mistakes in the client's financial

statements, the auditor becomes, in effect, an insurer of not only the financial statements, but of bad loans and investments in general."

Third, *Bily* expressed skepticism that exposing auditors to third party negligence suits would improve the quality of the audits "In view of the inherent dependence of the auditor on the client and the labor-intensive nature of auditing, we doubt whether audits can be done in ways that would yield significantly greater accuracy without disadvantages. Auditors may rationally respond to increased liability by simply reducing audit services in fledgling industries where the business failure rate is high, reasoning that they will inevitably be singled out and sued when their client goes into bankruptcy regardless of the care or detail of their audits."

Notably, *Bily* did not categorically hold that auditors never owe a duty of care to third parties. Instead, *Bily* limited the duty to a "narrow class of persons who, although not clients, may reasonably come to receive and rely on an audit report and whose existence constitutes a risk of audit reporting that may fairly be imposed on the auditor. Such persons are specifically intended beneficiaries of the audit report who are known to the auditor and for whose benefit it renders the audit report." In situations where an auditor "clearly intended to undertake the responsibility of influencing particular business transactions involving third persons" with "sufficiently specific economic parameters to permit the [auditor] to assess the risk of moving forward," liability for negligent misrepresentation may extend to persons "to whom or for whom the misrepresentations are

made" so long as those persons have actually and justifiably relied on the auditor's report.

The Justices then commented that the circumstances of the present case stand in contrast to the concerns in *Bily* that counseled against general recognition of an auditor's duty of care to third parties. First, unlike the secondary role played by the auditor in the financial reporting process, the design professional defendants' primary role in the Project bears a "close connection" to the injury alleged by plaintiff. According to the complaint, defendants were the only architects on the Project. In that capacity, defendants "reviewed and approved the course of action where the specifications for the exterior windows . . . were changed to a design that inadequately prevented heat gain, which causes a seriously defective and nonfunctional condition that is also unhealthy." Defendants also "recommended that the number of ventilation ducts be reduced by a significant quantity, which is a major factor in the nonfunctional, unhealthy condition of the interior of the units." The complaint alleges that these professional judgments were negligent and rendered the residential units unsafe and uninhabitable during certain periods of the year. Compared to "the connection between the auditor's conduct and the third party's injury which will often be attenuated by unrelated business factors that underlie investment and credit decisions" (*Bily*, at p. 402), the connection between defendants' unique role as the design professionals on the Project and plaintiff's damages resulting from negligent design is far more direct and immediate.

The trial court assigned dispositive significance to the fact that defendants did not go "beyond the typical role of an architect, which is to make recommendations to the owner," and that "the final decision rested with the owner." Similarly, defendants contend that "they had no role in the actual construction. Instead, the developer, contractors, and subcontractors retained primary control over the construction process, as well as final say on how the plans were implemented." However, even if an architect does not actually build the project or make final decisions on construction, a property owner typically employs an architect in order to rely on the architect's specialized training, technical expertise, and professional judgment. The Business and Professions Code defines "the practice of architecture" as "offering or performing, or being in responsible control of, professional services which require the skills of an architect in the planning of sites, and the design, in whole or in part, of buildings, or groups of buildings and structures." (Bus. & Prof. Code, § 5500.1, subd. (a)) The profession is licensed and regulated by the California Architects Board (§§ 5510, 5510.1, 5510.15, 5526), and the unlicensed or unauthorized practice of architecture is punishable as a misdemeanor (§§ 5536, 5536.1).

In this case, defendants were the principal architects on the Project. Among all the entities involved in the Project, defendants uniquely possessed architectural expertise. There is no suggestion that the owner or anyone else had special competence or exercised professional judgment on architectural issues such as adequate

ventilation or code-compliant windows. Just as a lawyer cannot escape negligence liability to clearly intended third party beneficiaries on the ground that the client has the ultimate authority to follow or reject the lawyer's advice, so too an architect cannot escape such liability on the ground that the client makes the final decisions. An architect providing professional design services to a developer does not operate in a "client-controlled environment" comparable to the relationship between an auditor and its client. Whereas an auditor's "client, of course, has interests in the audit that may not be consonant with those of the public", it would be patently inconsistent with public policy to hold that an architect's failure to exercise due care in designing a building can be justified by client interests at odds with the interest of prospective homeowners in safety and habitability.

Were there any doubt as to defendants' principal role in the design of the Project, it is dispelled by additional facts alleged here. According to the complaint, defendants not only provided design services at the outset of the Project but also brought their expertise to bear on the implementation of their plans and specifications by doing weekly inspections at the construction site, monitoring contractor compliance with design plans, altering design requirements as issues arose, and advising the owner of any nonconforming work that should be rejected — all for a fee of more than $5 million. In other words, defendants applied their specialized skill and professional judgment throughout the construction process to ensure that it would proceed according to approved designs. Defendants played a

lead role not only in designing the Project but also in implementing the Project design.

The Court was not persuaded by defendants' claim that the connection between their conduct and plaintiff's injury is "attenuated because . . . when the developer sold the units two years after construction, it was aware of, and concealed, the alleged defects." This specific allegation, if true, may inform whether defendants' conduct was the proximate cause of plaintiff's injury. It also may give rise to a claim of equitable indemnity by defendants against the developer. Notably, however, merely because the developer's alleged misdeeds are themselves derivative of defendants' allegedly negligent conduct, they do not diminish the closeness of the connection between defendants' conduct and plaintiff's injury for purposes of determining the existence of a duty of care.

Recognizing that an architect who is a principal provider of professional design services on a residential building project owes a duty of care to future homeowners does not raise the prospect of " 'liability in an indeterminate amount for an indeterminate time to an indeterminate class.' " As the complaint here alleges, defendants engaged in work on the Project with the knowledge that the finished construction would be sold as condominiums and used as residences. There was no uncertainty, as there was in *Bily*, as to "the existence, let alone the nature or scope, of the third party transaction that resulted in the claim." (*Bily*, at p. 400.) Defendants' work on the Project "was intended to affect the plaintiff," and "the end and aim of the

transaction was to provide" safe and habitable residences for future homeowners, a specific, foreseeable, and well-defined class. (*Biakanja*, at p. 650.) There is no "spectre of vast numbers of suits and limitless financial exposure" in this case. (*Bily*, at p. 400.) Further, as noted, defendants can limit their liability in proportion to fault through an action for equitable indemnification.

Defendants contend that plaintiff has options for redress within the bounds of privity: Plaintiff may seek an assignment of the developer's rights against defendants, or plaintiff may pursue its design defect claims against the developer, and the developer may in turn seek redress from defendants. But it is questionable whether this more attenuated form of liability will consistently provide adequate redress. More importantly, the chief interest of prospective homeowners is to avoid purchasing a defective home, not only to have adequate redress after the fact. The long-established common law rule holding architects as independent professionals directly accountable to third party homeowners is most likely to vindicate that interest.

Moreover, as we recognized in *Bily*, the sophisticated consumer of audit reports "might expend its own resources to verify the client's financial statements or selected portions of them that were particularly material to its transaction with the client. Or it might commission its own audit or investigation, thus establishing privity between itself and an auditor or investigator to whom it could look for protection." But it is unrealistic to expect homebuyers to take

comparable measures. A liability rule that places the onus on homebuyers to employ their own architects to fully investigate the structure and design of each home they might be interested in purchasing does not seem more efficient than a rule that makes the architects who designed the homes directly responsible to homebuyers for exercising due care in the first place. This seems especially true in "today's society" given the "mass production and sale of homes", such as the 595-unit condominium project in this case.

The opinion also addressed Defendants contention that the balance of *Biakanja* factors is no different in this case than in *Weseloh Family Ltd. Partnership v K.L.Wessel Construction Co., Inc.* (2004) 125 Cal.App.4th 152, where the court found no duty of care owed by a design engineer to the third party owner of commercial property. It distinguished the case by noting the defendants in *Weseloh* played a materially different role in the construction project than defendants did here. *Weseloh*, which expressly limited its holding to its facts, does not stand for the broad proposition that a design professional cannot be liable in negligence to third parties so long as it renders "professional advice and opinion" without having ultimate decision making authority. Instead, *Weseloh* merely suggests that an architect's role in a project can be so minor and subordinate to the role or judgment of other design professionals as to foreclose the architect's liability in negligence to third parties.

In conclusion, writing for a unanimous majority, Justice Liu stated: We hold that an architect owes a duty of care to future homeowners where the architect is a *principal architect* on the project — that is, the architect, in providing professional design services, is not subordinate to any other design professional — even if the architect does not actually build the project or exercise ultimate control over construction decisions. … For the reasons above, the Supreme Court is of the opinion that the allegations in the complaint are sufficient, if proven, to establish that defendants owed a duty of care to the homeowners who constitute the Association.

Finally the Court states that the trial court erred in sustaining defendants' demurrer on the ground that they owed no duty of care to the Association's members. Because the Court of Appeal correctly reversed the trial court's judgment, the Court of Appeal's judgment is affirmed.

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