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By Leslie Steven Marks and Ryan P. Eskin

Defective Solutions

Legislation intended to encourage the resolution of condominium defect disputes may inhibit effective association management

In 1965, there were 500 residential community associations in the United States. Today, there are more than 231,000. An estimated 47 million Americans now live in residential community associations.¹ The demand for new common interest developments has spurred a construction boom of unprecedented proportions over the past 20 years, and the California legislature has struggled to keep up with the pressures that this phenomenon has imposed on the courts. In the early stages of the boom, developers began to feel overwhelmed by the number of

lawsuits initiated by homeowners' associations alleging defects in the design and construction of their planned communities.

The legislature and the governor responded to this problem in 1995 by enacting Civil Code Section 1375 with the hope that it would provide an efficient mechanism for resolving disputes between homeowners' associations and developers before the filing of a lawsuit. Although well intended, the results have been mixed at best, most likely as a result of the flaws inherent in the statute. Indeed, the dispute resolution process often seemed to be nothing more than a speed

bump on the road to full-blown litigation. Among other shortcomings, the statute's prelitigation period was too short—and its penalties for noncompliance were too vague—for the dispute resolution process to be meaningful. The process clearly needed more teeth

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to be truly effective.

To address this need, on October 12, 2001, Governor Davis signed into law SB 1029, a bill that, effective July 1, 2002, made several significant changes to Civil Code Section 1375 with the aim of strengthening the usefulness of the dispute resolution mechanism. Nevertheless, the new amendments to Section 1375 may have rendered the prelitigation process too rigid and complex for meaningful settlements to be reached. Ironically, the revised Section 1375 may have unwittingly frustrated the original purpose of the statute—namely, the orderly and efficient resolution of disputes.

When the state legislature originally enacted Civil Code Section 1375, which is commonly known as the Calderon Process,² it was seeking to stem the tide of construction defect litigation and was no doubt prompted by lobbying efforts on behalf of the construction industry. The purpose of the Calderon Process was to provide a prelitigation forum for the informal resolution of construction defect claims brought by homeowners' associations.

In essence, the law required associations to engage in a structured settlement process

before commencing suit against a real estate developer for defective design or construction of a development of 20 units or more.³ Specifically, the law provided that before filing a complaint, the association must give written notice to the developer identifying the name and location of the project, a defect list, and the results of any testing or surveys.⁴ Any association that failed to satisfy this notice requirement risked having its action stayed by the trial court or dismissed.

Service of the notice triggered a 90-day window in which the developer and the association were to "attempt to settle the dispute or attempt to agree to submit it to alternative dispute resolution."⁵ The developer had the right to conduct additional discovery to further settlement efforts. At some point, both the developer and the association were supposed to meet and confer concerning any settlement offer or proposal for alternative dispute resolution.

The association was also required under the statute to communicate with the individual homeowners to discuss the merits of any proposed settlement offer.⁶ If the developer was unwilling to participate in the settlement process, however, the association's respon-

sibilities under the statute were excused.

The Calderon Process, as originally enacted, contained three basic flaws. First, the 90-day period in which the parties were to meet and confer was simply too short for accomplishing what needed to be done. By the time the developer had finished analyzing the association's defect list and related materials and had conducted its own inspection and testing, the 90-day period typically had expired. Additionally, there was simply not enough time to bring in subcontractors, insurance representatives, and other parties necessary to bring about an effective resolution of the dispute.

Second, subcontractors and insurers were not required to participate in the process. Without the participation of subcontractors and insurers, developers were left alone to grapple with the economic burdens of settlement. In many circumstances, the absence of these necessary parties in the Calderon Process forced developers to bring subsequent indemnity suits against subcontractors, which resulted in increased litigation.

Third, the statute was vague regarding the penalties to be imposed on parties who failed to adhere to the Calderon Process pro-

In the Wake of Aas

Civil Code Section 1375—which is applicable to all real estate developments that consist of 20 units or more and were sold before January 1, 2003—is currently the most important statutory scheme for construction defect litigation. However, SB 800, which was passed in 2002 and is codified in Civil Code Sections 875 et seq., will ultimately replace Civil Code Section 1375. SB 800 is the statutory framework for construction defect litigation involving all new residential property sold on or after January 1, 2003.¹

The California Supreme Court's 2000 decision in *Aas v. Superior Court*² became the impetus for SB 800. In *Aas*, the supreme court seemingly settled a longstanding issue: whether developers, contractors, and their insurers were liable to homeowners for repairs of construction defects that had not manifested damage. The court ruled that construction defect plaintiffs were not allowed to recover damages for economic loss when the alleged defects had not caused property damage. The court's holding, however, was met with derision from trial lawyers and many in the real estate industry. Many people echoed the sentiments of Chief Justice George, who, in dissent, asked why a homeowner should "have to wait for a personal tragedy to occur in order to recover damage to repair known serious building code safety defects caused by negligent construction."

In 2002, the California legislature answered Chief Justice George's question and passed SB 800. The principal purpose of SB 800 is to specify the rights and requirements of a homeowner seeking to bring an action for construction defects. The bill includes applicable standards for home construction, the statute of limitations, the burden of proof,

the damages that are recoverable, applicable prelitigation procedures, and the obligations of the homeowner.³ By its purpose and provisions, SB 800 overrules the *Aas* court's interpretation of what constitutes actionable damage.

The more significant changes in SB 800 include:

- **Accrual date for statute of limitations purposes.** In construction defect actions, the statute of limitations will run from either 1) the date of the close of escrow between the builder and the original homeowner or 2) the date of substantial completion of the project as defined by Code of Civil Procedure Section 337.15—whichever is later.⁴
- **Prelitigation procedure.** Prior to the filing of a complaint, the plaintiff is required to provide the developer with written notice of the plaintiff's intent to commence a legal proceeding. The plaintiff must describe the claim in reasonable detail sufficient to determine the nature and location, to the extent these are known, of the claimed violation. The notice has the same force and effect as the Notice of Commencement of Legal Proceeding outlined in Civil Code Section 1375.⁵
- **Receipt and acknowledgment of the notice of claim.** The developer must acknowledge receipt of the plaintiff's notice within 14 days of receiving it. Once the developer has acknowledged the claim, the developer has 14 days to perform an initial inspection and destructive testing.⁶
- **Notice to other parties related to the dispute.** The developer is required to provide notice of a planned inspection and testing to any subcontractors, design professionals, and other parties related to the dispute, including insurance carriers. The notice must be provided "sufficiently in

cedures. Many parties—developers and associations alike—simply chose to disregard the prelitigation process and march directly into litigation.

According to one commentator, ultimately the statute had “little to do with ADR or settling claims prior to litigation” but instead had “more to do with homeowner-association politics and deterrence of construction-defect claims.”⁷

Critics of the Calderon Process, spearheaded by the insurance industry, were vocal early and often. And in late 2000, after the California Supreme Court in *Aas v. Superior Court* barred construction defect plaintiffs from recovering damages for economic loss when the alleged defects do not cause property damage,⁸ it became readily apparent that a significant overhaul of the entire construction defect resolution process—including both the prelitigation and litigation aspects—was necessary.

The first step was the revision of Civil Code Section 1375 in 2001, which effected changes in the prelitigation dispute resolution process. The next step was the passage of SB 800 in 2002, which sets forth the framework for construction defect litigation after *Aas*

and also contains prelitigation procedures as well. Revised Section 1375, which became effective July 1, 2002, remains applicable for specified developments sold before January 1, 2003; SB 800 applies to all residential property sold after that date. (See “In the Wake of *Aas*,” page 40.)

Revised Civil Code Section 1375

The revised Civil Code Section 1375, like the original statute, requires an association to give written notice to the developer. The notice, titled the “Notice of Commencement of Legal Proceeding,” must include the name and location of the project, an initial defect list, a summary of the damages resulting from the defects, and either a summary of the results of testing and surveys or the actual test results.⁹

The revised statute also tolls all statutes of limitations on all parties for 180 days, which is an increase from the 150-day tolling period in the previous incarnation of Civil Code 1375.¹⁰ The parties can also agree to a further extension of up to another 180 days.¹¹

The revised statute still allows for an early meeting between the developer and the board of the association. In keeping with the legis-

lature’s intent on keeping the prelitigation process moving quickly and efficiently, the developer must call for the meeting within 25 days of the association’s service of the Notice of Commencement of Legal Proceedings.¹² The discussions at the early meeting are privileged communications and are not admissible in any subsequent civil action.¹³ This clarifies a point that was left ambiguous in the language of the earlier statute.

The legislature’s goal of expediting the prelitigation process is also reflected in the revised statute’s provisions dealing with document exchange. Civil Code Section 1375 now requires the developer to provide the association with full access to all plans, specifications, subcontracts, and other construction files for the project.¹⁴ Similarly, the association must provide the developer with access to all documents concerning the claimed defects, including all reserve studies, maintenance records, survey questionnaires, and test results.¹⁵ The same rules apply for subcontractors and all third parties involved in the dispute.¹⁶

The inclusion of subcontractors as well as design and related professionals (and their insurance companies) in the ADR process is

advance” in order to allow the relevant parties to attend the initial inspection (or, if requested, the second inspection) “of any alleged unmet standard and to participate in the repair process.”⁷

• **Second inspection and testing.** If considered “reasonably necessary,” the developer can conduct a second inspection and testing within 40 days of the initial inspection and testing.⁸

• **Offer to repair.** If the developer believes that repairs are warranted, the developer may, within 30 days of the inspection and testing, offer in writing to repair the violation. The offer to repair should also compensate the homeowner for all applicable damages as provided in Civil Code Section 944. These damages include the reasonable cost for repair, reasonable relocation and storage expenses, lost business income (if there is any), “investigative costs,” and “all other costs or fees recoverable by contract or statute.” These provisions of the new law regarding the applicable damages that may be part of the offer to repair specifically override *Aas*.

The offer to repair also must include a detailed, specific, step-by-step statement 1) identifying the particular violation that is being repaired, 2) explaining the scope, nature, and location of the repair, and 3) setting a reasonable completion date for the repair.⁹

• **Authorization to proceed with repair.** The homeowner has three options once the developer’s offer to repair is received. The homeowner can 1) authorize the developer to proceed with the repair, 2) request that the developer provide the names of three contractors other than the developer or the original contractor to perform the work, or 3) pro-

ceed to mediation.¹⁰

• **Use of alternative contractors.** If the homeowner elects to use an alternative contractor to perform the repairs, the developer (who may also be the original contractor) is entitled to an additional noninvasive inspection of the premises to permit the proposed contractors to review the proposed site of the repair.¹¹ The developer has 35 days from the date of the homeowner’s request for the names of other contractors to comply with the request. The homeowner then has 20 days to authorize either the developer or one of the three proposed alternative contractors to perform the requisite repairs.

• **Mediation.** The parties may choose to resolve their dispute through mediation. Either the developer selects and pays for the mediator or the developer and homeowner agree to split the cost and jointly select the mediator. The statute provides for a mediation limited to four hours unless the parties mutually agree to another arrangement.¹²—**L.S.M. & R.P.E.**

¹ 2002 Cal. Legis. Serv. ch. 722 (SB 800). See Civ. Code §911.

² *Aas v. Superior Court*, 24 Cal. 4th 627 (2000). See Cynthia A. R. Woollacott, *In the Land of Aas*, LOS ANGELES LAWYER, Jan. 2002, at 35.

³ Legislative Counsel’s Digest for SB 800.

⁴ Civ. Code §895(e).

⁵ Civ. Code §910.

⁶ See Civ. Code §§913, 916.

⁷ Civ. Code §916(e).

⁸ Civ. Code §916(c).

⁹ See Civ. Code §§917, 944.

¹⁰ See Civ. Code §§918, 919.

¹¹ Civ. Code §918.

¹² Civ. Code §919.

likely the most significant positive development in the revised statute. The revised statute now requires the developer to forward the Notice of Commencement of Legal Proceedings to these parties within 60 days of service of the original notice on the developer.¹⁷ The association, developer, and all relevant subcontractors and their insurers are deemed “nonperipheral parties” and are required to attend the case management meeting, participate in the selection of the neutral mediator (whom the statute refers to as the “dispute resolution facilitator”), and participate in other discovery and settlement sessions under the revised statute.

Once involved, any minor subcontractor or design professional whose total claimed exposure is less than \$25,000 can make a request to be designated a “peripheral party.”¹⁸ If no objection to that designation is received within 15 days, the subcontractor or design professional is only obligated to participate in dispute resolution sessions deemed “peripheral party sessions.”¹⁹

The revised statute thus tries to strike a balance between having developers bear alone the burden of responding to and settling a construction dispute and involving subcontractors and like parties in the settlement. This balance is accomplished without proce-

dures that completely clog the dispute resolution process.

The revised statute emphasizes the role of the neutral mediator. All involved parties must meet and confer to select the dispute resolution facilitator within 20 days of the developer’s service of its notice on subcontractors.²⁰ The dispute resolution facilitator’s powers and duties are vaguely defined, however. The revised statute states that the role of the facilitator is to “attempt to resolve the conflict in a fair manner.”²¹ The facilitator must be “sufficiently knowledgeable in the subject matter and be able to devote sufficient time to the case.”²² But there is little guidance on determining the appropriate grounds for rejection of a proposed neutral beyond the standard grounds specified in Code of Civil Procedure Section 170.1 for the disqualification of a judge based on a prior relationship. Ultimately, selection of the facilitator is left to the auspices of the court if the parties cannot agree on one themselves.

The facilitator’s chief role is to preside over the case management meeting, which must be held within 100 days of service of the association’s notice to the developer.²³ The primary purpose of the case management meeting is to develop a case management statement in which the parties detail the technical

aspects of the case. Among the items outlined in the case management statement are the use of a document depository and dates for visual inspection and invasive testing.

Once the procedural aspects of the case management statement have been accomplished, the focus of the resolution process under revised Civil Code Section 1375 shifts to settlement negotiations. The provisions of the revised statute that address settlement issues represent a drastic departure from the old scheme.

First, the revised statute allows a developer hoping to resolve a dispute to submit:

- A request to meet with the board of the association to discuss a written settlement offer.
- A written settlement offer to the association.
- A statement that the developer has sufficient funds to satisfy the conditions of the settlement offer.
- A summary of the developer’s test results, if any.²⁴

The statute is ambiguous as to whether the developer must submit all these items or whether the developer can pick and choose among them.

If the developer chooses to submit a settlement offer, the revised statute further requires the association’s board to hold an

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- Civil Code Section 1375 was first enacted in:
A. 1991.
B. 1993.
C. 1995.
D. 1997.
- Civil Code Section 1375 only applies to disputes between homeowner associations and real estate developers for defective design or construction of developments of 20 units or more.
True.
False.
- Under the revised version of Civil Code Section 1375 that became effective July 1, 2002, the statute of limitations on all claims is tolled 150 days.
True.
False.
- Revised Section 1375 requires the developer to forward the Notice of Commencement of Legal Proceedings to subcontractors, design professionals, and their insurers within 25 days of service of the original notice.
True.
False.
- Revised Section 1375 still allows for an early meeting between the developer and the board of the association.
True.
False.
- Discussions at an early meeting are privileged communications and are not admissible in any subsequent civil action.
True.
False.
- In order to be a dispute resolution facilitator, one must:
A. Have at least 5 years' experience as a court-appointed neutral.
B. Be sufficiently knowledgeable in the subject matter and be able to devote sufficient time to the case.
C. Be confirmed by the presiding judge of the court.
D. All of the above.
- In furtherance of settlement, revised Section 1375 allows the developer to submit to the association:
A. A written settlement offer.
B. Test results.
C. A request to meet with the association's board.
D. All of the above.
- A party that participates in the prelitigation process without settlement authority is bound by any subsequent settlement reached.
True.
False.
- The case management meeting must be held no later than 30 days before the association files its lawsuit.
True.
False.
- A subcontractor whose total exposure is less than \$25,000 may be considered a peripheral party.
True.
False.
- The board cannot initiate a lawsuit against the developer until it discusses any formal settlement offer proposed by the developer with the members of the association at an open meeting of the members.
True.
False.
- Revised Section 1375 requires the developer to personally attend any open meeting of the association's members.
True.
False.
- SB 800 applies to all residential property sold January 1, 2003, or later.
True.
False.
- New Civil Code Sections 875 et seq. apply only to real estate developments of 20 units or more.
True.
False.
- Under the new procedures in SB 800, the developer must give notice of a planned inspection and testing to subcontractors, design professionals, and other parties related to the dispute:
A. Within 14 days of receipt of the homeowner's notice.
B. Within 25 days of receipt of the homeowner's notice.
C. Within 60 days of receipt of the homeowner's notice.
D. Sufficiently in advance of the inspection and testing.
- According to SB 800, the developer can conduct a second inspection and testing of the premises at issue as a matter of right.
True.
False.
- Under SB 800, the developer may, within 30 days of any inspection and testing, offer in writing to repair the violation.
True.
False.
- According to SB 800, after the homeowner receives the developer's offer to repair, the homeowner may select an alternative contractor to perform the repairs—but the contractor must be one of three designated by the developer.
True.
False.
- If the parties agree to mediate their dispute, under SB 800 the mediator will be selected and paid for by the developer unless the homeowner agrees to split the cost.
True.
False.



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open meeting of the association to discuss the offer. If the board decides to reject the offer, the open meeting must still occur, where the discussion presumably will include the board's rationale for its decision to reject the developer's offer of settlement.²⁵

The importance of this requirement for an open association meeting following the submission of an offer by a developer should not be understated. The board cannot initiate formal litigation against the developer until such a meeting is held.²⁶ Additionally, the board is required to send each member of the association written notice about the meeting. In connection with this meeting, the revised statute requires that the board provide specified information in writing to the association, including:

- "That a meeting will take place to discuss problems that may lead to the filing of a civil action, and the time and place of this meeting."²⁷

- "The options that are available to address the problems, including the filing of a civil action and a statement of the various alternatives that are reasonably foreseeable by the association to pay for those options and whether these payments are expected to be made from the use of reserve account funds or the imposition of regular or special assessments, or emergency assessment increases."²⁸

Thus the statute now forces the association's board from the onset of the dispute to present worst-case scenarios to association members, thus increasing the chances for dissension among the ranks of the association. The board could essentially find itself in the middle of hostile forces, including the developer on the one hand and a potentially dissatisfied association on the other.

- "The complete text of any written settlement offer, and a concise explanation of the specific reasons for the terms of the offer submitted to the board at the meeting..."²⁹

In essence, revised Civil Code Section 1375 gives the developer unfettered access to association members, against whom the developer may use scare tactics to dissuade members from supporting a board's decision to proceed with litigation. For example, a developer with no intention of settling can make a nominal written settlement offer and include reasons why litigation would not be in the association's best interests: It will be too costly, will damage the market value of residences, and the like. This provision of the revised statute seems designed to undermine board authority and decision making in favor of mob rule. Association boards are now placed in the unenviable position of deciding between what may be right and what may be popular.

With all its flaws, the requirements of the

revised statute must be followed or penalties will ensue. Parties to a construction dispute can no longer circumvent or hope to delay the process by refusing to participate or hiding behind mountains of discovery and protracted litigation. To deter this kind of conduct, the legislature created new penalties to encourage participation in the new scheme. The revised statute provides that any party that does not participate in the process, or participates without settlement authority, is bound by any subsequent settlement reached.³⁰ Moreover, the revised statute severely restricts the ability of the parties to conduct further discovery once a complaint is filed.³¹ Finally, a new section of the Civil Code, Section 1375.05(b), provides that for purposes of trial setting, the complaint in any action that falls under Section 1375 is deemed to have been filed on the original date of service of the association's Notice of Commencement of Legal Proceedings, and the case will be given the earliest possible trial date.

Chilling Effect

Even if the parties do reach a successful resolution of the dispute, the requirements imposed on the association after settlement are hardly conducive to participating in the revised statute's settlement process.

In the first place, according to Civil Code Section 1375.1, the association must disclose to its members not only a description of the defects to be corrected and the date of completion of the work but also the status of all defects originally identified but not included in the final settlement agreement.³² Essentially, this provision forces the association to disclose to its members those items on which it compromised. Therefore, even if the board reaches an agreement that it feels is in the best interests of its members, it may be faced with the unenviable task of having to explain itself to its constituents.

Perhaps even more troublesome are the privilege issues implicated by requiring such a disclosure. Many if not all associations retain legal counsel to help them navigate through myriad tasks and procedures. Legally, the attorney's duty is to the association—not to the individuals who are represented by the association.³³ However, forcing the association to disclose what it chose to give up in the spirit of compromise is akin to disclosure of trial tactics and would appear to be a clear violation of the attorney-client privilege.

The settlement proposal provisions in revised Civil Code Section 1375, despite the legislative purpose of the statute, ultimately may prove to have a chilling effect on construction defect litigation and the prelitigation resolution of this type of dispute. While the



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revised statute represents a noble attempt to remedy the ambiguities and shortcomings found in the earlier version of Section 1375, the legislature, in its effort to install structure and fluidity to a process that was largely amorphous and undefined, may have created what it feared most—rigidity and intractability.

Given the complexity of the legal and factual issues in construction defect disputes, and the likelihood of the involvement of numerous parties, many homeowners' associations may forego dispute resolution in favor of a more relaxed and deliberate process, such as informal settlement negotiations. Still, this course is risky, because a mandatory prerequisite for construction defect litigation is the utilization of the revised Civil Code Section 1375 pre-litigation resolution procedure.

Nevertheless, some plaintiff's groups may forego litigation altogether rather than face the harsh requirements of disclosure that accompany the new provisions of Civil Code Section 1375. The new statute may satisfy its goal of curbing litigation—but only by creating a huge disincentive to bring an action in the first place. ■

¹ Figures from Community Associations Institute, at www.caonline.org.

² State Senator Charles M. Calderon was the author of the bill that became Civil Code §1375.

³ See generally Civ. CODE §1375(a), as added by SB 1029, 1995 Cal. Stat. ch. 864, §1.

⁴ Civ. CODE §1375(b).

⁵ *Id.*

⁶ See generally Civ. CODE §1375(g).

⁷ Ross R. Hart & Timothy K. Cutler, *Settlement Negotiations for Condominium-Defect Disputes*, LOS ANGELES LAWYER, July/August 1996, at 17.

⁸ Aas v. Superior Court, 24 Cal. 4th 627 (2000).

⁹ Civ. CODE §1375(b).

¹⁰ Civ. CODE §1375(b)-(c).

¹¹ Civ. CODE §1375(c).

¹² Civ. CODE §1375(d).

¹³ *Id.*

¹⁴ Civ. CODE §1375(e)(1).

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Civ. CODE §1375(e)(2).

¹⁸ Civ. CODE §1375(e)(3).

¹⁹ *Id.*

²⁰ Civ. CODE §1375(f)(1).

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ Civ. CODE §1375(k)(1)(A).

²⁵ Civ. CODE §1375(k)(1)(D).

²⁶ See *id.*

²⁷ Civ. CODE §1375(k)(1)(E)(i).

²⁸ Civ. CODE §1375(k)(1)(E)(ii).

²⁹ Civ. CODE §1375(k)(1)(E)(iii).

³⁰ Civ. CODE §1375.05(d).

³¹ For example, in most circumstances defendants are not permitted to conduct further inspections or testing once a complaint is filed.

³² Civ. CODE §1375.1.

³³ See, e.g., Smith v. Laguna Sur Villas Cmty. Ass'n, 79 Cal. App. 4th 639, 643 (2000) (holding that the condominium association, not individual unit owners, held the attorney-client privilege).

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