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### **Arizona Court of Appeals Deals Win To Contractors, Subs and Design Professionals in Subsequent Homeowner Negligence Claims**

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The Arizona Court of Appeals, Division One, handed down a favorable ruling for homebuilders in *Sullivan v. Pulte Home Corporation*<sup>[i]</sup>, upholding the dismissal of negligence based claims finding a lack of duty to a subsequent purchaser of a home, in this five-year-long fight over latent construction defects. This important case has a long and storied history. It already included one important construction law opinion delivered by the Arizona Supreme Court, which left open the question about the viability of negligence claims by subsequent purchasers of homes seeking only economic losses. This recent opinion, if upheld, is a step in the right direction for homebuilders, design professionals and contractors to further limit the claims of subsequent purchasers of homes.

#### **Facts of the Case**

The Sullivans were subsequent purchasers of a home constructed by Pulte. After discovering issues with a retaining wall abutting a hill (missing footings, rebar and grading and drainage problems) and Pulte's refusal to repair the issues, the Sullivans sued Pulte. The Sullivans' only damages were to the wall constructed by Pulte. The Sullivans' complaint included counts for negligence, negligent non-disclosure, negligence *per se*, negligent misrepresentation, consumer fraud, fraudulent concealment, and breach of implied warranty.

#### **Sullivan I<sup>[ii]</sup>**

In the Sullivans' first journey through the appellate process (*Sullivan I*), following the trial court's dismissal of Sullivan's case in full, the Arizona Court of Appeals upheld the dismissal of the Sullivans' implied warranty, consumer fraud and fraudulent concealment claims based on: 1) Arizona's statute of repose (the damage was found more than eight years after substantial completion), and 2) the fact that the Sullivans were not a party to the original transaction with Pulte. The Court of Appeals also held that the economic

loss doctrine (ELD)[iii] did not preclude the Sullivans' negligence based claims, because the parties were not in privity of contract despite breach of warranty claims sounding in contract.

The Supreme Court generally affirmed the Court of Appeal's holding and limited the application of the ELD to claims where the parties have a contract. It clarified that implied warranty claims, while based in contract, arose out of common law and not a bargain between parties. The Supreme Court also directed the trial court to review whether other statutes or case law permitted the Sullivans' negligence claims and sent the negligence based claims back to the trial court for further review. Clark Hill attorneys Doug Folk, Chris Hossack and Heather Seiferth participated in *Sullivan I* by authoring an amicus brief in support of Pulte's position, on behalf of Arizona design professionals.

## **Sullivan II**

The Sullivans' second trip to the appellate court comes after the trial court again dismissed all of their remaining negligence claims. Pulte successfully argued that it did not owe a duty to prevent economic losses incurred by a subsequent purchaser.[iv] The Court of Appeals accepted jurisdiction to decide whether a subsequent homeowner could maintain a negligence action against a homebuilder for hidden construction defects resulting in purely economic losses.

On appeal, the Sullivans argued that Pulte's duty did not arise out of traditional tort principals, but rather arose out of public policy principles based in the municipalities' building code, Arizona statutes and the Arizona Administrative Code governing contractors. The Sullivans claimed that they fell "within the class of persons protected by Arizona's public policy framework which mandates specific design and construction standards for safe residential construction" because the building code and laws governing contractors provided minimum standards to protect their property and safety, established workmanship standards and required compliance with building codes and contractor regulations.[v]

The Court of Appeals was not persuaded by the Sullivans' argument. It discounted the Sullivans' reliance on the building code because the relevant code "specifically disclaims any intent to protect or benefit a particular group or class" for purely economic losses.[vi] As the Sullivans' claims did not arise out of personal injury or damage to other property (for example, the wall failed to withstand a rock slide and collapsed causing damage to the Sullivans' house and injure someone standing on the patio), the Court of Appeals found that the building code did not create a duty on the part of Pulte to repair a subsequent purchaser's retaining wall.

Similarly, the Court of Appeals found that the statutes and administrative codes regulating contractors did not support the Sullivans' argument that Pulte owed them any duty for the economic damages sought. The Court held that the regulations governing contractors, while establishing licensing requirements and making contractors subject to discipline by the Arizona Registrar of Contractors for failure to comply with applicable building codes, did not create a private cause of action in tort for economic losses incurred by subsequent homeowners.

The *Sullivan II* Court further buttressed its decision with the tentative draft of the Restatement (Third) of Torts: Liability for Economic Harm §§ 1(a) and §6 as cited by the Supreme Court in *Sullivan I*, stating "that duties to avoid causing economic loss require justification on more particular grounds than duties to avoid causing physical harm." In the end, the Court of Appeals held 1) there is no general duty owed to prevent another from incurring economic losses, and 2) homebuilders do not owe a duty to subsequent homeowners for economic losses arising from hidden defects, because the subsequent homeowner could not have relied on the acts of the homebuilder.

## Outcome

The current holding in *Sullivan II* is another step in the right direction limiting the almost unending liability of homebuilders, contractors, subcontractors and design professionals for claims by subsequent homeowners. *Sullivan II* closes the door on the commonplace third party economic loss claims that generally consist of the same fact pattern. For defective design or construction claims, subsequent homeowners should now be limited to implied warranty claims (that are subject to Arizona's eight year statute of repose) when seeking economic losses unless they can prove that some other duty of care is owed to that homeowner.

The *Sullivan II* court's rejection of building codes and statutes/administrative codes governing the licensing of professionals as a basis of proving a duty to a subsequent homeowner is also noteworthy. Often in these types of cases the subsequent homeowner's experts rely on building codes and state licensing schemes to illustrate a duty to the subsequent homeowner. *Sullivan II* effectively limits the grounds that plaintiffs and their experts can rely on to create a duty.

The Arizona courts continue to be proactive in limiting the liability of homebuilders, design professionals and contractors. *Sullivan II* is a great step in the right direction to reduce the number of claims by subsequent homeowners for economic losses. We are hopeful that as a result of *Sullivan II*, homebuilders, design professionals and contractors will see further relief from the almost endless responsibility for purely economic losses claimed by subsequent homeowners.

If you have any questions about the subject matter of this e-alert please contact Heather Seiferth at [hseiferth@clarkhill.com](mailto:hseiferth@clarkhill.com) or 480.684.1137 or contact another member of Clark Hill's Construction Practice Group.

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[i] *Sullivan II*, 2015 Ariz. App. LEXIS 130 (July 28, 2015)

[ii] *Sullivan v. Pulte Home Corp.*, 232 Ariz. 344, 345, 306 P.3d 1, 2 (2013).

[iii] In Arizona, the economic loss doctrine serves to limit contracting parties to their contractual remedies and bars negligence claims between contracting parties when the damages are purely economic in construction cases (not arising out of personal injury or damage to other property).

[iv] 2015 Ariz. App. LEXIS 130 at ¶5.

[v] *Id* at ¶7.

[vi] *Id* at ¶¶ 8 and 11.