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## Shangri-La Gardens

### The Short Life of Eternal Waterproofing

Shangri-La Gardens was the latest and most fashionable condominium development in West Hollywood when it came on stream early in 1994. Reasonably priced and attractive, all 120 units were promptly sold. Because of the sloping site, most of the units had spectacular views out over Beverly Hills and beyond to Santa Monica.

The buildings were skillfully arranged around landscaped courtyards on top of a subterranean garage. Each condo unit was a two-story townhouse. Every unit had a so-called bonus room at the garage level that gave each of them direct access to their own parking spaces. The bonus rooms were not designated by the developer for any particular purpose, leaving that to the condo owners' imaginations. Some were furnished as music or entertainment rooms while others were developed as home offices or hobby rooms. That was the genius of the idea; the bonus room could be used for anything that the prospective purchaser might have in mind. It contributed greatly to the rapid sell-out of all 120 condos in less than 60 days.

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In early February 1995, the short Southern California rainy season was off to a robust start. It had been raining steadily all afternoon and evening and poured off and on all night. The next morning was beautiful, clear, bright, and sunny just as promised by the TV weather broadcaster.

After a hurried breakfast, Ken Lange, in Unit B23, kissed his lovely wife, said "Good-bye, Hon, seeya tonight," hoisted his briefcase, and proceeded spiritedly downstairs to cut through the bonus room and out to his car. Stepping off the last stair tread onto the bonus room carpeting, he could feel it squish. He also heard it. Instinctively, he quickly retreated back to the bottom stair tread. He couldn't believe his eyes. The whole bonus room carpeting glistened as though it was a small shimmering silver lake. He rushed back upstairs and shouted, "Barbie, come down here quick. You won't believe this!"

She followed him apprehensively down the carpeted stairway and they both stared at the indoor swamp. He could see that the carpet was like a huge wick that entrapped hundreds of gallons of water. He slogged gingerly across the room and opened the door to the garage. Water had been seeping out under the door and now it streamed out more freely. They spent the next hour carrying furniture up the stairs and drying it off with towels. Later they'd call the carpet people to pick up the carpeting and padding. Barbie said, "I hope it's not ruined! And our beautiful new furniture." She was heartsick, close to tears.

Ken, glancing at his watch, said, "Barbie, we better call the management company and report this. It must be a plumbing leak. A water pipe must have burst."

"I'll do it right now, Ken. You better get going. You're already late for work." Their faces were drained and grim-faced. They didn't know yet if this was covered by their household insurance. Ken said, "I'll check it out today. I'll call our broker."

As Ken was driving out of the garage he noticed some of his neighbors looking at the floors just outside their bonus rooms. He saw some water flowing toward the floor drains and said to himself, "There must be more plumbing leaks."

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The Certified Property Managers telephone lines were all tied up. Only one was equipped with an answering machine and it had been busily recording one message after another. The other two lines were ringing steadily when Melanie Newman opened the office at 8 AM. She answered one of the phones, asked the caller to hold, and went on to the second. It took nearly an hour to catch up with the ringing phones. In the first lull she played the answering machine back to pick up the recorded messages. The eleven stored messages were similar to the calls she had just taken. Something terrible was happening at Shangri-La Gardens.

Owen Pierce, one of Certified's senior property managers, running a little late this morning, showed up at 8:30 to find Melanie on the phone and furiously writing service requisitions. There was an untidy pile of the pink service slips on her desk. She looked up at Owen with a concerned expression and shoved the pile his way. He shuffled through them, quickly absorbing the information, then flew out the door headed for Shangri-La Gardens. There he was met by an anxious group of condo owners, some still in their bathrobes, all talking at once. He was ushered to one bonus room after another. They were all water-soaked. Some of the homeowners were angry and aggressive while others were more civil, realizing that Owen was probably not responsible for their problems and would only help solve them.

He immediately started marshalling assistance on his car phone. He called Melanie to send over another property manager, as he correctly perceived that the problem was widespread and too big to handle alone. He called Pronto Plumbing to come as quickly as possible. Two plumbers from Pronto were there within 20 minutes and started tracking down the leak. After two hours of probing and searching they reported to Owen that they couldn't find any plumbing problems. It must be something else. They asked for his signature on a service call bill for \$180.

Quincy Roberts, a junior property manager, soon arrived and started organizing labor to help move furniture, pick up carpeting, squeegee floors, and dry off belongings. He really pitched in and kept the operation moving effectively. He helped with carrying furniture and placating homeowners.

Owen was sleuthing around himself and, in several of the bonus rooms, he saw water seeping up through the joint between the floor slab and the concrete block wall. He also found numerous wet spots and water seepage in many of the concrete block wall joints. He saw water seeping through and running down the wall surface.

He spent the day at Shangri-La and looked at dozens of bonus rooms. Around 6 o'clock many of the condo owners who had been at work started arriving home. He looked at their damage and started making a record of the locations of all the water intrusions.

It took most of the week to clean and dry up the mess, but they couldn't risk moving any of the carpeting or furniture back in as it could happen again.

## Shangri-La Gardens

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Half a year later, 94 out of the 120 condo owners were completely disgusted with their purchases. Hundreds of complaints had been lodged with Certified Property Managers and, so far, nothing constructive had been done to alleviate the problems. The developer who had built the complex had workers running around with caulking guns practically every day but it did no good. Every time it rained more water showed up. More caulking would be done. Many of the homeowners had installed wood paneling or wallpaper in their bonus rooms and now most of it was warped, streaked, stained, peeling, and ruined.

The bonus rooms were useless. They were more suitable for mushroom culture or bean sprout growing than for all the wonderful dreams of the owners. Subterranean leaking was also widespread in the project's mechanical equipment rooms, storage areas, and communal exercise rooms. The garages always seemed to have trickles of water flowing out of the bonus rooms and into the floor drains. A dank musty odor was beginning to permeate all of the garage level spaces. Many of the condo owners were complaining of unpleasant odors getting into their upstairs living areas. Unsightly mildew and fungus stains were forming on the walls of their bonus rooms. Several had visited their physicians as they felt that their previously minor respiratory complaints were worsening.

Some had decided to bail out of the investment but quickly changed their minds when told by neighborhood real estate agents that resale prices would remain severely depressed as long as the leaking problem persisted. They pointed out that such defects must be disclosed to prospective purchasers. The situation at Shangri-La Gardens was by then well known in the real estate sales community.

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Recent meetings of the Shangri-La Homeowners Association, usually held monthly, had been consistently running past midnight so they decided to increase the frequency to bi-monthly, and finally, weekly.

Sam Tracy had been President of the Association from inception and now he fervently wished he hadn't been so quick to accept the honor. This was his retirement activity after 45 years of running his own wholesale grocery business. He was businesslike and worked well with people. But it was no longer a pleasure. The meetings were getting downright unpleasant. The neighbors were no longer friendly. Tempers were short. They bickered and wrangled. They treated Sam as though he was the cause of their problems. Every meeting of the association was a horrible and distressful experience for him and the other co-owners.

The developer was cooperative but didn't really know what to do. IJ Developers was headed by Ignatius Jones, who was more of a promoter than a builder. He put the deals together and hired staff people to do the physical things. Iggy was a great salesman and coordinator. He told the Homeowners Association, "Tell me what to do and I'll do it. This type of thing never happened before in any of my developments. It must be an act of God. Probably caused by the earthquake." Iggy was always friendly and cooperative.

The homeowners didn't know what to do either. The meetings didn't accomplish very much, if anything. They functioned mostly as a catharsis, a forum for sounding off, and for huddling together for mutual comfort.

Owen Pierce attended most of their meetings and was extremely supportive. He spent most of his time at Shangri-La, almost daily. He eased the owners' burdens as well as he could. But there wasn't really much he could do beyond being helpful and friendly. He had been keeping records and correlating them on a chart

posted in his office. He noticed that practically all of the leaking had been occurring in Buildings B, C, and D. There were no leaks on the north and west sides of Building A. He couldn't account for this strange and interesting anomaly.

Sam Tracy appreciated Owen's support but he realized that all of his costs and expenses were being billed by Certified Property Managers to the Association each month. It was expensive and the costs were mounting. Some of the Board members were starting to complain and questioned the adequacy of the Association's maintenance reserves. Although Iggy wasn't billing them for his frequent caulking efforts, they didn't seem to be doing any good.

At one of the Association meetings, someone, in desperation, asked, "Why don't we sue someone?"

Someone else replied, "Great idea! Who'll we sue?"

Sam said, "Maybe we should find an attorney to represent us. We need professional advice on whether someone is responsible for our problems."

The small committee formed to select a suitable lawyer received nominations from various Board members and talked to the three lawyers who were homeowners in Shangri-La. They accumulated names of a few law firms that specialized in condominium associations and then narrowed it down to one firm that also had considerable experience with defective construction. They invited Ursula Vickers of Vickers and Walsh, Attorneys at Law, to attend the next Association meeting.

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Ursula explained that there is no point in filing lawsuits willy-nilly without some rational objective. She continued, "We could enmesh innocent parties and completely overlook those responsible for your problems. First, we'll need to know all the parties involved in the development of Shangri-La. Second, we need to look into all possible insurance coverage. And finally, we need to find out exactly what is wrong with this building. This Board can help me with the first two categories, but we'll have to hire a competent technical expert to determine the precise nature of the problem. Where is the water coming from? Why is it leaking? How can it be fixed? What caused it? Then we'll have to discover who's responsible."

Sam Tracy asked, "Who can we get?"

Ursula replied, "Our firm has worked with Frank Grimm, FAIA, an experienced forensic architect. I'd like to call him and get him started."

Sam, answering for the Board, said, "Okay, Ursula, you have our approval."

"Good. Now we have to compile the list of individuals and firms who had anything to do with the development, construction, sale, and maintenance of Shangri-La. And I want to see all your insurance policies."

The Board meeting ended in a spirit of optimism. Finally, something constructive was happening.

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During the next couple of months Ursula and her paralegal assistant collected, dissected, analyzed, and organized volumes of relevant information. Frank Grimm had made extensive examinations of the building and construction documents and had rendered his report. Ursula had considerable trouble piecing together the circumstances surrounding the construction, but after numerous informal interviews with the homeowners, Iggy Jones, and many of the subcontractors and suppliers, she finally uncovered the whole picture.

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It all started in early March 1993. Alexander Barnes was now a free man for the first time in twenty-seven months. Freedom felt good. He was just released from Chino Men's Prison where he was sent following conviction for soliciting a \$4500 bribe as a county building inspector. Now he had to find a way to make a living. All he knew was the construction industry but he knew he couldn't be a building inspector anymore. He'd look around for a suitable opportunity. He still had the \$4500 stashed in a secure place. He'd testified that he'd lost it all on a weekend in Las Vegas.

Alex was at a coffee shop counter in Culver City when he struck up a conversation with the dejected-looking fellow on the next stool. He'd seen him drive up in a pick-up truck with "CD Waterproofing" painted on the side. Alex and Carl Dunn got along well from the start. Alex's natural friendliness, optimism, and upbeat personality were a counterbalance for Carl's constantly gloomy outlook. Carl gradually revealed his hopeless condition to Alex. He was ready to go out of business. His economic reverses were overwhelming. He'd just finished two large waterproofing jobs that were financial disasters. Although all the contract payments had now been received, he not only had nothing left, he owed his suppliers over \$8000. His insurance had been cancelled for non-payment of premium. All his men were gone except for his son who was looking for another job where he'll get paid cash money. Carl had no work in the offing. "Now is the time to face facts and throw in the sponge," he concluded.

Alex paid for Carl's coffee and doughnut, and as Carl left, Alex asked him for his business card.

The more Alex thought about it, the more he was convinced that this was the opportunity he was looking for. Why not? So, he phoned Carl.

Alex agreed to go to CD Waterproofing's Office on Venice Boulevard in Mar Vista. He caught the Sepulveda bus, as he hadn't found a car yet. He walked the rest of the way. CD's office wasn't fancy. Actually, it was a double garage on the back of a lot that had a body and fender repair shop on the street frontage. The garage had an old wooden desk and a couple of scruffy chairs, a 4 drawer filing cabinet with only 3 drawers, some shelving, and a work table for mixing waterproofing materials. There were a number of empty cans and buckets that formerly held waterproofing materials and half a dozen unopened cans. A few rolls of black plastic sheeting were stacked in one corner. There was barely room left over to park the truck.

When Alex arrived, Carl was sitting at the desk aimlessly doodling on a memo pad. He looked lifeless and despondent. He hardly looked up.

Alex came in, sat down, and said, "Carl, this is your lucky day!" Carl raised his head listlessly.

Alex continued, "I'm gonna buy your business! Whadda ya want for it?"

"It isn't worth anything. All I've got left is the old truck and I owe over \$8000 to my suppliers."

“That’s okay. You give me the business and the truck and I’ll pay your suppliers. I’ll even give you a job. You have the waterproofing contractor’s license so you can be my Responsible Managing Employee. Whatta ya say?”

“Okay with me. You gotta deal. Whatta we do now?”

“I’ll change the name of the business to Eternal Waterproofing. You’ll be my Field Superintendent. You can run the work. Let’s go. I’ll buy you a cuppa coffee.” Carl locked up the garage and gave Alex the keys to the garage and the truck. Maybe his bad luck streak had ended. Alex drove the truck.

In the next few days Alex had a bright new sign painted and put it up over the door. Eternal Waterproofing. He was now calling the garage their warehouse. He applied for a city business license and a state contractor’s license. He lined up a contractor’s license bond and got a minimum insurance program in place. He paid \$300 as a deposit on the premium. He had the truck repainted with Eternal Waterproofing on each door and on the tailgate. He ordered business cards for himself and Carl and some padded bid proposal forms. He opened a checking account at a nearby bank and deposited most of the balance of his funds, \$2900.

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Alex paid a visit to Economy Builders Supply to make a deal for paying off Carl’s delinquent account. “I’ve just taken over CD Waterproofing and I’m gonna pay off the account,” he announced.

The dour sales manager brightened a little and said, “Good. The balance is \$8123.47. Just make your check payable to Economy Builders Supply.”

Alex promised, “I’ll give you \$500 on account right now and I’ll start making monthly payments to clear the rest off. Now, I want to open an account for the new business, Eternal Waterproofing. We’ve got to start making money to pay you off.” The sales manager wasn’t 100% pleased with the arrangement but it was a lot better than the hopeless situation he had with Carl.

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Alex now ventured out in earnest to scare up some action. He drove the truck around visiting construction sites where large-scale residential work was commencing. He’d look up the site superintendent and engage him in friendly conversation. He’d try to find out if the below-grade waterproofing subcontract had been let. If not, he’d then start probing to find out what their low bid was at the moment. He’d usually offer the superintendent \$50 or \$75 for the information. Most of them would promptly throw him off the jobsite, but occasionally one would continue talking to him.

Alex felt that this type of work was ideal, as many residential developers didn’t engage their design architects and engineers to examine the construction in process. And he knew that no one paid much attention to work going on in an excavation.

After about three weeks of promotional activity, he landed on a site where foundations were being poured for four large condominium apartment buildings. Concrete block walls were going up on the subterranean garage of the first building. A flashy sign proclaimed Shangri-La Gardens, 120 luxury condominiums, IJ Developers. As Alex was walking up to the site office, he could hear the superintendent just winding up a phone call.

“That’s \$20 on Easymoney to win in the fifth at Santa Anita. Ya got it? Good. Don’t worry. I’ll pay ya what I owe ya. Don’t worry. I’m good for it.” He looked up as Alex stood in the doorway of the Portacabin that was his construction office.

“Whatta ya want?” he growled.

Alex came in. Smiling. Friendly. Introducing himself, he casually handed over his business card. He started his usual ingratiating banter and, eventually finding that the below-grade waterproofing subcontract was still up for grabs, he offered a friendly gratuity of \$50. The superintendent, Glen Harker, now interested, didn’t turn it down. Alex was still standing there and started ostentatiously counting off ten-dollar bills from a fat wad.

Glen said, “This is a big contract. Fifty bucks won’t go very far. Five hundred would be more like it.”

Alex said, “That’s too much. After all, I don’t have the contract. I haven’t made a cent yet.”

“Well, I’ve got expenses. I’ll tell ya what we can do. Give me \$300 now and \$700 when ya get the contract.”

“Ya gotta deal. Here’s the other \$250. Now, what’s the low bid, as of right now?”

“\$87,750. Go to the IJ Developers office in Santa Monica. Here’s the address.” He wrote it on a scrap of paper. “Tell Iggy I sent ya.”

As Alex headed back to his truck, elated, he said to himself, “Now we’re in business. Ya hafta make your own opportunities.”

His next stop was IJ Developers in Santa Monica. The secretary, after receiving the Eternal Waterproofing card, steered him to the plan room. He messed around with the plans for fifteen or twenty minutes. He saw no point in studying the plans and taking off quantities. That had already been done by the low bidder. He began writing out a bid on his pad of standard proposal forms. He considered several figures, raising and lowering them in his mind. It had to be lower than \$87,750 but not too low. No point in throwing away money. But it had to be low enough to sign up the deal today. He didn’t want IJ shopping his bid around. That would be unethical. He finally decided on a bid of \$86,250. He started writing the figure when he decided to lower it to \$85,250. That’s the right amount, he decided.

He went back out to the secretary and asked if he could present the bid directly to the construction manager. She disappeared for a moment and came back following a well-dressed energetic man. “I’m Iggy Jones. Lemme see your bid.” He seemed interested, as he invited Alex into his office.

“This bid is way too high. Most of the waterproofing bids are much lower than this. I’ve got a bid for \$84,750. You’re just too high. Outta the ballpark.”

Alex, knowing now that he was dealing with a kindred spirit, said. “I’m willing to give you my best bid if you’re willing to sign up today, right now, before I walk out of here.”

“Well, what’s your figure?”

“\$83,750. There’s practically no profit in it. I’ll take it just to keep my crews busy.”

Iggy thought it over for about 5 or 6 seconds and said, "Okay, we'll prepare a subcontract." Then, referring to his construction schedule on the wall, continued, "You gotta be ready to start on Building A on May 11 and finish it in two weeks. You gotta start Building B on June 7th, Building C on July 5th and Building D August 2nd. You can have each building for two weeks, then we backfill. Unnerstand?"

Alex walked out to the truck with a signed contract in his pocket. He was thinking, "\$83,750 is still not too bad. Even after paying that crook Harker \$1000. We'll just have to find ways to economize."

He toiled his truck over to Economy Builders Supply and made another payment of \$500. He now had them softened up for all the credit he needed. The sales manager was his.

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Carl had spent the last couple of weeks cleaning up the warehouse and the miserable collection of tools. He had painted the warehouse and it was now shipshape. He was feeling a lot better even though he had lost his business. At least he wasn't forced into bankruptcy.

He looked up from his broom and saw his old truck heading in for a landing. It pulled into the warehouse and Alex was waving a piece of paper and shouting, "Eternal Waterproofing is off the ground. We're in the big time now!" He described the whole deal to Carl. At least he disclosed most of the deal. He didn't mention the \$1000 for Glen Harker and he didn't explain how he figured the price. Carl assumed he'd made a take-off from the plans and specs. He also neglected to mention the economies that would have to be made.

Alex further explained, "We gotta start in about a week and a half, on Monday, May 10th. The first building has to be done in two weeks. Then we'll be off two weeks before we start the second. There are four buildings altogether. We'll need about five workers to help you. Can you get a crew together?"

"Sure. That's easy. I'll get right on it." Carl headed for the desk and the telephone. He flipped through his soiled, dog-eared card file. Carl was happy again.

Alex waved to Carl as he left in the truck. He sped to Economy Builders Supply and went to the order desk. He ordered ten 15-gallon buckets of Superseal Primer Coat and the same quantity of Superseal bituminous, fiber-reinforced waterproofing compound. This was top-grade stuff; exactly what was specified in the construction documents. He also ordered fifty 15-gallon buckets of Econ-O-Coat primer and the same quantity of Econ-O-Coat waterproofing compound. The Superseal products cost \$49 per bucket while the Econ-O-Coat equivalents were only \$11 per bucket. This preliminary order would be enough to get the job started. He asked them to deliver the 20 buckets of Superseal products to the jobsite and the 100 buckets of Econ-O-Coat to the Eternal Waterproofing warehouse. When they arrived in the warehouse, Alex covered the stack of Econ-O-Coat buckets with black plastic sheeting.

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Early on Monday morning, May 10, 1993, Alex and Carl, with 5 helpers in the back of the truck with an assortment of trowels and other small tools, arrived ready for action. Glen Harker told Alex where the twenty 15 gallon buckets of Superseal were stored. Glen suggested that the \$700 balance be paid now before any work is done. Might as well be businesslike. So Alex peeled off 14 fifty-dollar bills and placed them in Glen's greedy hand.

Alex told Carl to get the crew going on Building A. They should start at the southwest corner and proceed clockwise around the building. Alex cautioned him to save the empty Superseal buckets as they were emptied and bring them back to the warehouse. Carl asked, "Why do you want to save them? We'll just have to get rid of them. It'll cost us. Maybe Glen'll let us dispose of them in the general trash heap."

Alex said, "Just save them. No more argument." Carl didn't understand. He wasn't used to anyone giving him orders.

Alex took off in the truck to continue his promotional rounds. Maybe he could find a fill-in job to utilize the two weeks idle period after each building at Shangri-La. He returned to the job at the end of the workday to drive Carl and the crew back to the warehouse. They also loaded up 10 empty Superseal buckets. After the men left the warehouse, Alex told Carl to go on home and get some rest. He would stay on to tie up some loose ends.

Carl put his hand on Alex's shoulder and said, "It's really good to be back to work, Alex. I'm sure glad I met you in the coffee shop. You're a great guy, a true friend. You've saved my life. See you in the morning." He left and walked home.

Alex closed the warehouse door and got to work. He filled the 10 empty Superseal buckets from the Econ-O-Coat buckets and then went home.

The next morning, he told the crew to load the refilled Superseal buckets onto the truck. After work that day, Carl went home leaving Alex to finish up whatever he had to do. About 20 minutes after Carl left he returned to pick up his forgotten lunch box. He found Alex pouring Econ-O-Coat into Superseal buckets. He was astounded. He demanded, "What're you doing, Alex?"

"What the hell do you think I'm doing? I'm making a profit for you."

"But, Alex, you can't do that. It's a specification violation."

"Now I know why you went broke."

"But, Alex, that Econ-O-Coat is no damn good for waterproofing. It's only dampproofing. The buildings will leak. Sure as hell!"

"So what? By then we'll be long gone."

"I don't like it."

"Who asked you to like it?"

Alex continued pouring Econ-O-Coat into Superseal buckets. Carl went home.

The next day the crew loaded the newly filled cans of Superseal onto the truck and they went to work, continuing on Building A. The west and north walls were completed with Superseal products and then Econ-O-Seal was used on the east and south walls. By the end of the week, Carl was so disgusted with the situation that he told Alex he could have the business and he left. Carl never returned. Alex promoted one of the crew to Foreman and gave him a 50 cents an hour raise. Alex told him that they were applying the

waterproofing compound too thick. He explained that it was a much better job if it was spread out thinner and would be less likely to crack.

Eternal Waterproofing finished the work and all of it was promptly covered up with earth backfilling.

Alex was very efficient in his billing procedures and had collected all the contract payments from IJ Developers by 30 days after completion of Building D. He'd been paying Economy Builders Supply a little at a time to keep the deliveries coming but still owed them a little over \$28,000 including the unpaid balance of Carl's delinquent account.

When Economy's mechanics lien arrived at IJ Development, Alexander Barnes was long gone. Eternal's warehouse was locked and the bank account closed. Alex was never located. Carl Dunn was not found financially responsible but lost his contractor's license. IJ Development found little consolation in Eternal's \$5000 license bond or their written guarantee.

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Ursula Vickers wound up the incredible story by revealing the forensic architect's recommendations. "In his report Frank Grimm concludes that the sub-grade walls will have to be excavated and completely exposed so they can be properly waterproofed. Earth backfill will have to be replaced and the surface features such as walks, landscaping, and irrigation sprinklers will have to be restored. His estimates vary from \$280,000 to \$300,000. This doesn't include the cost of repairing interior damage to homeowners' property and that in communal areas."

One of the Board members asked, anxiously, "But, Ursula, who's responsible? Who can we sue?"

"Fortunately, IJ Development is a solvent company and they're insured. They're responsible and they'll pay." Sighs of relief were heard all around the table.

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# Points of Law 9

## Shangri-La Gardens Intentional Misconduct

### 9.1 Who Shall Bear the Loss?

The condo owners in this story have taken losses. Water has come into their bonus rooms and spoiled their carpets, wall coverings, and furniture. Mildew is attacking. Unpleasant odors persist. Though many would like to, they can't sell their units now because the source of water intrusion has not been determined and problems have not been corrected. The market value of a unit may be less than the amount owed on the mortgage. The owners want compensation. They and their lawyers want to transfer the loss so that it will fall on the persons who are responsible for the problem. One of the functions of the law is to determine under what circumstances it is appropriate to transfer losses and the procedures by which this may be achieved.

The person who should bear the loss is the one who dishonestly and surreptitiously substituted Econ-O-Coat for Superseal. Since Econ-O-Coat is damp-proofing material and not waterproofing material, once the substitution was made, the water intrusion and the damage to condo owners was inevitable. Alex, the truly responsible person, has absconded with his loot, leaving behind his company, Eternal Waterproofing.

The owners must therefore seek to transfer their loss to parties who are more or less innocent of wrongdoing. The first target is IJ Developers. Iggy Jones accepted a low bid (perhaps suspiciously low) from a waterproofing subcontractor that, although it was properly licensed, was not known to Iggy either personally or by reputation. IJ Developers did not inspect the work closely enough to detect the switch from Superseal to Econ-O-Coat.

Carl Dunn, who sold out to Alex and then acted as his superintendent, bears responsibility because he briefly participated in the deception, and didn't blow the whistle.

To determine the potential liability of these parties we look to three branches of law: *torts*, *contracts*, and *sales*.

### 9.2 Branches of Law

The function of *tort law* is to deter wrong conduct by requiring wrongdoers to compensate innocent people who are damaged by the wrongdoing.

The law of the *contracts* seeks to deter breaches of contract by imposing loss caused by breach upon the breaching party.

Sellers of defective goods are responsible under the law of *sales*.

### 9.3 Torts vs. Contracts

Although the condo buyers do not have contracts with Alex or Carl, they have rights against them under tort law, which provides compensation for damages caused by conduct that the defendant knows, or should know, will cause unjustified injury. Alex and Carl are liable to the condo owners even though they had no way of knowing who they would be as personal individuals. The whole purpose of the development was to build condos for sale so Alex and Carl knew that the buyers would be damaged even though they might not have known their individual identities. The condo owners should try to find out whether Eternal Waterproofing carried liability insurance. Even though Alex has disappeared the owners could make a claim against his liability insurance carrier. They will find, to their disappointment, that most liability insurance policies do not cover damages caused by intentional misconduct.

The condo owners may also have a tort claim against Iggy and his company, IJ Developers. This claim would depend on showing that IJ negligently failed to provide proper waterproofing.

### 9.4 Negligence

Negligence is defined as failure to exercise due care to avoid causing foreseeable harm. It would come down to a question of whether Iggy exercised due care to prevent Alex from substituting Econ-O-Coat for Superseal. The case against IJ would run as follows: The circumstances of the low bid submitted by Alex should have made Iggy suspicious enough to investigate Alex's background and to carefully inspect the "waterproofing" materials and their application. Careful inspection would have revealed the fraud and prevented the loss. Iggy knew that the waterproofing work would be covered up when the walls were backfilled and that the potential condo purchasers would have no opportunity to inspect the waterproofing for themselves. So he had a heightened duty to make rigorous inspections in order to make sure that the waterproofing was properly performed.

### 9.5 Sales

The owners would also have a case against IJ Developers under the law of sales. When a developer sells a residence the law imposes in favor of the buyer an *implied warranty of habitability*. Water intrusion breaches that warranty and entitles the buyers to compensation.

### 9.6 Liability Insurance

When the condo owners make their claims against IJ Developers, Iggy will tender the claims to his liability insurance carrier. Whether the claims are covered will depend on the type of policy that Iggy purchased. The standard form policy excludes damage to work performed by IJ Developers or its subcontractors. The broad form covers damage to work performed for IJ Developers by subcontractors. Therefore the standard form would not cover but the broad form would.

### 9.7 Property Insurance

The condo owners should look at their homeowners policies. The damage to their new units might be covered, although it must be said that many homeowners policies exclude coverage for damage caused by water intrusion.

## 9.8 Mechanics Liens

Economy Builders Supply recorded a mechanics lien for \$28,000, which included the unpaid balance for the Econ-O-Coat material plus the unpaid balance of Carl's delinquent account.

Carl's old delinquent account is "not lienable" because it is for materials that were not used on the Shangri-La Gardens project. The underlying purpose of the mechanics lien law is to prevent a property owner from being unjustly enriched. Shangri-La Gardens owners could not be enriched by materials that were not consumed on the Shangri-La Gardens job!

There are also a couple other defenses to the lien. Economy Builders Supply may not be able to fulfill the requirement that it sold its materials with the specific intention of improving the Shangri-La Gardens job.

If Economy Builders Supply does prove that it delivered the Econ-O-Coat with the intention that it be used on the Shangri-La Gardens job, that could raise another defense. Economy Builders Supply had sold Superseal for the Shangri-La Gardens job. Therefore Economy Builders Supply should have suspected that Econ-O-Coat was destined to be misused as waterproofing rather than damp-proofing. This would bring into play the doctrine of "unclean hands". The mechanics lien remedy is known as an "equitable remedy" that can be defeated if the property owner can show that the mechanics lien claimant has unclean hands. Economy Builders Supply would have unclean hands if it knew the materials for which it claims mechanics lien rights were to be misused to the detriment of the condo owners.