Contracts Tea no. 15 (November-December 2012)

SOUTH CAROLINA

A purchaser of a home containing defective windows which allegedly caused damage to the home and to personal property has difficulty formulating a theory to obtain meaningful recovery.

This dispute arose from allegations that MI Windows and Doors, Inc. ("MI") manufactured, marketed, and sold windows containing defective seals.[1] The defective window seals allowed water to seep into the house resulting in damage to walls, finishings, and personal property. Janna Walsh brought a class action suit against MI in the E.D.PA. in diversity; the matter was later transferred to D.S.C. The court applied Pennsylvania substantive law and federal procedural law. Walsh presented (1) claims for unfair or deceptive acts or practice under the Pennsylvania Unfair Trade Practices and Consumer Protection Law ("UTPCPL"); (2) breach of express warranty; (3) breach of implied warranty; and (4) a request for declaratory relief. MI sought dismissal of each through a Rule 12(b)(6) motion. Walsh's UTPCPL claim was the lone survivor of MI's motion.

MI argued that the economic loss doctrine warranted dismissal of the claim. The court rejected the dismissal but only because Walsh alleged that some personal property was damaged. Indeed, the business economic loss doctrine did bar recovery for the bulk of damages. The court reasoned that the economic loss doctrine limits tort awards where the damages emanate from a contract and involve the product itself. Under this limitation, recovery is not possible when a component part of a product causes damage to the larger product. When a product causes damages, tort awards are only proper where there is physical injury or damage to property *other* than the product itself (being the focus on the product *purchased* as opposed to the component manufactured by the defendant.) These limitations apply even where, as here, intentional fraud is alleged in a UTPCPL claim.

Since the product that Walsh purchased was the home (being the windows a component of it), the business economic loss doctrine barred recovery for damages to walls, carpets, finishings, etc., which were all part of the home. As said, however,Walsh's UTPCPL claim survived the economic loss doctrine as to personal property. Arguments by MI that Walsh could not show justifiable reliance (a requirement for a UTPCPL claim) were rejected.

The court dismissed the breach of express warranty claim without prejudice

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[1] Walsh v. MI Windows & Doors, Inc., 2012 U.S. Dist. LEXIS 142803 (October 3, 2012).

because Walsh failed to allege that MI's warranty was a basis of the bargain for her home[2] and because Walsh did not notify MI of the warranty breach before bringing suit.[3]

The court dismissed without prejudice also the breach of implied warranty claim because it was not brought within the four-year statute of limitation period and Walsh was unable to establish fraudulent concealment to toll the running of the limitations period.[4]

Walsh sought declaratory relief on behalf of all potential class members who own defective MI windows but have not yet suffered harm. The court held declaratory relief to be inappropriate at this stage of the litigation where Walsh's substantive claims had yet to be adjudicated.

Evidence that a developer has not paid the project full contract price to the general contractor allows a subcontractor to proceed on *quantum meruit* against the developer.

These are the facts that led to the decision in *Williams Carpet Contractors, Inc. v. Skelly*, 734 S.E.2d 177 (October 24, 2012).

For a number of years, Williams Carpet (a flooring installation company) provided Skelly (builder/developer) with materials for various projects under oral agreements. M.S. Industries, which was owned by Skelly along with another fellow shareholder, acquired a property for development. Skelly selected flooring materials from Williams Carpet for the

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[2] Pennsylvania does not follow a consumers' expectation law. Indeed, under Pennsylvania law, a promise made by the seller which relates to the goods and becomes a basis of the bargain creates an express warranty. Plaintiff, however, must have read, heard, saw, or knew of the advertisement containing the promise. Walsh's complaint failed to allege that she or other class members minimally knew of MI's express warranty prior to purchasing their homes.

[3] As it is common, Pennsylvania law requires the home buyer to notify the seller of a warranty breach before seeking recovery. Although the complaint contained conclusory allegations that MI was made aware of the breach in advance of litigation and that MI had received thousands of notices from dissatisfied customers and notice through various court proceedings, it failed to specifically allege that Walsh or any of the class members provided notification to MI.

[4] Under a fraudulent concealment theory Walsh was required to plead "(1) an affirmative act of concealment; (2) which misleads or relaxes the plaintiff's inquiry, who (3) exercised due diligence in investigating his cause of action." (Citations omitted). Fraud requires particularity as to the underlying facts under the heightened pleading standard. The court held that Walsh's allegations did not meet the pleading standard because they failed to allege any communications at all with MI that would ground an implied warranty.

project but did not inform it that anybody else was involved in the developing. M.S. Industries hired Baldwin Construction Company as the general contractor and later replaced them with Ruonala and Company ("Ruonala"), again, without informing Williams Carpet. After beginning installation work, Williams Carpet was troubled by Skelly's request that all invoices be sent to Ruonala. Skelly ensured Williams Carpet that all invoices would be paid and it relented.

After completing work for five of the six homes of the development, Williams Carpet informed Skelly that it had not been paid, was considering filing a mechanic's lien, and would not perform additional work until it was compensated. Skelly asked Williams Carpet not to file a mechanic's lien and ensured that payment was forthcoming upon completion of the final home. Skelly asked that all invoices be sent to him and Williams Carpet performed the work on the final home. Williams Carpet only received a fraction of the amount due.

Williams Carpet brought a *quantum meriut* action against Skelly. The jury found in favor of Williams Carpet and awarded $168,000 in damages. In a subsequent motion for JNOV, Skelly argued that M.S. Industries had already paid Ruonala the full contract price and the jury award would unfairly force Skelly to pay twice. Williams Carpet, however, had introduced certain evidence at trial that Skelly had not paid Ruonala the full contract price. The trial court ultimately ruled in favor of Skelly's JNOV motion.

The South Carolina Court of Appeals sided with Williams Carpet's argument that the evidence that Skelly had not paid Ruonala the full contract price precluded the grant of the JNOV motion. The court outlined the elements for *quantum meruit* which are (1) a benefit conferred upon the defendant; (2) where the defendant realized the benefit; and (3) retention of the benefit. However, the court added that when an unjust enrichment claim by a subcontractor against a property owner is at issue, courts typically deny recovery when the property owner paid on its contract to the general contractor. However, the evidence submitted by Williams Carpet that Ruonala was not fully paid *on the contract* was sufficient to overturn the grant of the JNOV.

Skelly also argued that the existence of a contract between Williams Carpet and Skelly and Williams Carpet's failure to pursue a mechanic's lien precluded a *quantum meruit* award. Although there is a circuit split as to whether, as a matter of law, a subcontractor's failure to pursue a mechanic's lien bars *quantum meruit*, the court noted that South Carolina allows *quantum meruit* to proceed where plaintiff can "otherwise prove circumstances establishing unjust enrichment." In particular, Skelly had persuaded Williams Carpet not to pursue a mechanic's lien when it threatened to do so. Therefore, a *quantum meruit* claim was appropriate.

Although a plaintiff cannot recover under *quantum meruit* when "the tasks the plaintiff is seeking compensation for under a quantum meruit theory are encompassed within the terms of an *express contract* which has not been abandoned or rescinded", here Williams Carpet had abandoned its contract claim with no objection at an earlier stage of the litigation. (Emphasis added). The jury never considered whether a contract was formed and never concluded that an express contract existed. The result, held the court, was that Williams Carpet was not barred from *quantum meruit*.

South Carolina Supreme Court holds that the retroactivity provision in Act 26 violates the Contract Clauses of both the state and federal constitutions.

In *Harleysville Mutual Insurance Co. v. South Carolina,*[5] the S.C. Supreme Court decided whether Act 26 was unconstitutional because, among others, in violation of the state and federal Contracts Clauses.

Act 26 of the South Carolina Acts and Joint Resolutions[6] provided regulation for commercial general liability insurance policies ("CGL policies") for work related to construction. The legislation inserted *retroactively* into existing CGL policies an express definition of the term "occurrence" which was previously defined by case law. The Court's task was to determine whether this new definition clarified existing law and therefore did not offend the Contracts Clause or fundamentally changed the definition. The petitioner had challenged the statute because it did not want to insure more risk under this new statutory definition than it previously bargained to insure.

The majority wrote that prior case law of the Court implied "that a CGL policy *may* provide coverage where faulty workmanship causes third party bodily injury or damage to other property besides the defective work product." (Citations omitted). This left opened the possibility that there would be instances where coverage was not provided in a faulty workmanship scenario. Also in a prior case, the Court held that occurrence "traditionally means an 'accident' or a 'continuous or repeated exposure to substantially the same general harmful conditions.' " (Citations omitted). The Court opined that Act 26 rewrote and expanded the occurrence definition to include faulty workmanship language (and applied this language retroactively) as follows:

> Commercial general liability insurance policies *shall* contain or be deemed to contain a definition of "occurrence" that includes:

[5] Opinion No. 27189 (November 21, 2012).

[6] 2011 S.C. Acts 88.

(1) an accident, including continuous or repeated exposure to substantially the same general harmful conditions; and
(2) property damage or bodily injury resulting from faulty workmanship, exclusive of the faulty workmanship itself.

For an alleged Contract Clause violation, the analysis is whether (1) there is a contractual relationship; (2) the change in the law impairs the contractual relationship; and (3) the impairment is substantial. Clearly a contract was at issue here so the only issue was whether the retroactive change to the meaning of occurrence *substantially* impaired existing CGL policies. The Court held hat it did because the new definition materially changed the terms of existing contracts.

The next inquiry of the Court was whether Act 26 "was reasonable and necessary to effectuate a legitimate legislative purpose." The Court reached the conclusion that Act 26 was not adopted to "address a pressing emergency". The Court held that the retroactivity provision in the statute was neither "reasonable nor necessary" and was therefore unconstitutional. As a result of the Court's holding, Act 26 is now only applicable to CGL policies issued *after* its adoption.

New York

For unjust enrichment plaintiff has to plead a relationship between the parties inclusive of business dealings.

In *Georgia Malone & Co., Inc. v. Rieder*,[7] a real estate company ("Malone") brought an unjust enrichment claim against a rival firm, Rosewood Realty Group, Inc. ("Rosewood"), and other parties involved in a commercial property transaction. Malone prepared due diligence reports for CenterRock Realty, LLC ("CenterRock") related to various properties which CenterRock was considering purchasing. CenterRock agreed to pay Malone for the services and to keep the due diligence materials confidential. CenterRock later entered into a contract to purchase the properties. After repeatedly representing that it would be ready to close on time and would compensate Malone for its work while Malone continued to provide materials, CenterRock ultimately terminated the agreement to purchase the properties during the due diligence period which it was contractually able to do with no penalty. When Malone demanded that its commission be paid, CenterRock refused. CenterRock's managing member ("Rieder") sold Malone's due diligence materials to

[7] 19 N.Y.3d 511 (June 28, 2012).

a third party -- but for the purpose of selling the materials to Rosewood. Rosewood paid Rieder for the materials and helped to close the transaction which resulted in a commission to Rosewood.

The New York Court of Appeals faced the issue of whether or not a sufficiently close business relationship existed between Malone and Rosewood to support a claim for unjust enrichment against Rosewood for the sales commission it received.

The Court enunciated the relevant elements which are "that (1) the other party was enriched, (2) at that party's expense, and (3) that it is against equity and good conscience to permit the other party to retain what is sought to be recovered." (Citations omitted). It then held that the relationship between the competitor firms was "too attenuated" to support a claim of unjust enrichment. While conceding that privity between the parties was not required, Malone and Rosewood lacked the required relationship because they had no dealings with each other. Malone's allegations of Rosewood's awareness that Malone created the reports and expected to be reimbursed by CenterRock if a purchase agreement was reached fell short. The Court also held there were no allegations that Rosewood knew that the materials were confidential or that Malone had not been compensated by CenterRock.

Ultimately, the Court disfavored a rule imposing a burdensome requirement that a purchaser such as Rosewood investigate the relationships between parties with which they have no direct connection. In the Court's view Malone should more properly recover from CenterRock or Rieder. The dissenter in *Malone* would have focused on the equity and good conscience elements to hold that an unjust enrichment claim could proceed.

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