

To Whom Is The Contract To Benefit? Court of Appeal Rules
That Attorneys' Fee Provision In Standard Residential Subcontractor
Agreement May Apply In Favor of Homeowner As A Third Party Beneficiary
Even Though Homeowner Was Not A Party To Subcontractor Agreement

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In a published decision which may have significant impacts, a California Court of Appeal has recently ruled that an attorneys' fee provision in a routine residential subcontractor agreement between a general contractor and subcontractor applied in favor of a homeowner in the homeowner's capacity as a third party beneficiary even though (i) the homeowner in that case was not a party to the subcontractor agreement and (ii) the attorneys' fees awarded to the homeowner were three (3) times the total amount of the subcontractor's compensation under the subcontractor agreement.

This decision was rendered in the matter of Loduca v. Polyzos (2007) DJDAR 10877 ("Loduca case"). In that case, the California Court of Appeal, Third Appellate District, ruled that a homeowner, as a third party beneficiary, could recover attorneys' fees as a prevailing party in a litigation with a subcontractor for a home remodeling project even though the homeowner was not a party to the contract with the subcontractor and the subcontractor had been sued in contract and tort for breach of the subcontractor agreement between the subcontractor and general contractor.

The facts of the Loduca case are common enough. In 1998, plaintiff Vincent Loduca began to develop a custom home for his family in the Sacramento area. Loduca entered into a general contractor agreement with MCM Builders, a general contractor builder. MCM Builders then solicited bids from among others, George Polyzos, doing business as Quality Manufacturing Company ("QMC"). QMC agreed to manufacture and install custom cabinetry in the home for a total cost of \$63,947.64. In the course of the project, a dispute arose when certain of the cabinetry goods were found by Loduca to be unsuitable because, according to him, cabinet doors did not fit and other doors and parts were missing. When the balance owed to QMC (which was less than \$15,000.00) was not paid, all of the cabinetry that had not been fastened or nailed down were taken out of Loduca's home without his permission. QMC never completed the job.

An altercation later took place between a QMC representative and Loduca at a warehouse near Loduca's home which resulted in the QMC representative filing a civil complaint against Loduca for assault and battery. Thereafter, Loduca filed a cross-complaint against the representative and QMC for breach of contract, fraud, negligent misrepresentation, conversion, assault and battery and intentional and negligent infliction of emotional distress (punitive damages were also sought). The complaint was later compromised and dismissed. Loduca's claims were then tried without a jury. On the second day of trial, QMC's counsel stipulated that its client had breached the contract and thereafter counsel stipulated that the total amount of contract damages was \$40,000.00. At the conclusion of the trial, the trial court determined that the contract had been breached and awarded attorneys' fees to Loduca in the amount of \$190,350.00. Based on those findings as well as others by the trial court, both sides appealed.

With respect to the issue of attorneys' fees, QMC appealed from the trial court's award of attorneys' fees on the basis that Loduca was not a party to the subcontractor agreement between QMC and MCM Builders and that Loduca could not claim third party beneficiary status to recover attorneys' fees in the context of Loduca's cross-complaint.

On appeal, the Court of Appeal found that Loduca was a third party intended beneficiary to the subcontractor agreement citing Kaiser Engineers, Inc. v. Grinnell Fire Protection Systems Co. (1985) 173 Cal.App.3d 1050, 1055, Civil Code section 1559 and other authority. In its reasoning, the Court stated that the trial court had properly determined the contracting parties (QMC and MCM Builders) must have intended to benefit Loduca as the work was being performed for the homeowners' benefit.

However, the Court of Appeal also found that the subcontractor agreement was written broadly enough so that, if the subcontractor would have prevailed, it could have been awarded attorneys' fees against the homeowner and, therefore, under the reciprocity rule under California Civil Code section 1717, the homeowner was likewise entitled to attorneys' fees in the event it prevailed against the subcontractor (Civil Code section 1717 provides that if an attorneys' fee clause applies in favor of one party, it must be construed in favor of all parties who prevail on any dispute). In this regard, the Court of Appeal cited Real Property Services Corporation v. City of Pasadena (1994) 25 Cal. App. 4th 375, 382, a breach of contract case in which a movie theater operator had sued the City of Pasadena as a third party beneficiary to a lease which was entered into between a developer and the City of Pasadena (the movie theater operator lost and the Court of Appeal in that case ruled that since the operator was named

in the lease with the City of Pasadena and would have been entitled to attorneys' fees had it prevailed, the City of Pasadena was entitled to its attorneys' fees).

In considering the impacts which may result from the Loduca case, there are two issues which must be considered. First, the Court of Appeal's ruling that the homeowner was a third party intended beneficiary under Civil Code section 1559 is consistent with California precedent which has found that a property owner may sue a subcontractor for the implied warranty of fitness, even though the property owner is not a party to the subcontract and may not even be named in the subcontractor agreement. See, Gilbert Financial Corporation v. Steel Form Contracting Co. (1978) 82 Cal.App.3d 65 and Kaiser Engineers, Inc. v. Grinnell Fire Protection Systems Company, Inc., *supra*, see also, Miller & Starr, California Real Estate (2007) chptr. 29 "Defective Construction" sec. 18.

However, what is somewhat surprising is that the Court of Appeal found that the homeowner could have been liable for attorneys' fees to the subcontractor if the subcontractor had prevailed against the homeowner. The Court of Appeal reasoned that the language of the subcontract and the intent of the parties, as manifested by the language of the subcontract, will require, as in that case, a case by case analysis to determine third party beneficiary rights and obligations. The Court of Appeal cited the decision in Kaiser Engineers, Inc. v. Grinnell Fire Protection Systems Company, Inc., *supra*, a case where an engineering firm was found to potentially be a third party intended beneficiary to an indemnity contract between a general contractor and a government agency, as an example where the third party could be an intended beneficiary to an attorneys' fee clause as well as the decision in Real Property Services Corporation. The Court of Appeal also cited the case of Sessions Payroll Management v. Noble Construction Co., Inc. (2000) 84 Cal.App.4th 671, a case where a payroll management company for a subcontractor failed in its claim of third party beneficiary status with respect to a subcontractor agreement between its client, the subcontractor, and a general contractor, as an example where third party intended beneficiary status did not exist. However, the two cases which were cited which dealt with construction contracts, Kaiser Engineers, Inc. and Sessions Payroll Management, present different factual scenarios in comparison to the Loduca case and the decision in the Loduca case does appear to be an expansion of existing precedent in the context of construction contracts.

As to this second issue, the Loduca court's reasoning appears to be on less than firm ground. The authors are not aware of any case wherein a subcontractor has successfully sued a homeowner, not a party to the subcontract between the subcontractor and general contractor, and won an award of attorneys' fees against the homeowner on a third party beneficiary theory. In fact, in routine mechanic's complaints against homeowners by subcontractors

who are not in privity with the homeowner, rarely are breach of contract claims even asserted against the homeowner.

The Loduca case could therefore have substantial impacts for homeowners as well as subcontractors, although the case is likely more problematic for subcontractors. Unless a subcontractor agreement specifies who are the intended beneficiaries to the contract and who might be considered a prevailing party under the subcontractor agreement, a question at least exists as to the liability of the homeowner and the subcontractor for what could be substantial attorneys' fees. Subcontractors and homeowners alike may therefore be well advised to consider the inclusion of language in their subcontractor agreements as to what parties may be considered a "prevailing party" for purposes of an attorneys' fee clause.

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