

**A SURVIVOR'S GUIDE TO
CONSTRUCTION DEFECT RESOLUTION
An Overview**

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PURPOSE OF THIS GUIDE

Over the last 15 years we have found that Associations are not always aware of their rights when their projects are impacted by defective construction.

Defects in residential construction are common. Associations may not know how to compel the project's developer to remedy the defects. The alternative may be a substantial homeowner assessment for expensive repairs.

The purpose of this guide is to help an Association Board and Association managers understand the construction defect resolution process and how to take full advantage of the Association's legal rights.

INTRODUCTION

Levin & Edin has helped over one hundred condominium and townhome Associations resolve their construction defect claims with the developers of their projects.

In the course of our work we have come to appreciate the following:

- Seriously defective construction is common.
- It is often extremely expensive to correct.
- If correction is unreasonably delayed, the physical damage caused by the defective construction significantly increases, and so does the cost of the corrective work.
- It is common for defects to remain hidden until long after serious damage has already taken place inside the building envelope, and valuable Association rights have been lost or otherwise compromised.

An early, proactive approach to evaluating the construction can avoid substantial homeowner assessments for expensive repairs.

THE ASSOCIATION'S RESPONSIBILITIES

Often Association Boards wait too long before acting. They do so for a variety of reasons.

- They are not aware of defects.
- They are not aware of the seriousness of the defects.
- They are not aware of their Association's rights against the developer.
- They are not aware of the time limits imposed by law.

Regardless of the reason for Board delay, the result is often increased physical damage, a more costly fix, and the potential loss of valuable rights.

To avoid that situation, a Board needs to understand an Association's responsibilities to unit owners, and an Association's rights against the developer.

Typically, it is the responsibility of the Association, and not of individual unit owners, to maintain the Association's common areas. Where the damage within a unit is the result of a common area defect, the Association is responsible.

Once transition has occurred from developer control to home-owner control, common area problems become the responsibility of the Association's homeowner Board members.

Board members have a duty to the Association to act in good faith and in a manner that they reasonably believe to be in the best interests of the Association. Failing to take the necessary steps to enforce Association warranty rights or otherwise ignoring defective construction can give rise to personal liability for Association directors who breach that duty.

TOP 10 CONSTRUCTION DEFECTS

Some of these defects may be obvious to homeowners. Other defects may not be apparent, and the resulting damage may not become observable for many years. For example, defects causing water intrusion can cause structural damage and mold growth that gets progressively worse, and remains hidden for years. A proactive approach by the Board to reduce this risk is discussed in this Guide. The top ten defects are:

1. Improperly manufactured or installed windows, resulting in water intrusion, air leakage, physical distortion of the window frames and other problems.
2. Installation of exterior building material (brick, plaster, wood, etc.) without adequate allowance for expansion and contraction due to weather conditions, which results in cracking, water intrusion and other problems.
3. Inadequate ventilation of crawl spaces and attics, and other construction defects resulting in excessive humidity and mold growth in those areas and in the creation of ice dams on roofs.
4. Improperly sloped decks and balconies, which causes rain water to be directed into the building rather than away from it.
5. Improperly sloped or installed roofs, resulting in excessive ponding of rain water, roof leaks and premature deterioration of roof materials.
6. Improperly installed framing, resulting in reduced structural strength of framing members, sagging horizontal surfaces and excessive susceptibility to wind damage.

7. Improperly installed plumbing and heating systems, leading to their premature deterioration, leaks, and excessive noise transmission when in use.
8. Improperly installed ceiling and wall systems, resulting in excessive noise transmission between units.
9. Improperly waterproofed planters and garage walls, leading to water seepage into garages and other building locations.
10. Improper preparation of soils to compensate for periodic subsurface frost conditions, resulting in heaving hardscape and other project problems.

WHY CONSTRUCTION DEFECTS ARE SO COMMON

Since construction is subject to inspection and approval by City or County inspectors, why is defective construction so common?

- A. The inspector may not be properly trained or qualified.
- B. The inspector may not do his or her job properly. If the weather is unpleasant (cold, rainy or windy, for example), the inspector may be inclined to perform a cursory inspection rather than a more careful one.
- C. The inspector rarely inspects all of the work. Instead, “spot” inspections are performed. This means the inspector will miss defects in the parts of the work that were not inspected.
- D. The inspector often limits inspections to that portion of the work which involves public health or safety issues, such as the structural aspects of the construction. Other aspects, such as whether the construction will allow water intrusion, may be ignored.
- E. In many states, including Minnesota, government agencies and their employees usually enjoy immunity from liability, in most instances. Since building inspectors and the cities and counties that employ them are rarely held accountable for construction defects, they may have limited incentive to ensure that builders avoid construction practices that result in construction defects.

WORKING WITH THE DEVELOPER

An Association should always work with the developer in an effort to resolve claims.

Developers tend to want to offer inexpensive, temporary fixes where more expensive, permanent and costly fixes are required. Developers may also seek to drag out the inspection and claim resolution process.

A lawyer can help a Board to select the right consultant, define the consultant's duties, and make sure that the developer responds to a Board's concerns in a timely manner.

WHAT IF THE DEVELOPER GOES OUT OF BUSINESS?

If a developer goes out of business, claims may exist as to other persons and entities.

Historically, the resolution of most construction defect claims has been funded by insurance companies for the developers and their contractors. While insurers occasionally go out of business, most do not.

Even after the developer has gone out of business, its insurance will often fund resolution of the construction defect claim.

The sooner the claim is made the better. Otherwise, rights may expire and insurance policies may be exhausted.

STEPS A BOARD SHOULD TAKE TO PROTECT THE ASSOCIATION'S RIGHTS AND WHEN IT SHOULD TAKE THEM

As soon as possible after transition of Association control from the developer, the Board should distribute homeowner surveys, and retain a consultant to review the responses and to perform a building envelope inspection. A failure to do so can result in a loss of legal rights and/or an increase in damage and consequent cost of repair. We have included in the Guide the survey that we usually use.

If the investigation confirms the presence of serious defects, deliver a copy of the consultant's findings to the developer. Invite the developer to take the necessary corrective actions as explained in the consultant's report.

Throughout this entire process the Board needs to keep clearly in mind the time limits for giving the developer notice of a defect, and taking legal action. The time limits can be as short as six months, and are discussed generally in this Guide.

WHY YOU NEED A PROFESSIONAL EVALUATION OF YOUR PROJECT

Many of our clients want to know why it is important to obtain an evaluation of the construction quality of a condominium, townhome or Co-op housing project, or of a single family home, by a qualified professional. After all, won't defects be apparent to the homeowners without such an evaluation?

Take for example water intrusion. Damage from water intrusion usually starts inside the building envelope and works its way out to the exterior and interior surfaces. As a result, it may take several years before the damage becomes apparent to a homeowner.

Even where damage becomes apparent, homeowners need the independent advice of a qualified professional to ensure that the developer's proposed fix is appropriate and not merely a temporary solution.

Improper construction can be very expensive to correct. A developer has an incentive to minimize a problem and avoid necessary and permanent corrective work.

Developers tend to treat rain water leaks as a maintenance issue whereas it usually is a result of defective construction. Even when confronted with an obvious defect issue, developers are more likely to offer a temporary, band-aid type fix instead of a permanent fix.

If a problem is not apparent or is apparent but not properly addressed, damage will continue to occur inside the building envelope, and the ultimate cost of repair will continue to go up.

Inspection by an independent and qualified professional may lead to discovery of a problem early on, before serious damage has occurred. It may also result in discovery of a problem before valuable legal rights have been lost by the passage of time.

WHO IS BEST SUITED TO DO THE EVALUATION — AND WHO ISN'T

What do we mean by an evaluation by an independent, qualified professional?

The inspection should be performed by someone who does not work for or owe allegiance to the builder. Also, the inspection should be performed by a "qualified professional". This typically means an engineer or architect with experience in construction quality assessment. Contractors and home inspectors may be ineffective in discovering serious defects which are not obvious.

THE EVALUATION PROCESS

STEP 1 - Initial Site Inspection

We recommend that an evaluation start with a review of homeowner survey responses, followed by an initial site inspection.

As we said before, defects can remain hidden for many years and may not become apparent on an initial site inspection until after serious damage has occurred. Therefore, after the initial site inspection, the consultant should actually look inside the building envelope to check for water intrusion and damage.

STEP 2 - Inspecting Inside The Building Envelope

While an initial site inspection may take several hours, a more thorough investigation may take several days. During this more thorough investigation the consultant will look inside the building envelope at a number of locations.

Once a small portion of a building's exterior surface is removed, the investigator can observe whether there is water intrusion and damage.

After the field investigation is completed, a written report will be prepared.

All consultant reports should be referenced in Board minutes so that there is a permanent record of what the Board did to protect Association legal warranty rights and when they did it.

Some Associations have discovered defects and damage costing millions of dollars to repair after legal rights against the developer had expired. An early inspection is generally prudent and cost effective, given the potential financial risk to the Association from defective construction.

COST OF THE EVALUATION

The cost of a thorough evaluation of construction quality depends on a number of factors, including the size of the project, and the scope of the investigation. The larger the project, the more extensive the investigation required.

A written proposal should be obtained, including a fixed price or a budget that spells out exactly what will be done and what it will cost. If the exact cost cannot be given, a "not to exceed sum" should be provided.

PREFACE TO WARRANTY SECTION

This section discusses some of the law applicable to the making and resolution of construction defect claims. However, it is intended to serve only as a general guide and is not a substitute for legal advice. For such advice, please consult a lawyer and preferably one who has substantial experience in this area of law.

For example, please note that the discussion in this Guide of the time within which an Association may assert a claim does not take into account the impact that the dissolution of the developer entity may have on that time period. Such dissolution, for example, may drastically shorten the time within which a claimant might otherwise be permitted to assert a claim.

A SUMMARY OF AN ASSOCIATION'S STATUTORY WARRANTY RIGHTS

The Minnesota Common Interest Ownership Act

The Minnesota Common Interest Ownership Act (MCIOA) governs condominium, townhome and most co-op housing Associations formed on or after June 1, 1994. That Act contains warranties against defective construction.

Associations may have as little as two years, and never more than six years, to take legal action, depending on the terms of the initial purchase agreements. The time period can begin to run as early as the sale of the first unit.

Disclaimers or waivers of statutory warranty rights are generally legally invalid.

Chapter 327A Warranties

Claims may be asserted under Chapter 327A of the Minnesota Statutes as well as MCIOA discussed above. If the statutory warranties under MCIOA have expired, an Association may have to rely on the warranties provided in 327A.

327A creates statutory warranties against defects in new construction similar to the MCIOA warranties. But whereas the MCIOA warranties generally apply only to condominium, townhome and co-op housing projects, 327A warranties apply not only to such projects, but also to both attached and detached single family homes.

Under 327A, the claimant must give the developer written notice of a defect within six months after the defect was or should have been discovered. Legal action must be started within two years after breach of the 327A warranties, but no later than ten (and in some instances up to twelve) years after initial sale or occupancy. Breach occurs when the claimant knew or should have know that the defect was not going to be corrected.

Statutory Warranty Rights and Declarant Disclosure Requirements in Conversion Projects

MCIOA applies to all common interest ownership projects regardless of whether they are newly constructed or conversions. However, the Act's statutory (implied) warranties and disclosure requirements may vary, depending on whether the condominium project is new or a conversion.

The Bottom Line: Timing is Everything.

Under MCIOA, an Association may have as little as two years in which to take legal action, regardless of when the Association finds out about the defect. In most single phase projects that period will start to run on termination of developer control.

Normally, an Association will also have two years in which to take legal action under 327A. Under that Act the two year period will start to run when the Association should have become aware of the warranty breach, which may be before it actually became aware of the breach.

CONTRACT (EXPRESS) WARRANTY RIGHTS

Sales contracts between the developer and original purchasers may contain express provisions giving the buyer a warranty against defective construction of the home. Such warranty rights are referred to as "express warranties" or "contractual warranties."

Express or contractual warranty rights are separate from warranty rights created by statute. Statutory warranty rights exist regardless of whether mentioned in sales or purchase contract documents.

Express warranty rights contained in a sales contract are often of limited value. The warranty period provided in the contract is usually short, the warranty rights usually must be exercised within the warranty period, and conditions usually are imposed that restrict buyers' ability to exercise these contractual warranty rights. Warranty rights under Minnesota statutes are more substantial than a seller is likely to provide in a sales contract.

Express or contract warranty provisions are often misleading, because they often purport to nullify statutory warranty rights. The attempt to nullify statutory warranty rights is usually invalid.

NON-WARRANTY CLAIMS

Negligence Claims

Negligence claims in the context of construction defects are claims arising out of substandard construction practices, such as failure to comply with the applicable Building Code. Where this substandard practice results in a construction defect, an Association may have a negligence claim against the developer and/or the contractors.

There may be circumstances under which an Association may want or need to make a negligence claim against a developer and/or against the contractors hired by the developer.

However, the right to pursue a negligence claim to recover for damage caused by defective construction has come under increasing attack in recent years by lawyers for developers and contractors. Therefore, Associations should seek to preserve their statutory warranty rights and to enforce them in a timely manner, to avoid ending up in a situation where the only claims they have left are negligence claims.

Nuisance Claims

Arguably, a substantial defect that interferes with unit owner enjoyment of his or her unit may constitute a nuisance. If so, a two year statute of limitations would appear to apply, triggered by discovery of the nuisance. If no other claim appears viable, a nuisance claim may be the only remaining claim an Association can assert.

Breach of Fiduciary Duty Claims

A breach of fiduciary duty claim may save the day for an Association that has lost all of its other rights against a Declarant (the project's developer). During Declarant control, agents of Declarant normally will sit on and control an Association Board. Such directors have a duty to act in good faith and in a manner that they reasonably believe to be in the best interests of the Association. They have fiduciary obligations to the unit owners. As a result, failure to retain a

lawyer on the Association's behalf to advise the homeowner membership or Board of the Association's legal rights to pursue warranty claims, or of the time limits imposed on the exercise of the Association's warranty rights, may breach that fiduciary duty.

A failure to cause the Association to make a warranty claim against Declarant for a known defect may also breach that fiduciary duty. Failure to cause the Association to obtain a warranty inspection is another possible ground for making a breach of fiduciary duty claim.

Breach of fiduciary duty claims may produce a favorable outcome for an Association that otherwise would have no viable claim against Declarant.

The statute of limitations on a breach of fiduciary duty claim is six years. Arguably, that six year period begins to run when Association rights are lost as a result of the breach.

Homeowner Board members should also keep in mind that they too have a duty to the Association to act in good faith and in a manner that they reasonably believe to be in the best interests of the Association. Failing to take the necessary steps to enforce Association warranty rights or otherwise ignoring defective construction can give rise to personal liability for Association directors who breach that duty. This is true regardless of whether these directors are homeowners or developer representatives.

DO YOU REALLY NEED A LAWYER?

Maybe you don't. But chances are you do. Your lawyer will help you select the appropriate consultants to evaluate your project. Some consultants are better than others. You will want help in selecting them.

You will also want help in deciding what building systems to evaluate. Do you limit the evaluation to the building envelope, or do you include other systems for evaluation as well? If a wide range of systems are to be evaluated, will more than one consultant be required? Your lawyer can help you with these decisions.

Your lawyer can also help ensure that your consultants' findings are laid out in their reports with sufficient clarity, that the conditions described are adequately documented, and that the reports' findings are adequately supported.

In addition, your lawyer can help you with the following:

- A. Does the Association have a duty to give the developer notice of its claims within a specified time period? If so, what is this time period, what should the notice contain, and how should it be served on the developer?
- B. What do you tell your homeowners during the investigation process? How is the investigation to be coordinated? How is unit access to be obtained where required?
- C. What happens if the developer claims it has no obligations to your homeowners because warranty rights have allegedly run out? What happens if the developer

claims it has no assets? What happens if the developer is out of business? What happens if the developer claims to have no insurance? Where substantial claims are involved, the developer is likely to raise some and perhaps all of the above issues.

- D. Many claims require a mediation process to achieve resolution. Who do you choose as the mediator? How should the mediation process proceed? What can be done to maximize the chances for a successful mediation?
- E. How can the necessary pressure be put on the developer to resolve the matter? How can the claimant assist the developer in pressuring the developer's insurers to help resolve the matter?

Very few Association Boards would choose to deal with such matters without legal advice. Your lawyer can explain how to deal with these and other issues as they arise.

Where there are significant defects in the construction of a project, these defects are likely to cost hundreds of thousands, and sometimes millions of dollars to correct, depending on project size and the nature of the defects. Resolution of the claim in such circumstances involves the active participation of the developer, its insurers, its contractors and their insurers.

Consequently, the dispute resolution process can be complex, and the services of a law firm with substantial experience in how to get these matters resolved is often essential. This is especially true where a large number of defects exist or where the cost of corrective work is substantial. With so many parties involved and so many dollars at issue, most claimants will need the assistance of a team of professionals. A lawyer is a necessary, and usually the key member of that team.

DO YOU HAVE TO FILE A LAWSUIT?

Nobody likes lawsuits. That is why every effort should be made to resolve a claim without a lawsuit. This means that the Association needs to take the required steps to ensure that the developer gets the information necessary to resolve a claim without a lawsuit.

However, even in situations where formal action is required, we find that in many cases the conventional forms of civil litigation can be avoided or minimized. This can be accomplished by agreeing to forego the formal litigation process by in effect "staying" any lawsuit to allow the parties to work towards a mediated resolution without trial or trial preparation.

THE MEDIATION PROCESS

Claims should be resolved using the mediation process. While the consultants for the two sides may not be able to fully resolve their areas of disagreement prior to the mediation sessions, we have found that they are usually able to narrow them. This makes it much easier to focus a

mediation on the remaining limited areas of disagreement, to get these remaining disagreements resolved by compromise, and to resolve the entire claim as a result of this mediation process.

The mediator is usually a retired judge or an attorney or some other professional who is experienced in dispute resolution. This mediator does not “try the claim”. Instead, he or she helps the parties to resolve the claim on a voluntary basis through mutual agreement, thus avoiding contentious litigation.

WHO PAYS THE ATTORNEY AND CONSULTANT FEES INCURRED IN THE PROCESS OF RESOLVING A CONSTRUCTION DEFECT CLAIM?

Under the Minnesota Common Interest Ownership Act, an Association may be entitled to an award of attorney fees. If the Association is proceeding under that Act, the Association’s attorney should insist on the developer contributing to the Association’s attorney fee obligation. Since most claims are resolved by a negotiated settlement, how much of the attorney fees incurred by the Association is paid by the developer should be part of the negotiation.

There is no attorney fee provision in the New Home and Home Improvement Warranty Act. However, even where a claim is pursued under the New Home and Home Improvement Act, or as a negligence or nuisance claim, there may be a right to an attorney fee award pursuant to an attorney fee provision in an underlying sales contract between the developer and original purchasers. There may also be an attorney fee provision in the Declaration of Covenants, Conditions and Restrictions that may be applicable to the Association’s claims.

Arguably, the consultant fees incurred in investigating and documenting the claim are necessary elements of the repair cost. They should always be included in an Association’s claim, and reimbursement should be requested as part of a negotiated settlement.

The goal is to obtain a negotiated recovery sufficient to fix all the defects discovered in the investigation and to cover all attorney fees and other costs incurred in making the claim and pursuing it to resolution.