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Debra Pogrund Stark

Andrew Cook

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Article

PAY IT FORWARD: A PROACTIVE MODEL TO RESOLVING CONSTRUCTION DEFECTS AND MARKET FAILURE

Debra Pogrund Stark* and Andrew Cook**

I. INTRODUCTION

Imagine the following scenario. A criminal law professor decides to purchase a condominium unit converted from an apartment building in the city of Chicago. The professor is the first of six buyers to purchase a unit and move into the newly converted condominium. The developer continues to work converting the remaining five units, promising the professor that rehab of the common elements will occur at the end of the conversion. The remaining buyers sign contracts with the developer and

* Debra Pogrund Stark is a professor of law at The John Marshall Law School specializing in the areas of property law and real estate transactions. Professor Stark thanks Peter Desch, Chief of the Bureau of Homeowner Protection, Dept. of Community Affairs, State of New Jersey; Joyce Murray, Senior Counsel, Office of Legislative Services, State of New Jersey; and Elizabeth Trimble, Principal Counsel of the Maryland Office of Labor, Licensing & Regulation for, their valuable insights on the protective legislation relating to defects in home construction enacted in New Jersey and Maryland, respectively. She also thanks the following attorneys in private practice who have written on construction defects and who provided feedback to her on the reform proposal outlined in this article: James Landgraf, Delran, New Jersey; Roy Scharf, Branford, Connecticut; George R. Grasser, Buffalo, New York; G. Wendell Thomas, Jr., Knoxville, Tennessee; Robert Krapf, Wilmington, Delaware; and P. Daniel Donohue, Sioux Falls, South Dakota. Professor Stark also thanks David Rutter, J.D., The John Marshall Law School, for his excellent research assistance and her co-author Andrew Cook, J.D. candidate, The John Marshall Law School, for his ability to dig deeply into a topic, his tenacity, and his good humor. Finally, she thanks Robert Gilbert Johnston, Dean of The John Marshall Law School, for his interest in and support of her legal publications and Professor Jack Gorby for sharing his war story with her and inspiring this article.

** Andrew Cook is a third-year student at The John Marshall Law School. Mr. Cook thanks Professor Stark for giving him this opportunity and for being a true mentor throughout his law school career. He also thanks his wife, Jessica, for her love, support, and tireless encouragement through law school.

pay the purchase price. Because of the lag time between each buyer actually signing the contract and moving in, the unit owners are unable to meet to discuss any potential problems with the entire building. After completing the units, the developer makes some superficial improvements to the common elements, but then abandons the property, leaving the unit owners with substantial latent defects that are not discovered until the remaining units are sold. The developer fails to upgrade the electrical wiring, costing the unit owners approximately \$20,000 in repairs. In addition, the developer fails to apply for all required city permits covering the renovation of the building. Further problems are found in the basement, where sewage is backing up from broken pipes, and the windows are discovered to be rotting out, costing the unit owners another \$10,000 to repair.

The law professor, who specialized in criminal law when in private practice, assumes that he and the other unit owners must have some recourse under the law and demands that the developer come back and fix the problems. The developer responds by quipping, "Where is that in my contract?" The developer drags his feet, fails to make the requested repairs, and eventually abandons the building and its new owners.¹

Can the developer simply walk away from these construction defects? It is our contention that even if there is a theoretical cause of action against the developer,² as a practical matter, the developer may in fact be able to walk away from a badly done job.

There are two major obstacles to successfully compelling the developer to make the repairs or pay the cost of such repairs. First, the developer and his or her partners/investors have probably made themselves "judgment proof." It is typical for a real estate developer to establish a limited liability entity, such as a limited liability company,

¹ Taking a risk, the professor decides to contact the City of Chicago building department to put pressure on the developer to fix the defects. This is a risky move because the building is currently owned by the condominium unit owners, not the developer, and the building department could choose to simply force the current owners to remedy the problem and ignore the developer. Fortunately, the building department was sympathetic to our law professor and his fellow condo owners and told the developer that it would not issue him any more permits for new developments in the city until he fixed the problems (this position is not one provided for in the current local or state laws, but is one that this article will propose as part of the proactive approach to resolving construction defects).

² Such theoretical liability could be under an implied warranty of habitability, an express limited warranty, or perhaps a tort theory of negligent construction or fraud.

which then owns the apartment building the developer is converting or the homes in a subdivision he or she is constructing. The building or homes are the sole asset that this entity owns. Once the building or the homes are sold, the investors and creditors are paid what is owed to them, and any remaining assets are shifted to other entities the developer creates for future projects. By the time the owners of the condominium building or the owners of the detached homes discover the defects, the developer/entity that sold the units and homes to them no longer has any assets from which the owners can recover.³ Consequently, even if the developer is liable to the owner for either breaching a contractual based warranty or under a tort theory, the owner will be unable, as a practical matter, to recover the costs of repairing these defects if faced with an unprofessional and unscrupulous builder/developer. As a typical home buyer might exclaim if faced with this situation, "Warranty shmoranty, show me the money!"⁴

A second major impediment to recovering the costs of remedying the defects is the time⁵ and expense involved in litigating the case. When the claim is relatively small (such as in our described scenario where \$30,000 represents approximately three percent of the amount the six unit owners paid for their units), the costs in litigating the case can consume a large portion of what is recovered in the lawsuit.⁶ Litigation is expensive due to many factors, including the fact that proving liability is not always clear-cut, especially if one is bringing a claim under the nebulous standard of the implied warranty of habitability, which requires that the defect renders the property "uninhabitable." In addition to the expense of paying for the attorney to litigate the case, the attorney may need to hire experts to prove the other elements necessary to make out the cause of action (such as the existence of the defect and that the defect caused

³ There is the possibility of "piercing the corporate veil," but as will be discussed in Part III.D *infra*, there tends to be a requirement of a showing of fraud to be able to recover against the assets of the individual shareholders or members of the entity.

⁴ David Pogrun, a "Seinfeld" fan and brother of one of the co-authors, suggested that quotation as the title to this article. It does capture the expectations and frustrations of a typical home purchaser when construction defects arise and an unprofessional builder/developer fails to stand behind his or her work.

⁵ The fact that it can take years to resolve a construction defect dispute in a court is problematic to the condominium and homeowners because they may not have the funds to make the repairs themselves, and the property can further deteriorate during this period or even become uninhabitable, thus, adding to the damages the owners suffer.

⁶ Fees associated with litigating a lawsuit range from thirty to sixty percent of the total recovery. See JEFFREY O'CONNELL, *THE LAWSUIT LOTTERY: ONLY THE LAWYERS WIN* 86 (1979).

the damage). Although express limited warranties should be clearer than the implied warranty, they are drafted by the builder/developer and may not cover the defects that have arisen. Therefore, the professor in our scenario, and the rest of the unit owners, are left with the option of years of litigation with an uncertain result against a corporation that probably has little or no assets. This same problem also arises when an individual purchases a newly constructed home. Although that person can do a thorough inspection of the entire house and routinely does so,⁷ certain defects are not discoverable from a reasonable inspection immediately after the house is completed. By the time these latent defects are discovered,⁸ the developer entity has already divested itself of its assets and made itself “judgment proof.”

The true story that opens this article strikes on a number of levels. The story shows that a developer or builder can leave the most sophisticated condominium buyer facing material expenses from latent defects, and also, the likelihood of no practical remedy. Furthermore, if the amount at issue is relatively small, for example, a \$3,000 flooding problem in a single-family detached house, the new owner may in fact decide not to seek recovery from the developer because the costs of the lawsuit could exceed the amount at issue.⁹

One may wonder, how widespread is this problem? How often do construction defects arise that are not handled in a responsible fashion by the builder/developer?¹⁰ This problem becomes particularly acute

⁷ With a condominium purchase, the purchaser rarely inspects the common elements of the building, especially if there are a large number of units for the building. But, pursuant to state condominium laws, there is typically a lengthy Property Report that is provided to the purchaser that should disclose the condition of the common elements.

⁸ Most defects are usually discovered within one year of closing, but defects to masonry and concrete often are found several years later. See PAUL GOLDSTEIN & GERALD KORNGOLD, REAL ESTATE TRANSACTIONS: CASES AND MATERIALS ON LAND TRANSFER, DEVELOPMENT & FINANCE 208 n.1 (rev. 3d ed. 1997).

⁹ It is highly doubtful that a home purchaser could bargain for the purchase contract to provide for attorney’s fees in a successful lawsuit against the developer relating to remedying construction defects. Indeed, due to the “seller’s market” of late, the new construction sales contracts tend to be a take it “as is” or leave it proposition. For example, in one such situation that this author encountered, the developer had the nerve to provide in the contract form that if the developer is delayed in commencing construction of the house by more than sixty days due to matters beyond the developer’s reasonable control, the developer can increase the purchase price by two percent and an additional one percent for each thirty days thereafter until it is commenced (even if not due to the buyer’s fault!).

¹⁰ According to a report compiled by the Department of Housing and Urban Development in conjunction with the Federal Trade Commission, builders resolved about

during periods of skyrocketing real estate development.¹¹ During a period of rapid house building, building departments become swamped with more permit requests than they can expeditiously handle. In this climate, some developers will side-step the permit process altogether because they do not want to wait to get their plans approved. Even when the permits are properly applied for, it is likely that building department personnel may be over-worked and fail to spot problems they might have otherwise detected. The final nail in the coffin is that, because the purchase contracts are in essence contracts of adhesion, a purchaser is unable to bargain for the type of protection that they need and desire.

This situation clearly calls for reform, and this Article includes two detailed proposals that address directly the two previously identified major impediments to compelling developers to repair or pay for the repair of defects in construction they have performed.

This Article first describes the extent and nature of the defects that are increasingly occurring with newly built and converted condominiums and detached single-family homes. The Article then reviews the existing common law and statutory protections in the United States. The Article then focuses on two states' attempts to provide more than the typical protections currently, and generally, available to new homeowners against construction defects and evaluates the effectiveness of these protections in practice. Finally, the Article proposes model legislation that addresses the identified problems through an attempt to discover and then require the type of *ex ante* proactive bargain that the parties would have struck if they were truly of equal bargaining power and sophistication. The Proposal adopts those features from the most innovative state statutes and local ordinances examined within this Article and keeps in mind the need to avoid requirements that will create undue expense on developers, expenses that the developer may pass along to home purchasers in the form of higher housing costs. The Proposal also contains a description of the basic warranty that would be required for all new homes, provides a procedure for handling the claims, and offers a source for repayment of these claims. This Article

one-half the problems brought to their attention in the first year, and thirty-six percent in the second year. RICHARD L. KALUZY, DEP'T OF HOUSING & URBAN DEVELOPMENT, A SURVEY OF HOMEOWNER EXPERIENCE WITH NEW RESIDENTIAL HOUSING CONSTRUCTION vii (1980).

¹¹ This was the market at the time that our criminal law professor was purchasing his condominium unit.

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also proposes a more expansive warranty that would not be mandatory, but that the developer and the new home buyer could agree to for an additional charge.

II. EXTENT AND NATURE OF THE CONSTRUCTION DEFECTS

As long as there is construction there will be construction defects. It is inevitable with respect to a portion of the new homes built that something will go wrong with either the materials used or the workmanship. Based upon data collected in New Jersey, valid claims were raised against builders/developers in approximately ten percent of the new homes built.¹² Obviously, not all construction defects are considered valid claims under the law; therefore, one can expect that of the new condominiums and houses being built there will be construction defects discovered in at least ten percent of these new homes. This percentage can go up of course, when special circumstances arise, such as a hot market that includes more inexperienced developers. Recently, it has become increasingly common for individuals, who are inexperienced and who fail to provide adequate reserves in their budgets for construction defect claims and the costs for repair work, to enter into the development field.¹³ In addition, the number of construction claims has increased because of a recent nationwide increase in the volume of newly built homes and converted condominiums.¹⁴

The real estate market boom during the 1990s, which has lasted into the new millennium, brought with it an influx of new condominium development and conversions, as well as an increase in the construction of single-family detached homes.¹⁵ Despite the current economic downturn, condominium sales and new single-family home sales have continued at a steady increase. The seasonally adjusted annual rate of existing condominium and co-op sales in the United States is at an all-

¹² Memorandum from Peter Desch, Chief, Bureau of Homeowner Protection, State of New Jersey, to Andrew Cook, Research Assistant to Professor Stark, The John Marshall Law School 2 (July 12, 2002) (on file with author).

¹³ Mary Umberger, *After a Bad Year, Home Insurers Boosting Rates; Some Customers Deemed too Risky After a Few Claims*, CHI. TRIB., June 9, 2002, at C1.

¹⁴ *Id.*

¹⁵ Nat'l Ass'n of Home Builders, *Annual Housing Starts (1978-2002)*, available at <http://www.nahb.org/generic.aspx?sectionID=130&genericcontentID=554> (last visited Oct. 21, 2003).

time record high of 846,000 units.¹⁶ From 1997 through 2000, 140,000 new condominium and cooperative apartments were completed in the United States.¹⁷ The median existing condominium price in the U.S. was \$123,500 in the third quarter of 2001, up 9.6 percent from the year before.¹⁸ The average price for a new home in 2002 was forecasted as \$187,100, an increase of more than 6.8 percent from 2001.¹⁹

While the skyrocketing real estate market has led to solid investments on new condominiums and single-family homes for many, it has also meant more headaches for some unwary buyers. Many new condominium owners have experienced costly defects relating to the common elements and latent defects affecting the units themselves. For example, according to Chicago's Department of Consumer Services, more than five to ten calls a day are received relating to condominium problems, up substantially from the early 1990s.²⁰ The number of complaints against builders/developers for single-family homes also increased dramatically during the housing boom of the 1990s. According to the Better Business Bureau, the number of complaints it received from 1990 to 1998 nearly doubled.²¹

One of the most common complaints is water seepage. For example, water seepage is a particular problem in Chicago with respect to newly built condominiums. Often, the problem arises due to cheaply made concrete blocks that are used by many developers of new condominium buildings.²² One expert opined that water seepage is so serious that water damage could cause sagging, or worse yet, collapsing floors.²³ According to one Chicago-based home inspector, twenty-five to thirty-five percent of new or renovated buildings have water problems.²⁴

¹⁶ Walt Molony, *Condo Co-Op Sales Set New Record in First Quarter* (May 5, 2003), at <http://www.realtor.org/PublicAffairsWeb.nsf/Pages/1stqtrcondosales03?OpenDocument> [hereinafter *Condo Sales*].

¹⁷ U.S. Census Bureau, *Survey of Market Absorption* (Sept. 20, 2001), at <http://www.census.gov/hhes/www/housing/soma/qtr402/q402tab5.html>.

¹⁸ *Condo Sales*, *supra* note 16.

¹⁹ Walter Molony, *New Record Firming for Home Sales this Year* (June 4, 2002), at <http://www.realtor.org/publicaffairsweb.nsf/pages/juneoutlk>.

²⁰ Leon Pitt, *City Looks at Condo Troubles: Boom Brings a Rise in Serious Complaints*, CHI. SUN-TIMES, Apr. 27, 1998, at 8.

²¹ Michael Rezendes, *Spotlight Luxury By Design: Quality By Chance Last of Four Parts; Builders Get Little Oversight*, B. GLOBE, May 2, 2001, at A1.

²² *Id.*

²³ *Id.*

²⁴ *Id.*

The water seepage problems are not isolated to new condominiums using the cheap concrete block. In a city like Chicago, where numerous old industrial buildings are being converted into condominiums, major water problems also plague these new owners.²⁵ For example, in one converted condominium building the water problems were so bad that the owners brought a suit against the developer alleging that masonry fell from the walls and the units flooded because of leaks in the walls.²⁶

Other common defects found in the construction of new homes include faulty workmanship and materials that lead not only to water seepage, but also relate to damaged wood and defective plumbing. Other common complaints involve roofing defects, gas or electrical safety, and fire safety violations.²⁷ One survey performed by Zurich, an insurance company, found that when new homes required remedial work, forty-three percent of the time windows were the main problem.²⁸

III. ANALYSIS OF EXISTING PROTECTIONS FOR UNIT OWNERS AGAINST CONSTRUCTION DEFECTS

A. Breach of Express Contractual Warranty

Condominium and detached single-family homeowners faced with construction defects do have some existing remedies under the current law in most states. When the developer provides any express warranty, the homeowner, unit owner, or association may bring an action to prove breach of the warranty. An express warranty is created when the seller makes a false affirmation of fact or promise—one that is not just a statement representing the seller's opinion.²⁹ Generally, if the developer breaches the contract, the injured owner may elect either to rescind the contract and recover the value of any performance, or proceed under the contract and ask for damages for the breach.³⁰ Before the owner files an action against the developer, the most efficient procedure is to bring to

²⁵ See Bill Rumbler, *Old Brick, Cheap Solutions Put Lofts at Risk, Too*, CHI. SUN-TIMES, Aug. 13, 2000, at 18.

²⁶ *Id.*

²⁷ Barry Stone, *Buyers Should Not Exclude New Houses from Inspections*, WASH. POST, Aug. 4, 2001, at H09.

²⁸ *Double-Glazing. Why Is It, Asks Andy Pearson, That After All These Years, We Still Can't Get It Right?* BUILDING, October 19, 2001.

²⁹ Stanley P. Sklar, et al., *Implied Duties of Contractors: Wait a Minute, Where Is That in My Contract?*, 21 CONSTR. LAW. 11 (2001).

³⁰ Lynn Y. McKernan, *Strict Liability Against Homebuilders for Material Latent Defects: It's Time, Arizona*, 38 ARIZ. L. REV. 373, 378 (1996).

the developer's attention the defects and negotiate to have them cured. Most developers build into the purchase price of the condominium unit or house a percentage of their profits to be used for settlement proceeds that will be given back to the association or owner for repair work.³¹ However, the particular defects may not be covered by the express warranties, or the warranty period may expire before the defects are discovered, precluding the owner from bringing suit against the developer based on the express warranties.³² The purchaser will also face the cost and time of a lawsuit, as well as the risk of the developer entity having no assets even if a judgment is obtained against it for the costs to repair the defects.

B. Breach of the Duty to Disclosure Latent Defects

Buyers of a new home or condominium may also have a cause of action against the developer/vendor for failing to disclose latent defects. Some courts have held that a seller of real estate must disclose defects to the prospective buyer where (1) the defect is unknown to the buyer; (2) the defect would not be discovered by a reasonable inspection (i.e. a latent defect); (3) the defect materially affects the habitability or value of the home; and (4) the vendor has knowledge of the defect.³³ The last element, seller's actual knowledge, is extremely difficult to prove, which inevitably will cause any litigation over this issue to be less certain and more costly.

Most states require the prospective purchaser to make a reasonable and diligent inspection of the premises.³⁴ Although the majority of jurisdictions require sellers to disclose latent defects to prospective purchasers, a handful of states do not impose such a duty on the seller.³⁵

³¹ Jordan I. Shifrin, *A New Board Needs to Evaluate the Condition of the Premises*, CHI. DAILY HERALD, March 10, 2001, at 8.

³² See *supra* note 9, for a discussion of the inability of home purchasers to bargain with developers on the terms of the purchase/construction contracts they enter into. If the developer is not required by law to provide a warranty to the buyer and can disclaim the implied warranty of habitability, then the buyer is unlikely to receive an adequate warranty from the developer.

³³ *Thacker v. Tyree*, 297 S.E.2d 885, 888 (W. Va. 1982); see also *Shapiro v. Sutherland*, 76 Cal. Rptr. 2d 101, 107 (Ct. App. 1998).

³⁴ *Mitchell v. Skubiak*, 618 N.E.2d 1013, 1017 (D. Ill. 1993).

³⁵ Florrie Young Roberts, *Disclosure Duties in Real Estate Sales and Attempts to Reallocate the Risk*, 34 CONN. L. REV. 1 (2001). States not imposing a duty to disclose include: New York, Indiana, Alabama, and Minnesota. Massachusetts does not impose a duty to disclose on the vendor when there is no inquiry by the purchaser.

Sometimes the defect that affects the value of the home does not directly relate to the property sold. Courts in these situations have applied similar principles as to when to require disclosure. One court found that a builder/developer was liable for failing to disclose information concerning a landfill that was previously filled with illegally dumped chemical wastes.³⁶ The court held that a builder/developer is liable for nondisclosure of off-site physical conditions when (1) the builder/developer has knowledge of the conditions, the purchaser does not have knowledge, and the conditions are not readily observable to the purchaser; and (2) the conditions materially affect the habitability, use, or enjoyment of the property to the point of rendering the property less valuable or less desirable to an objectively reasonable buyer.³⁷ This precedent could be helpful with respect to defects in the common areas of a condominium, but not to the unit purchased.

In addition, many states have enacted statutes specifically dealing with disclosure by sellers.³⁸ These statutes provide the buyer with protection by requiring the seller to disclose all *known* defects to the prospective buyer.³⁹ Most of the state statutes imposing mandatory disclosure by sellers do not allow the parties to use "as is" clauses in order to relieve the seller from its obligation to disclose.⁴⁰ The problem, again, is the difficulty of proving that the seller had knowledge of the defect.

C. Breach of the Implied Warranty of Habitability

An alternative remedy to express warranties for the new homeowner is the common law implied warranty of habitability, which is now recognized in the majority of jurisdictions.⁴¹ Under the common law, homeowners had no cause of action against sellers for construction defects due to the doctrine of *caveat emptor* ("let the buyer beware"). However, courts began to move away from *caveat emptor* after the seminal case *Miller v. Cannon Hill Estates*,⁴² in which the court ruled in favor of the owner in his action against the builder for structural defects.

³⁶ *Strawn v. Canuso*, 657 A.2d 420, 428 (N.J. 1995).

³⁷ *Id.* at 431.

³⁸ Alan M. Weinberger, *Let the Buyer Be Well-Informed? – Doubting the Demise of Caveat Emptor*, 55 MD. L. REV. 387, 414 (1996).

³⁹ *Id.*

⁴⁰ *Id.* at 416.

⁴¹ GOLDSTEIN & KORNGOLD, *supra* note 8, at 208-09.

⁴² 2 K.B. 113 (1931).

Several rationales explain this development in the law. First, courts were influenced by the implied warranties of merchantability and fitness that became the law for personal property under the Uniform Commercial Code. Second, courts recognized that with new construction it is difficult for buyers to protect themselves by inspecting the property before buying it, since many defects could not be discovered at that stage. When it came to latent defects inherent in new construction, it did not make sense to "let the buyer beware." Finally, the courts recognized that the sellers/builders were more knowledgeable about construction defects generally, possessed more knowledge about any potential defects with respect to the homes they were building, and typically enjoyed a greater bargaining power than the home purchaser. Consequently, the courts determined that the home purchaser under these circumstances was in need of court protection. It is useful to keep these underlying rationales in mind, because they help explain the scope and terms of the implied warranty of habitability and its application in different scenarios.

Before imposing the implied warranty of habitability, several elements must be satisfied. First, the structure must be new and the purchaser must be the original owner.⁴³ A few states have extended liability by allowing subsequent purchasers to bring an action under the implied warranty of habitability doctrine.⁴⁴ Generally, extension of liability to subsequent purchasers is limited to a reasonable length of time after the purchase and where there is no substantial change or alteration in the condition of the building from the original sale.⁴⁵ The implication of a warranty to subsequent purchasers will also be limited to latent defects not discoverable by a reasonable inspection.⁴⁶ Second, the builder/vendor often is required to be regularly engaged in the business of constructing and selling houses.⁴⁷ Finally, the buyer must have been unaware of the defect and the defect must not have been visible to a reasonably prudent person.⁴⁸

⁴³ Major Robert M. Fano, *The Implied Warranty of Habitability and Its Extension to Subsequent Purchasers of Real Property*, 102 MIL. L. REV. 133, 138 (1983).

⁴⁴ The Honorable Sheldon Gardner & Robert Kuehl, *Acquiring an Historical Understanding of Duties to Disclose, Fraud, and Warranties*, 104 COM. L.J. 168, 193-94 (1999).

⁴⁵ *Id.* at 194.

⁴⁶ Fano, *supra* note 43, at 139.

⁴⁷ *Id.* at 138.

⁴⁸ *Id.*

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Generally, the implied warranty of habitability provides purchaser protection from losses where latent defects make the newly built dwelling uninhabitable.⁴⁹ Under the implied warranty of habitability, each structure built contains an implied warranty that the structure is fit to live in.⁵⁰ The doctrine has sometimes been further defined as a warranty that the house is "reasonably suited for its intended use."⁵¹ Defects covered under the implied warranty of habitability include a basement that pitched in the opposite direction of the drain,⁵² seepage into a crawl space,⁵³ and defective drainage on property surrounding a building.⁵⁴ However, an example of a defect not considered to be a breach of the implied warranty of habitability involves improper ductwork that caused a house to be insufficiently air-conditioned.⁵⁵

One of the first cases extending the implied warranty of habitability theory to condominiums was a 1972 Florida case.⁵⁶ Today, the majority of jurisdictions recognize the implied warranty of habitability to condominium owners.⁵⁷ However, in some jurisdictions, the doctrine of implied warranty of habitability will not apply to protect condominium unit owners for defects when the apartment building is converted into a condominium. In this circumstance the building is not "new" and there is a lesser chance of latent defects. Instead, it is presumed that any defects could be discovered with a "reasonable inspection."⁵⁸ This is problematic in part because there are improvements that are usually made to the apartment building in the process of condominium conversions, and any defects relating to this work could be difficult to detect. In addition, it is probably not fair to require each prospective unit owner to inspect the common areas, since a typical condominium unit purchaser does not in fact do this. It is also inefficient to require

⁴⁹ Gardner & Kuehl, *supra* note 44, at 194.

⁵⁰ Sklar, et al., *supra* note 29, at 15.

⁵¹ Petersen v. Hubschman Constr. Co., 389 N.E.2d 1154, 1159 (Ill. 1979).

⁵² *Id.* at 1159.

⁵³ Park v. Sohn, 433 N.E.2d 651, 655 (Ill. 1982).

⁵⁴ Briarcliffe W. Townhouse Owners Ass'n v. Wiseman Constr. Co., 454 N.E.2d 363, 368 (Ill. App. Ct. 1983).

⁵⁵ Naiditch v. Shaf Home Builders, Inc., 512 N.E.2d 1027, 1039 (Ill. App. Ct. 1987).

⁵⁶ Gable v. Silver, 258 So. 2d 11 (Fla. Dist. Ct. App. 1972).

⁵⁷ Christopher S. Brennan, Note, *The Next Step in the Evolution of the Implied Warranty of Habitability: Applying the Warranty to Condominiums*, 67 *FORDHAM L. REV.* 3041, 3042 (1999). *But see, e.g.*, Snow Flower Homeowners Ass'n v. Snow Flower, Ltd., 31 P.3d 576 (Utah Ct. App. 2001) (refusing to apply the implied warranty of habitability to condominiums).

⁵⁸ Kelley v. Astor Investors, Inc., 462 N.E.2d 996 (Ill. App. Ct. 1984).

each unit owner to separately undergo this expense and duplicate each other's efforts.

While the implied warranty of habitability is a positive legal development because it attempts to protect a homebuyer's legitimate expectations that his or her home be warranted as habitable and fit for its intended purpose, there are many serious problems with relying on the implied warranty. First, the imposed standard is vague. What defects are material enough to make a home uninhabitable or unfit for its intended purpose? Second, even if a defect would ordinarily be covered under the vague standards, most developers, disfavoring such vague standards, have placed disclaimers of the implied warranty of habitability in their contract forms, and either provided for no express warranty in its place or provided for a more limited warranty.⁵⁹ These disclaimer clauses have been enforced in many jurisdictions, so long as the disclaimers are conspicuous in the contract. This is problematic, though, because even when a buyer sees the disclaimer, the buyer lacks the bargaining power to negotiate for either its deletion or a more favorable limited warranty in its place. The ability of the home purchasers to understand the significance of the disclaimer and then negotiate for better terms is further limited by the fact that most home purchasers today, especially those who are buying homes in certain parts of the country, are not represented by counsel. The seller's broker, or even the buyer's broker, is unlikely to try to negotiate for better legal terms.⁶⁰

D. Potential Tort Liability

It is sometimes advantageous for homeowners to seek remedies against developers/builders for construction defects under tort theories rather than contract theories. There are three different reasons why a homeowner would prefer a tort action to a contract action. First, it is possible that the statute of limitations for a contract cause of action has expired but has not expired under a cause of action grounded in tort law. Second, it is possible that the contract contained a waiver of the implied warranty and no substitute warranty or a limited warranty that does not cover the defect at issue. Finally, if a homeowner can show that the

⁵⁹ JORDAN I. SHIFRIN, WELCOME TO CONDO WORLD . . . WHERE LIFE IS ALMOST PERFECT 129 (2002).

⁶⁰ GOLDSTEIN & KORNGOLD, *supra* note 8, at 208; *see also* Joseph M. Grohman, *A Reassessment of the Selling Real Estate Broker's Agency Relationship with the Purchaser*, 61 ST. JOHN'S L. REV. 560, 560-63, 584-88 (1987).

officers of the limited liability entity established as the seller/builder had actually committed fraud, then it may be possible to pierce the corporate veil and recover against those officers personally.⁶¹ Indeed some states have enacted consumer fraud type statutes that might enable a homeowner to sue the officers of the development entity.⁶² However, it should be noted that to make out a cause of action for fraud, one must show not only a misrepresentation of a fact, reliance on that misrepresentation, and damages; one must also show intent to defraud.⁶³ Because this last element is so difficult to prove, it is very unlikely that a homeowner will be successful at piercing the corporate veil based on alleged fraud by the officers of the selling/building entity.

In addition to the difficulty of proving fraud, when a homeowner brings a suit against a seller/builder in tort for negligent construction, he or she may face another serious obstacle to recovery, namely, the "economic loss doctrine." The theory behind the economic loss doctrine is based upon the perceived fundamental difference between the inherent nature of a contract action and a tort action. When suing in contract, a plaintiff seeks to recover the benefit of his or her bargain; when suing in tort, a plaintiff seeks to recover the damages he or she suffered when the individual or property was damaged. Thus, under the economic loss doctrine, courts generally hold that a purchaser may not successfully bring a negligence or strict liability claim based upon a product being defective, unless the defective product causes personal injury or causes damage to any property other than itself.⁶⁴ "Economic loss" includes "damages for inadequate value, costs of repair and

⁶¹ Bd. of Dir. of Carrdinal Place Condo. v. Carrhomes P'ship, No. 164207, 2000 WL 33406723 (Va. Cir. Ct. Dec. 21, 2000).

⁶² For example, one Illinois court recognized a statutory cause of action under the Consumer Fraud Act against developers who were corporate officers of a corporation. See Wash. Courte Condo. Ass'n v. Wash.-Golf Corp., 643 N.E.2d 199 (Ill. App. Ct. 1994). The corporation was formed solely for the construction of the condominium project the defendants were being sued for. *Id.* at 203. The court "pierced the corporate veil" and held the principals of the corporation individually liable, stating, "[C]orporate officer status does not insulate him from individual liability for the torts of the corporation in which he actively participates." *Id.* at 217. The court upheld the lower court's ruling that the defendants were liable for damages resulting from water infiltration they had knowledge of prior to selling the units. *Id.* at 199. The court enunciated the statutory elements of fraud as (1) a deceptive act or practice including concealment or omission of any material fact; (2) defendants' intent that the plaintiffs rely on the concealment; and (3) the concealment occurred in the course of conduct involving trade or commerce. *Id.* at 221. Remedies under the statute include injunctive relief, restitution, civil penalties, and damages. *Id.*

⁶³ Zimmerman v. Northfield Real Estate, Inc., 510 N.E.2d 409, 413 (Ill. App. Ct. 1986).

⁶⁴ Seely v. White Motor Co., 403 P.2d 145, 151 (Cal. 1965).

replacement of the defective product, or consequential loss of profits – without any claim of personal injury or damage to other property.”⁶⁵ Although a few courts have ruled in favor of homeowners who bring suit to recover economic losses in a tort action,⁶⁶ the majority of jurisdictions apply the economic loss doctrine, thus, precluding any tort liability against the builder/developer for such economic losses.⁶⁷

For example, in *Casa Clara Condominium Ass’n v. Charley Toppino and Sons, Inc.*,⁶⁸ the Florida Supreme Court ruled that the homeowners were precluded from bringing a negligence cause of action for damages resulting from a defective foundation. The defendant supplied concrete with a high salt content, which caused the steel reinforcements to rust. As a result, the concrete cracked.⁶⁹ The court opined that the economic loss rule separates contract law and tort law.⁷⁰ Specifically, the court stated, “Economic losses are ‘disappointed economic expectations’ that fall under the ambit of contract law rather than tort law.”⁷¹ Because no person was physically injured, nor was any property damaged other than the concrete itself, the court ruled that the homeowners were seeking purely economic damages, which were not allowed under a tort theory.⁷²

Even if the homeowner is in a jurisdiction that does not recognize the economic loss doctrine, it is possible that the house will not be deemed a product for purposes of a strict liability action sounding in tort. For example, Illinois courts have refused to extend the doctrine of strict liability, reasoning that a condominium is not a product as stated under the *Restatement (Second) of Torts*.⁷³

⁶⁵ *Casa Clara Condo. Ass’n v. Charley Toppino & Sons, Inc.*, 620 So. 2d 1244, 1246 (Fla. 1993).

⁶⁶ See *Blagg v. Fred Hunt Co., Inc.*, 612 S.W.2d 321 (Ark. 1981); *Kennedy v. Columbia Lumber & Mfg. Co.*, 384 S.E.2d 730 (S.C. 1989) (explaining that a cause of action in negligence is available where a builder violates a legal duty, no matter what types of damages result, but that the “economic loss” rule, rather than negligence theory, applies where duties are created solely by contract).

⁶⁷ Charles R. Walker, Casenote, *Moransais v. Heathman and the Florida Economic Loss Rule: Attempting to Leash the Tort-Eating Monster*, 52 FLA. L. REV. 769, 772 (2000).

⁶⁸ 620 So. 2d at 1244.

⁶⁹ *Id.* at 1245.

⁷⁰ *Id.* at 1246.

⁷¹ *Id.* (citing *Sensenbrenner v. Rust, Orling & Neale Architects, Inc.*, 374 S.E.2d 55, 58 (Va. 1988)).

⁷² *Id.*

⁷³ *Heller v. Cadral Corp.*, 406 N.E.2d 88 (Ill. App. Ct. 1980).

In summary, there are certain advantages to suing in tort, but there are several serious obstacles to successfully recovering for the costs to repair construction defects. Further, as with a cause of action under a contract theory, there may be heavy costs in litigating the claim and the risk that there will be no assets from which to recover.

E. Two States with Innovative Statutory Protections

1. New Jersey's New Home Warranty and Builder's Registration Act

Among the fifty states, New Jersey provides the most comprehensive protection to new homeowners. The New Home Warranty and Builder's Registration Act ("New Jersey Act"), enacted in 1977, and the Regulations Governing New Home Warranties and Builders' Registrations ("Regulations"),⁷⁴ promulgated by the Department of Community Affairs ("Community Affairs"), are very thorough, providing both builder⁷⁵ and homeowner detailed information on how to proceed in the event of a purported defect.

a. Summary of the Key Features of the Home Warranty and Builder's Registration Act

Under the New Jersey Act and Regulations, all builders are required to register with the State prior to building any new home.⁷⁶ The builder must disclose on the registration application form whether it is enrolled in a warranty plan provided by the State ("State Plan") or a private warranty plan approved by the State and administered by a private warranty company ("Private Plan").⁷⁷ If a builder is not enrolled in a Private Plan, it will automatically be enrolled in the State Plan.⁷⁸ The builder pays a nonrefundable registration fee of \$200,⁷⁹ and if approved, receives a registration card needed to begin construction of any new home.⁸⁰ The builder can be fined up to \$2,000 for each home it builds

⁷⁴ N.J. ADMIN. CODE tit. 5, §§ 25-1.1 to -5.5 (2003).

⁷⁵ "Builder" is defined as "any individual corporation, partnership or other business organizations engaged in the construction of new homes." N.J. STAT. ANN. § 46:3B-2 (West 2003).

⁷⁶ N.J. ADMIN. CODE tit. 5, § 25-2.1.

⁷⁷ N.J. STAT. ANN. § 46:3B-8. The State Warranty Plan and Private Plans are discussed in Part III.E.1.a.

⁷⁸ N.J. ADMIN. CODE tit. 5, § 25-5.3.

⁷⁹ *Id.* § 25-2.2(a)(1).

⁸⁰ *Id.* § 25-2.4

and sells if the builder does not register, or if the builder fails to renew its registration every two years.⁸¹

The registration requirement of the New Jersey Act provides further protection to prospective owners because it provides for the revocation or suspension of a builder's registration for various improprieties. The builder's registration is revoked for fraud, misrepresentation of material information in the registration process, or for violating the New Jersey State Uniform Construction Code.⁸² Furthermore, a builder's registration may be suspended if (1) the builder fails to participate or enroll in a State Plan or Private Plan; (2) the builder fails to correct or settle a defect claim after determination is made that the defect was the builder's responsibility; (3) an officer, partner, director, or stockholder of the builder is not registered or the registration is revoked or suspended; (4) the builder fails to compensate the New Home Warranty Security Fund, or; (5) the builder fails to participate in the dispute settlement process.⁸³ The builder may not begin building prior to receiving the proper building permit, and this permit will not be issued until the builder has obtained the building registration card issued by the State.⁸⁴ Similarly, a certificate of occupancy will not be issued to the builder unless the builder can show proof of enrollment in either the State Plan or a Private Plan.⁸⁵

According to State officials, the coverage provided to the homeowner under the State Plan is the same as the Private Plan.⁸⁶ However, the manner in which settlement disputes are carried out, along with the costs and enrollment rates charged to homeowners, varies from plan to plan.⁸⁷ The State Plan is currently operating at twenty-five percent of the market share when compared to the competing private companies providing warranty plans approved by the State.⁸⁸

⁸¹ *Id.* § 25-2.6.

⁸² *Id.* § 25-2.5.

⁸³ *Id.*

⁸⁴ See STATE OF NEW JERSEY, NEW HOME WARRANTY PROGRAM: AN INFORMATIONAL GUIDE FOR BUILDERS TO THE NEW HOME WARRANTY AND BUILDERS' REGISTRATION ACT 2 (2002).

⁸⁵ *Id.*

⁸⁶ Letter from Peter Desch, Chief, Bureau of Homeowner Protection, State of New Jersey, to Andrew Cook, Research Assistant to Professor Stark, The John Marshall Law School (June 28, 2002) (on file with author).

⁸⁷ *Id.*

⁸⁸ *Id.* There are three private companies approved by New Jersey. *Id.*

Both the State Plan and the Private Plans provide a one-year warranty that covers "performance standard defects."⁸⁹ The performance standards set a minimum standard of quality in the workmanship and materials and are found in the Regulations accompanying the New Jersey Act.⁹⁰ The Regulations specifically delineate what items are covered, along with the possible deficiencies, the performance standard, and the responsibility of the builder/warrantor in the event of a construction deficiency.⁹¹ Below is an example of a performance standard for roofing from the Regulations:

Possible Deficiency: Roof or flashing leaks.

- (1) Performance standard: Roof or flashing leaks that occur under normal weather conditions is a deficiency.
- (2) Exclusion: Where cause is determined to result from severe weather conditions such as ice and snow build-up, high winds and driven rains.
- (3) Builder/Warrantor responsibility: Correct any roof or flashing leaks which are verified to have occurred under normal weather conditions.⁹²

In addition to the performance standards, warranty coverage for the first year includes (1) appliances, fixtures, and equipment defects;⁹³ (2) defects to mechanical and electrical systems;⁹⁴ and (3) major structural

⁸⁹ N.J. ADMIN. CODE tit. 5, § 25-3.2(a)(1) (2003).

⁹⁰ *Id.* § 25-3.5.

⁹¹ *Id.*

⁹² *Id.* § 25-3.5(f)(5)(i).

⁹³ *Id.* § 25-3.2(a)(1)(ii); see also *id.* § 25-1.3, which states:

"Appliances, fixtures, and equipment" [includes but is not limited to:] furnaces, boilers, heat pumps, humidifiers, air purifiers, air handling equipment, ventilating fans, air conditioning equipment, water heater, pumps, stoves, ranges, ovens, refrigerators, garbage disposals, food waste disposers, compactors, dishwashers, automatic garage door openers, washers, and dryers, plumbing fixtures and trim, faucets, fittings, motors, water treating equipment, ejectors, thermostats and controls, including any fitting attachments; electric receptacles, switches, lighting fixtures, and circuit breakers.

⁹⁴ *Id.* § 25-3.2(a)(1)(iii); see also *id.* § 25:1.3, which states:

"Mechanical and electrical systems" [means and includes:] (1) Plumbing system: Gas supply lines and fittings, and water supply, waste and vent pipes and their fittings; septic tanks and their drains;

defects.⁹⁵ In the second year, the warranty covers defects to (1) mechanical and electrical systems, and (2) major structural defects.⁹⁶ Most notably, the second year warranty does not include the performance standards. In years three through ten, the State Plan only covers major structural defects.⁹⁷ Builders are not required to cure any major structural defects found during this time period as builders are for defects raised during the first two years.⁹⁸ The State Plan assumes financial responsibility for defects after year two, and the owner must then file a claim with the State.⁹⁹ A claims analyst from the New Home Warranty Program ("Program") will then determine if a covered defect exists, and if so, the Program will reimburse the owner.¹⁰⁰

The builder is required to pay a warranty premium when enrolling in either the State Plan or one of the Private Plans. The State uses the premium to compensate homeowners for claims brought against the builder in the event a builder fails to repair or reimburse the owner for the cost of having the defect cured. Under the State Plan, the amount the builder is required to pay for each new home, known as the "contribution percentage," is determined by the builders' track record and length of time registered with the State. The contribution percentage

water, gas, and sewer service piping, and their extensions to the property line which tie-in to a public utility connection or on-site well and/or sewage disposal system; (2) Electrical system: All wiring, electrical boxes, and connections up to the public utility meter connection, excluding appliances, fixtures and equipment; (3) Heating, Ventilating, Cooling and Mechanical systems: All ductwork, steam, water and refrigerant lines, registers, convectors, radiation elements and dampers.

⁹⁵ *Id.* § 25-3.2(a)(1)(iv); see also *id.* § 25-1.3, which states:

"Major structural defect" means any actual damage to the load-bearing portion of the home, including consequential damages, damage due to subsidence, expansion or lateral movement of the soil (excluding movement caused by flood or earthquake) that affects its load-bearing function and that vitally affects or is imminently likely to vitally affect use of the home for residential purposes.

⁹⁶ N.J. STAT. ANN. § 46:3B-3(c)(2) (West 2003).

⁹⁷ *Id.* § 46:3B-3(b)(3).

⁹⁸ See STATE OF NEW JERSEY, NEW HOME WARRANTY PROGRAM: HOMEOWNER'S BOOKLET 6 (1997) [hereinafter HOMEOWNER'S BOOKLET] (prepared by the Commissioner pursuant to her regulatory authority provided by N.J. STAT. ANN. § 46:3B-3(a)).

⁹⁹ The owner must fill out a "Notice of Claim and Demand for Major Structural Defects for Claims in Years 3-10" with the State. HOMEOWNER'S BOOKLET, *supra* note 98, at 14. A copy of this form can be found in the *Homeowner's Booklet*, which is distributed by the New Jersey Department of Community Affairs. *Id.* at app. E.

¹⁰⁰ See *id.* at 14.

is multiplied by the purchase price of the new home or the fair market value on the completion date if there is no arms-length sale.¹⁰¹ When determining the contribution percentage the builder is required to pay upon enrollment with the State Plan, the State looks to the number of claims the builder has had to pay for defects covered in years one through ten, and the number of years the builder has been enrolled in a Private Plan or the State Plan.¹⁰² For example, if a builder has not had to pay a claim under either the State Plan or a Private Plan for ten years, the builder is required to pay only 0.17% of the cost of the new home.¹⁰³ Therefore, if a builder with no claims brought against it for ten years builds a new home that sells for, or that has a fair market value of, \$200,000, the builder would be required to make a payment of \$340 to the State fund.¹⁰⁴ The rates builders are required to contribute to the State fund range from the above quoted 0.17% to 0.595%.¹⁰⁵ The contribution percentages change incrementally, correlating with the number of years the builder has been enrolled in a warranty plan and the number of claims he has had to pay to homeowners during that time period.¹⁰⁶ The fewer number of years the builder has been enrolled in either a Private Plan or the State Plan, along with a higher incidence of claims or discovered major structural defects, the higher the contribution percentage the builder is required to pay for each new home.

The State Plan also provides detailed and thorough dispute resolution guidelines, or “claims procedure.” Claims procedures offered by Private Plans may differ slightly from the State Plan; however, the Regulations provide basic guidelines that each private plan must follow when implementing its own claims procedure.¹⁰⁷ Thus, every builder

¹⁰¹ N.J. ADMIN. CODE tit. 5, § 25-5.4 (2003).

¹⁰² *Id.*

¹⁰³ *Id.* § 25-5.4(b)(1).

¹⁰⁴ Contribution percentage 0.17%, or 0.0017, multiplied by the sale of the new home (or fair market value) of \$200,000, equals \$340.

¹⁰⁵ The 0.595% contribution percentage occurs when it has been determined that the builder must make a payment as a result of a claim or major structural defect within the prior two years, and within that same time another successful claim is brought against the builder. *See id.* § 25-5.4(b)(7).

¹⁰⁶ Seven to ten years, contribution percentage equals 0.213; five to seven years, contribution percentage equals 0.255; two to five years, contribution percentage equals 0.298; two years or less, contribution percentage equals 0.319; if within two years the builder has been required to make a payment for a claim or major structural defect, contribution percentage equals 0.425. *Id.* § 25-5.4(b).

¹⁰⁷ *Id.* § 25-4.2(a).

must disclose to the owner the warranty coverage and the claims procedure on or before the closing of the sale.¹⁰⁸

Once an owner discovers what he or she believes is a covered defect, the owner must give written notice to the builder explaining the nature of the defect or defects.¹⁰⁹ The owner must give notice to the builder within seven days after the coverage for the defect expires.¹¹⁰ After the owner properly gives notice to the builder, the builder has thirty days to inspect the home and respond to the owner in writing what actions, if any, it will take to cure the defect.¹¹¹ If the builder agrees to cure the defect, the builder must either (1) remove the defect by repairing or replacing the defect, or (2) make a payment to the owner for the reasonable cost to remove the defect.¹¹² The builder is also required to cover the reasonable shelter costs, if needed, during the period the residence is uninhabitable.¹¹³ If the builder refuses to repair or pay for correction of the defect, the owner may opt to file a Notice of Claim and Demand ("claim") with the State.¹¹⁴ The owner must file the claim with the State within fourteen days after the last day of the thirty-day timeframe that the builder is given to respond to the owner's original complaint.¹¹⁵

If the builder refuses to cure the defect, and the owner properly files a claim with the State, the State will then begin the dispute resolution process. It must be noted that the owner may not take actions to have the defect cured before the dispute resolution process is finished, unless an official from the Program inspects the alleged defect and authorizes the repair.¹¹⁶ The State designates a neutral, independent third-party to conduct a conciliation procedure with the owner and the builder at the owner's premises.¹¹⁷ If the conciliator/arbitrator is successful in

¹⁰⁸ *Id.* § 25-5.5(a)(1).

¹⁰⁹ *Id.* § 25-5.5(b)(1).

¹¹⁰ *Id.*

¹¹¹ *Id.* § 25-5.5(a)(5).

¹¹² *Id.* § 25-3.3(b).

¹¹³ *Id.*

¹¹⁴ *Id.* § 25-5.5(b)(3) (prohibiting an owner from filing a claim within the first 120 days after commencement of the warranty, unless it is an emergency situation or a major structural defect).

¹¹⁵ *Id.*

¹¹⁶ See HOMEOWNER'S BOOKLET, *supra* note 98, at 14.

¹¹⁷ N.J. ADMIN. CODE tit. 5, § 25-5.5(c)(1). As of the time of writing this article, New Jersey had a contract with the Office of Dispute Settlement, a state agency. The State previously had contracted with the American Arbitration Association and the National

reaching an agreement between the owner and the builder, he will then process an award.¹¹⁸ If the parties fail to reach an agreement concerning the purported defect, the conciliator/arbitrator will go directly into the arbitration process upon agreement of both parties.¹¹⁹ The arbitrator will then render a judgment, which legally binds both parties.¹²⁰ The judgment of the arbitrator details the extent of the defect and the date by which the builder must cure the defect.¹²¹ The arbitration award is not appealable through the Program;¹²² however, either party may seek to have the award confirmed, vacated, modified, or corrected in Superior Court within three months of the arbitration award.¹²³

In the event that neither the owner nor the builder agree to enter into arbitration after the conciliation process, the matter is reviewed by the Program.¹²⁴ The Program's decision is binding; however, both sides may appeal within fifteen days of the decision.¹²⁵ If the Program's decision is appealed, the matter is handled through an administrative hearing administered by the New Jersey Office of Administrative Law.¹²⁶ If the administrative law judge finds in favor of the owner, and the builder still refuses to make repairs or cure the defect, the owner may file a request for payment with the State, and the State will compensate the owner for the defects.¹²⁷ The State will proceed against the builder to obtain payment, and either revoke or suspend the builder's registration.¹²⁸

The New Jersey Act and Regulations also provide an election of remedies provision.¹²⁹ If the owner files a claim with the State Plan

Academy of Conciliators. See Memorandum from Peter Desch, Chief, Bureau of Homeowner Protection, State of New Jersey, to Andrew Cook, Research Assistant to Professor Stark, The John Marshall Law School (July 12, 2002) (on file with author).

¹¹⁸ N.J. ADMIN. CODE tit. 5, § 25-5.5(c)(1).

¹¹⁹ *Id.* § 25-5.5(c)(5).

¹²⁰ *Id.* § 25-5.5(c)(3)(i)(2).

¹²¹ *Id.* The regulations do not permit the arbitrator to make a monetary award to the owner.

¹²² *Id.*

¹²³ N.J. STAT. ANN. § 2A:24-7 (West 2003). The decision of the arbitrator "shall be binding on both parties and reviewable only under such circumstances and to such extent as is available pursuant to the New Jersey Arbitration Act." N.J. ADMIN. CODE tit. 5, § 25-5.5(c)(3)(i)(2); see also N.J. STAT. ANN. § 2A:24-1.

¹²⁴ N.J. ADMIN. CODE tit. 5, § 25-5.5(c)(5)(ii)(1).

¹²⁵ *Id.*

¹²⁶ *Id.*

¹²⁷ *Id.* § 25-5.5(e)(1).

¹²⁸ *Id.* § 25-2.5(b)(3).

¹²⁹ See N.J. STAT. ANN. § 46:3B-9 (West 2003); N.J. ADMIN CODE tit. 5, § 25-3.10.

under this provision, the owner may not file a lawsuit in a court at the same time. Another feature of the New Jersey Act allows an owner to opt out of the Program and file a lawsuit against the builder in a court of law. However, opting out precludes the owner from subsequently filing a claim with the State Plan.¹³⁰

b. Analysis of the New Jersey Act

The New Jersey Act is truly unique in the United States, and although not “perfect,”¹³¹ it provides the owner with the most comprehensive and effective protections of all the home warranty statutes we have researched.

i. *Clear Standards*

Perhaps one of the biggest problems with relying on the implied warranty of habitability is the difficulty in knowing what defects render a house “uninhabitable” or “unfit.” This is problematic for both the homeowner, who will have difficulty knowing if the defect with his or her house is a covered defect, and the builder, who does not have a clear idea before construction has begun as to what standard the builder will be held. The New Jersey Act contains highly detailed and clear standards as to what is covered under a warranty and what repairs the builder is required to perform.¹³² This should help the builder know exactly where the bar is and what it must do to equal or exceed the required standards of performance. Indeed, the relatively low percentage of claims honored in the system may be based in part on the clarity of these standards, which facilitates the builders’ compliance with the requirements of the Act. For example, the State issued 6021 warranties for new homes in 2001, and only 544 successful claims were raised, which is slightly less than ten percent.¹³³ The first-year performance standards are very comprehensive and would be expected to exceed what would be covered under the implied warranty of habitability or any limited warranties that a developer typically provides

¹³⁰ See HOMEOWNER’S BOOKLET, *supra* note 98, at 16.

¹³¹ “Perfect” is defined as requiring the type of ex ante bargain that a builder and new home purchaser would likely strike if they had equal knowledge and bargaining power.

¹³² See N.J. STAT. ANN. § 46:3B-9.

¹³³ Letter from Peter Desch, Chief, Bureau of Homeowner Protection, State of New Jersey, to Andrew Cook, Research Assistant to Professor Stark, The John Marshall Law School (July 12, 2002) (on file with author).

in place of the implied warranty of habitability.¹³⁴ However, as previously discussed, what is covered under the New Jersey Act in year two is more limited than in year one, and after year two only “structural” defects are covered.

One problem with the setup of the standards, from the homeowner’s perspective, is that if they do not discover the defect until after year one it is less likely to be a covered defect, and if it is discovered after year two, it is even less likely to be covered since few defects would fit under the narrow definition of “structural defect” under the New Jersey Act. For example, in 2001, of the 544 successful claims raised, the majority, 387 claims, were claims for defects covered during either the first or second year.¹³⁵ The remaining 157 were major structural defect claims filed during years three through ten after the commencement of the warranty.¹³⁶ Obviously, any expansion on what is covered after year one and after year two would add to the costs of the warranty program, and these costs would get passed to homeowners in the form of higher housing costs. The New Jersey legislature tried to balance the goal of protecting homeowners from construction defects against the goal of keeping housing costs down.

After seeking feedback on the New Jersey Act from attorneys who have practiced this area of law in New Jersey, we identified two problems with the standards imposed. First, some of the performance standards are too low, in that even if the builder meets these minimum standards, the buyer may not be satisfied.¹³⁷ Second, some homeowners, especially those who have purchased expensive homes, expect that aesthetic-type defects are also covered, but such defects are not covered to their satisfaction even under the first year performance standards.¹³⁸ Another problem we foresee occurring regularly is homeowners not

¹³⁴ *Id.*

¹³⁵ *Id.*

¹³⁶ *Id.*

¹³⁷ For example, the rules defining the performance standard for cracks in basement floors provide, “Cracks exceeding one quarter inch width or one quarter inch in vertical displacement is a deficiency.” N.J. ADMIN. CODE tit. 5, § 25-3.5(c)(1)(ii)(1) (2003). However, the performance standards do not regulate the quantity of cracks that are unacceptable before there is a considered deficiency. *See id.*

¹³⁸ For example, the performance standards provide that “Interior paint not applied in a manner sufficient to visually cover wall, ceiling and trim surfaces is a deficiency.” *Id.* § 25-3.5(h)(7)(vi)(1). The standard, “sufficient to visually cover” is vague. This standard may be too low, especially for an owner purchasing a very expensive home and who expects a higher quality of workmanship.

discovering defects relating to performance standard matters within the first year, and these defects are not covered if discovered after the first year. Indeed, many published cases relate to claims that certain defects are structural defects when it is clear that the defects, if discovered before year three, would have been covered under the performance standards or year two standards.¹³⁹ Our proposal builds on the positive aspects of the clear and fairly comprehensive standards set up in the New Jersey Act, but our proposal also addresses some of the problems identified with these standards.

ii. Inexpensive Claims Resolution Process

A second outstanding feature of the New Jersey Act is that the New Jersey legislature and its Bureau of Homeowner Protection devised a claims procedure that is much quicker and less expensive to administer than that which occurs in a typical litigation of a construction claim.¹⁴⁰ These savings in resolving construction defects benefit both homeowners and sellers/builders. Indeed, the system set up originally in 1977 has in fact become more efficient in its operations as time has gone by. The average warranty rate (i.e., the average cost of warranty premiums compared to the average cost of new homes) decreased from 0.4 percent in 1980 to 0.292 percent in 2001.¹⁴¹ Most surprising, at first blush, is the fact that the New Jersey Builders Association has positively endorsed this required warranty and registration system.¹⁴² Upon reflection, it is clear that they must be doing something right in New Jersey if builders are happy with a system where they pay to the State or an approved private party a registration fee and abide by certain clearly defined standards. We speculate that two features of the system that the builders are particularly pleased with are the fact that (1) what they are responsible for in the first two years is clearly spelled out, and they are not responsible for claims after year two, and (2) the inexpensive cost resolution process which requires the homeowner to notify the builder

¹³⁹ *Sharma v. Homeowner Prot. Bureau, New Home Warranty Program*, 94 N.J. Admin. 2d (CAF) 83 (claim made after one-year warranty had expired); *Harborview Condo. Ass'n v. Bureau of Homeowner Prot. New Home Warranty Program*, 95 N.J. Admin. 2d (CAF) 38 (claims under new home warranty program were either untimely filed or insufficient for failure to establish major structural defects).

¹⁴⁰ The arbitration fee of \$500 is paid out of the warranty premium paid to the State fund. See memorandum from Peter Desch, Chief, Bureau of Homeowner Protection, State of New Jersey, to Andrew Cook, Research Assistant to Professor Stark, The John Marshall Law School (June 28, 2002) (on file with author).

¹⁴¹ *Id.*

¹⁴² *Id.*

and give the builder an opportunity to cure the defect before a claim is raised and the mediation/arbitration process begins to resolve any dispute. Our proposal incorporates the same claims resolution processes that have worked so well in New Jersey.

iii. Process to Weed Out Unscrupulous Builders

The registration requirement in the New Jersey Act is an important step in weeding out and monitoring potentially unscrupulous builders. If a builder does not make good on its defective construction, it will not be allowed to build any new homes in the State. In addition, those builders who have a history of claims, are required to pay a higher registration fee than those with a clean record. This feature of the New Jersey Act creates proper incentives by rewarding those builders with the best records and forcing those builders who are adding to the costs of the system to internalize some of those costs. To better weed out the unscrupulous builders, the application that the builder/seller entity must fill out in order to be registered, seeks information as to the individuals who comprise the entity. The Regulations pursuant to the New Jersey Act stipulate that the State can deny registration to the builder entity if the builder *or other person with an economic interest in the builder's entity* had its registration revoked or suspended.¹⁴³ This should help prevent builders with bad track records from hiding behind newly created entities.

iv. Public Notice of the Protections

It is critical for new homeowners to be aware of the comprehensive protections available to them under the New Jersey Act. To facilitate this knowledge, the New Jersey Act requires the seller/builder to disclose to the buyer/owner the warranty coverage at the closing of the sale.¹⁴⁴ The Bureau of Homeowner Protection has created various booklets for new owners and for builders that provide substantial information and easy to understand procedures in the event of a defect. Pursuant to the regulations accompanying the Act, the builder is required to provide the purchaser with a booklet titled, *Homeowner's Booklet* along with the State-issued warranty document "Certificate of Participation." The booklet and the Certificate of Participation are considered legal documents in the

¹⁴³ N.J. ADMIN. CODE tit. 5, § 25-2.5(a).

¹⁴⁴ *Id.*

nature of a contract, establishing that the purchaser agrees to the terms, conditions and exclusions contained therein.¹⁴⁵

v. An Adequate Amount of Money is Available to Pay Claims

Perhaps the most important safeguard offered to new homeowners under the New Jersey Act is providing a source of funds to recover from in the event the builder fails to correct the construction defects. The registration and warranty fees paid by each builder are used to pay for the administration of the New Jersey Act, the review of the registration applications, the resolution of claims, and the correction of defects covered under the New Jersey Act when the builder is not required or able to do so. The warranty program, as previously stated, is operating in the black and more efficiently over time.

vi. Problems with the New Jersey Act

Although the New Jersey Act and Regulations generally provide many effective safeguards to homeowners, they do contain a few drawbacks. As previously discussed, some believe that the performance standards do not sufficiently protect homeowners from visual or aesthetic defects.¹⁴⁶ More importantly, if a homeowner does not discover the defect until after one year or more than two years after closing, then the defect is less likely covered under the New Jersey Act. Another drawback is that the warranty only covers new homes, not older buildings converted into condominiums.¹⁴⁷ Therefore, in our scenario at the beginning of the article, the defects found in the professor's newly converted condominium would not be covered under the New Jersey Act because the building itself was not new. From the reputable builder's perspective, one problem with the New Jersey Act is that it forces the builder to pay a registration fee and warranty premium even if the builder consistently builds outstanding homes and would make good on any defects with respect to work performance.

¹⁴⁵ See HOMEOWNER'S BOOKLET, *supra* note 98, at 1.

¹⁴⁶ E-mail from James Landgraf to Andrew Cook, Research Assistant to Professor Stark, The John Marshall Law School (July 23, 2002) (on file with author).

¹⁴⁷ N.J. STAT. ANN. § 46:3B-2 (West 2003).

2. Maryland's Custom Home Protection Act

The Maryland Custom Home Protection Act¹⁴⁸ ("Maryland Act") could be construed as providing equally broad protections to new homeowners as the New Jersey Act, except for one major flaw—its protections are optional. Under the Maryland Act, the builder is required to disclose in writing to the owner, before entering into the contract, whether the builder participates in a new home warranty security plan.¹⁴⁹ If the builder does not participate in a new home warranty security plan, it must disclose (1) that the owner should be aware that builders of new homes are not required to be licensed by the state and are not licensed in most jurisdictions,¹⁵⁰ and (2) that the owner may only have certain limited implied warranties without a new home warranty.¹⁵¹ In addition, the purchaser is required to acknowledge in writing that she understands that the builder does not participate in a new home warranty security plan.¹⁵² If the purchaser enters into a purchase or construction contract without the required purchaser's acknowledgment, the contract is voidable.¹⁵³ The purchaser may rescind the contract within five working days, and upon rescission shall receive any money the purchaser paid to the builder for the new home.¹⁵⁴

If the builder elects to participate in it, the new home warranty security plan warrants for one year that the new home is free from any defects in materials and workmanship.¹⁵⁵ A two-year warranty covers any defects in "electrical, plumbing, heating, cooling, and ventilating" equipment.¹⁵⁶ The Maryland Act also provides for a five-year warranty for any structural defects.¹⁵⁷ A material breach of contract by the builder allows the purchaser any remedies "provided by law including . . . [r]escission of the contract" and "a refund of any money paid to the builder for the new home."¹⁵⁸

¹⁴⁸ MD. CODE ANN., REAL PROP. §§ 10-601 to -610 (2000).

¹⁴⁹ *Id.* § 10-602(a).

¹⁵⁰ *Id.* § 10-603(a)(1)(i).

¹⁵¹ *Id.* § 10-603(a)(1)(ii).

¹⁵² *Id.* § 10-603(a)(2).

¹⁵³ *Id.* § 10-603(a).

¹⁵⁴ *Id.* § 10-603(b).

¹⁵⁵ *Id.* § 10-604(a)(1)(i).

¹⁵⁶ *Id.*

¹⁵⁷ *Id.*

¹⁵⁸ *Id.* § 10-604(c)(2).

Under the new home warranty security plan the developer/builder must do the following:

- (1) Provide for the payment of claims against a builder for defects warranted;
- (2) Be operated by a corporation, partnership, or other legal entity authorized to do business in Maryland;
- (3) Demonstrate to the Division that the plan will maintain financial security to cover the total number of claims that the plan reasonably anticipates will be filed against participating builders;
- (4) File with the Division a surety bond or an irrevocable letter of credit from a federally insured financial institution in an amount set by the Division, but not less than \$100,000, for the benefit of owners injured by the failure of the new home warranty security plan to pay [the required] claims;
- (5) Provide within the new home warranty documents the performance standards that describe the builder's obligations for defects warranted[; and]
- (6) Provide for the mediation of disputes between an owner and a builder before a claim will be paid by the builder's new home warranty security plan.¹⁵⁹

The statute also provides for a fine up to \$50,000 or imprisonment up to two years, or both, for "[a]ny person that knowingly violates the provisions . . . or knowingly misrepresents the existence of a new home warranty."¹⁶⁰

The key problem with the Maryland Act is that with adequate disclosure to the new home purchaser, the developer can opt out of the protections provided in the Maryland Act, including the requirement to post a \$100,000 letter of credit or security bond in that amount to secure the payment of any claims under the Act. The ability to bargain over opting in or out of the Maryland Act's protections would not be

¹⁵⁹ *Id.* § 10-606(a).

¹⁶⁰ *Id.* § 10-609.

troubling if it were true that developers and new homeowners possessed equal bargaining power and sophistication. However, this is rarely the case, especially during times of tremendous house building in a "seller's market." Even if the purchaser understands the significance of the "opt out" provisions in a long and complicated contract, it is unlikely he or she can bargain for a different result.¹⁶¹

IV. PROPOSED LEGISLATION

We have formulated two proposals to address the problems previously identified. The first proposal is comprehensive in nature and adopts the basic features of the New Jersey Act, with three key modifications. The second proposal also addresses the major problems identified in this article, but in a more modest fashion.

A. *Comprehensive Legislation*

Our first proposal picks up the concept in the New Jersey Act of requiring all homebuilders to be registered. In order to maintain this registered status,¹⁶² the builder would have to pay a fee and be in compliance with the requirements of the statute. The fee covers the costs of enforcing the statute and pays for the conciliation and arbitration of disputes under the statute. As previously discussed, the ability to prevent builders who have failed to pay to correct covered defects from continuing to build is very helpful in weeding out negligent or unscrupulous builders.

Our first proposal also adopts the dispute resolution process, or "claims procedure," detailed in the New Jersey Act. As previously discussed, one of the largest hurdles facing prospective litigants in attempting to recoup the costs to correct construction defects is the substantial expense and delay involved in litigation.¹⁶³ This problem is often a direct result of court calendar congestion, the extensive procedural and discovery rights, and the long appellate process. By the year 2020, it is estimated that civil cases in the federal courts will exceed

¹⁶¹ See *supra* note 9.

¹⁶² Our proposal would require evidence of the registered status for the developer/builder to obtain any building permits or certificates of occupancy for any work done in the state.

¹⁶³ Scott E. Mollen, *Alternate Dispute Resolution of Condominium and Cooperative Conflicts*, 73 ST. JOHN'S L. REV. 75, 88 (1999).

one million and appeals will approach 325,000 cases.¹⁶⁴ As a result, an action brought by a homeowner or condominium association may languish for years before a judgment is rendered.

For a more efficient resolution of construction defect disputes, our proposed legislation provides initially for a conciliation of the dispute and then for a binding arbitration of the dispute pursuant to procedures similar to those established in the New Jersey Act. This will ensure that the homeowner has an expedited, yet fair, process to resolve his or her claim against the builder. Thus, if a new homeowner discovers a defect in construction, the owner can bring this claim to the attention of the developer and have a simple and inexpensive means of resolution under our proposed legislation. Similar to the New Jersey Act, the homeowner must first notify the builder of the defect and provide the builder with an opportunity to correct it before filing a claim. This type of notice and opportunity to cure has been sought by numerous homebuilders in many states.¹⁶⁵

Our proposal also addresses the equally troubling problem that occurs when the costs involved in compelling the developer to make or pay for the repairs lead to purchasers either not pursuing such claims or pursuing them, but not being made whole. One cause of these high costs is the ambiguity of vaguely defined implied warranties. Consequently, our proposal includes the specific warranties contained in the New Jersey Act (with certain modifications discussed below) to make clear what is covered and what is not.

To better protect new homeowners, however, our proposal would extend the performance standards warranty past the current one-year coverage and provide the owner with a two-year coverage. We recognize that this would lead to more claims being filed and covered in year two, which in turn would lead to an increase in the contribution percentage that would be required to be paid by all or some of the builders. It should be noted, though, that the current warranty premiums charged in New Jersey are a very low percentage relative to the purchase price of the home, so even a doubling of the premium

¹⁶⁴ *Id.* at 87.

¹⁶⁵ Kenneth R. Harney, *New Approach Seeks to Crimp Builder Lawsuits*, CHI. TRIB., June 23, 2002, at 2.

charged to some builders would not be a large amount.¹⁶⁶ For example, even if the premium were doubled to extend the performance standards warranty to two years, if a house sells for \$200,000 a builder with a clean record would only be charged \$680, or less than one-quarter of one percent, as the warranty premium.

Our proposed legislation would thus cover appliances, fixtures, and equipment defects, as well as defects to mechanical and electrical systems and the other performance standards of the New Jersey Act, but for two years rather than one. Similar to the New Jersey Act, our proposed legislation would also cover “structural defects,” as defined by the New Jersey Act, to be paid for by builders in years one and two and by the State in years three through ten using the funds established by the warranty premiums.

As previously mentioned, the New Jersey Act does not cover defects found in rehabilitated homes or buildings, and New Jersey case law further confirms that remodeled and rehabilitated homes are not covered under the New Jersey Act.¹⁶⁷ Our proposal, however, would change the definition of “new home” to cover defects found in existing buildings converted into condominiums and sold to homeowners. This would ensure that developers converting older buildings into new condominiums and lofts would not be exempt from liability, and thus the owner would not be left unprotected from the risks previously identified.

Finally, our proposal would also allow a buyer/new homeowner the option to purchase an extended warranty for performance standard defects, mechanical and electrical systems defects, and major structural defects that would run for up to five years. The optional extended warranty could also include an expansion of the performance standards in the first year to cover some of the aesthetic type defects not currently covered. Private companies that are designated by the State as approved alternative warranty plans would be allowed to provide their own warranty coverage to owners. The rates the owner would be required to pay would have to be calculated after a study of the costs associated with providing these expanded warranties. Obviously, such rates will be

¹⁶⁶ Letter from Peter Desch, Chief, Bureau of Homeowner Protection, State of New Jersey, to Andrew Cook, Research Assistant to Professor Stark, The John Marshall Law School (July 12, 2002) (on file with author).

¹⁶⁷ *Glaum v. Bureau of Constr. Code Enforcement, New Home Warranty Program*, 533 A.2d 986 (N.J. Super. Ct. App. Div. 1987).

more costly than the basic required warranty; however, this proposal provides a viable option to those owners that have the financial ability to afford the extra expense and who desire to have extended coverage for their new homes. The builder would be required to disclose this option to the buyer/new homeowner before the sale closes, but would not be required to provide this extended coverage. We anticipate that only those purchasing luxury homes would opt to pay this added expense.

B. A Scaled Back Proposal

Based upon the overwhelmingly positive experience with the New Jersey Act, we devised our first comprehensive proposal based largely on that Act. We recognize, however, that the New Jersey Act, and a proposal based in large part on that Act, might constitute a legislative reform bite that is just too big for some states to swallow. Although based on the data analyzed, it appears, that the State-operated system is operating efficiently; those who favor less government, especially when a governmental agency takes on tasks that private parties could, might blanch at this comprehensive proposal. As a result, we have created a more scaled back reform proposal as an alternative, with less governmental involvement and less costs to builders that are not reimbursed, but also with somewhat less protection to new homeowners.

Our alternative proposal adopts some of the concepts from the New Jersey Act and some of the reform features that certain villages and towns outside of Chicago, Illinois have enacted. The alternative proposal picks up the provision in the New Jersey Act of requiring all homebuilders to be registered. In order to maintain this registered status,¹⁶⁸ the builder would have to pay an annual, non-refundable fee of \$200 and be in compliance with the requirements of the statute.¹⁶⁹ The fee would cover the costs of enforcing the statute and the anticipated costs associated with conciliation and arbitration of disputes under the statute, similar to the New Jersey Act.¹⁷⁰ Similar to the comprehensive

¹⁶⁸ Our proposal would require evidence of the registered status for the developer/builder to obtain any building permits or certificates of occupancy for any work done in the state.

¹⁶⁹ Under the New Jersey Act, there is also a non-refundable registration fee of \$200 to be paid every two years. We are requiring it to be paid each year because there will be no non-refundable warranty premium to be paid under the alternative proposal, and thus, the annual \$200 will go towards not only the cost to review the registration application, but also the costs of the mediation/arbitration when claims are raised.

¹⁷⁰ The legislation would provide for a reduction in the fee charged to a builder if there are no valid claims raised against it for the prior year and would provide for an increase in

proposal, the alternative proposal would provide (1) a two-year warranty for the performance standards, and (2) a two-year warranty for appliance, fixture, and equipment defects, and for mechanical and electrical system defects. It would also provide for an optional extended warranty as detailed in the comprehensive proposal.

The alternative proposal differs from the comprehensive proposal and the New Jersey Act in two important ways. First, builders will not be required to pay a non-refundable warranty premium but instead deposit three percent of the overall cost of each condominium unit and new home sold into an escrow account with the title insurance company that closes the sale. This will ensure that adequate reserves are available to repair the most common and frequent types of construction defects that arise.¹⁷¹ After the closing, the developer is required to pay the three percent of the unit purchase price to the title company, acting as escrowee, who in turn deposits the money in a federally insured bank or savings and loan institution. The proposed legislation requires that the money remain in escrow for a two-year period. Following the two-year warranty period on the specific unit/house, if no complaints are filed against the developer, the builder/developer is reimbursed the amount placed in escrow plus interest accrued during the period. In the event of a claim raised during the two-year period, the money would remain in escrow until the claim is settled.

The main benefit to this alternative proposal is that if no claims are raised against a builder, the only cost incurred by the builder is the \$200 registration fee—there is no non-reimbursable warranty fee as with the comprehensive proposal. The main drawback to the alternative proposal is that structural defects will only be covered for the two-year period that the deposits are held in escrow; this limitation is the second major difference between the comprehensive proposal and the alternative proposal.

This alternative proposal would directly address the problem posed earlier of the developer entity with no assets to recover from. Most importantly, it addresses this problem at no cost to the developer since

the fee charged to a builder after a certain number of valid claims are raised against it in the prior year.

¹⁷¹ Most common defects include: walls, ceilings, floors, plumbing, roof, foundation, central heating and cooling, and interior electric. See RICHARD L. KALUZNY, U.S. DEP'T OF HOUS. & URBAN DEV. & FTC, A SURVEY OF HOMEOWNER EXPERIENCE WITH NEW RESIDENTIAL HOUSING CONSTRUCTION 24 (1980).

they will be reimbursed and the amount deposited into escrow with interest thereon if no valid claims are filed. Indeed, many professional builders voluntarily provide in their own internal budgets a percentage of the purchase price for post-closing claims.¹⁷² The three percent escrow requirement is consistent with a similar requirement currently existing in three towns near Chicago, Illinois.¹⁷³ According to officials in one town, neither the costs nor the volume of homebuilding in these towns has suffered as a result of this requirement.¹⁷⁴

V. CONCLUSION

Both the comprehensive first proposal and the scaled back second proposal provide a fair and efficient proactive model to resolving construction defects. This proactive model is necessary because home purchasers lack the knowledge and bargaining power to negotiate for the basic or expanded warranties that they need and desire and, equally important, to ensure that a source of repayment exists if defects are discovered and not corrected by the builder. As previously addressed, current case law and statutes (with the exception of New Jersey) do not adequately protect new homeowners' reasonable expectations that the builder will construct for them a home free from serious construction defects.¹⁷⁵ When the new homeowner discovers any serious construction defects, he or she has a reasonable expectation that the builder who caused the defects will in fact repair them or pay the repair costs for them.

Homeowners face two major obstacles to having their reasonable expectations met. First, is the uncertainty of success in litigating the claim under the vague standard of what defects make a house not "habitable" and the high costs associated with litigating this type of claim.¹⁷⁶ Second, even if the homeowner is able to obtain a judgment against the builder, when the builder is a limited liability entity there may be no assets from which a homeowner can recover judgment.

¹⁷² Jordan I. Shifrin, *A New Board Needs to Evaluate the Condition of the Premises*, CHI. DAILY HERALD, March 10, 2001, New Homes, at 7.

¹⁷³ EVANSTON, ILL., CITY CODE § 5-4-3-4 (2002); OAK PARK, ILL., VILL. CODE § 12-4-4 (2002); SKOKIE, IL. VILL. CODE §§ 30.08, 30.09 (2003).

¹⁷⁴ Anecdotal evidence based on phone conversation with Barbara Mangler, Village of Skokie attorney.

¹⁷⁵ See *supra* Part III.A-D.

¹⁷⁶ See *supra* note 6.

Both of these problems are addressed in the two proposals. Under both proposals, clear standards of what is warranted are created and construction defects are resolved in a mediation/arbitration, and these costs have already been paid for up front in the registration fees charged to each builder in the state. Second, under the proposals, either a warranty fund or an escrow would be required to be established as each new home is constructed and sold, guaranteeing a source of repayment for valid claims. The proposals provide an efficient and fair resolution of construction defects claims by meeting the reasonable expectations of the homebuyers, by providing incentives for builders to meet well-articulated building standards, and by reducing the costs associated with resolving claims when they arise. Finally, when crafting these proposals, care was taken to try to create the *ex ante* bargain that a buyer and a builder would engage in if they had equal knowledge and bargaining power. Although a homeowner desires maximum protection from construction defects once they arise, such protection comes at a cost, and not all future homeowners can afford or would want to pay the costs for the "perfect" house with the "perfect" warranty. Thus, we provide for a certain minimum required warranty that we believe the average home buyer would bargain to pay for and then provide for a more expanded but optional warranty that only more affluent home buyers would likely want to pay for.

Purchasing a home is usually the largest single investment that a person makes.¹⁷⁷ Much can go wrong, especially with new construction.¹⁷⁸ Surprisingly, attorneys have been largely displaced from the role of representing buyers in this situation.¹⁷⁹ Indeed, even when a purchaser has hired an attorney to represent her, attorneys are often told that the contract is "take it or leave it" when they attempt to negotiate protections for their client. Thus, it is critical that the state step in and enact laws similar to the ones proposed herein that will provide home buyers with the protections they so badly need.

¹⁷⁷ See *supra* text accompanying notes 18-19.

¹⁷⁸ In addition to patent defects, homebuyers may face latent defects that surface after closing. Plus, there is the whole issue of closing the sale on time and on budget.

¹⁷⁹ See GOLDSTEIN & KORNGOLD, *supra* note 8, at 27.