

# **Multi-Family Dwelling Construction Defect Litigation**

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**MULTI-FAMILY DWELLING CONSTRUCTION DEFECT LITIGATION  
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Amendment to CIC Declaration

Exhibit A

## **Multi-Family Dwelling Construction Defect Litigation**

When claims of defective construction arise in multi-family dwellings additional issues must be considered beyond those which arise in cases of single-family dwellings. This paper will provide a basic framework for analyzing claims for defective construction in condominium and townhome developments in Minnesota.

Although it is not possible within the scope of this paper to analyze all of the differences between the condominium form of residential ownership and the townhome form of ownership, the practitioner confronted with advancing or defending against claims of defective construction in either type of development should bear in mind that there are differences because those differences may impact the type of rights which may be asserted, who may assert them, and who may compromise them. Generally speaking, a condominium is a form of common interest community in which the interior surfaces and spaces of an individual living unit is owned separately in fee together with an undivided interest in everything else, including the land, shared walls, exterior surfaces, and inter-unit plumbing, mechanical, and electrical systems. The maintenance of all elements except the individual living unit is the responsibility of all the owners, acting in common, through a corporate structure. A townhome development, on the other hand, is one in which the owner holds the fee to the entire unit and the land on which it sits. The other elements of the development are owned by a separate corporation comprised of all of the townhome unit owners which may have defined maintenance responsibilities.

Effective June 1, 1994, both types of cooperative living arrangements came under the umbrella of a statutory scheme in which both condominiums and townhomes are treated as Common Interest Communities (CICs). The remainder of this paper will focus on that concept.

A CIC in Minnesota may be a condominium, a townhome, or a housing cooperative. In general, a purchaser of property in a CIC does not acquire the same right, title and interests that a purchaser of single-family home real estate acquires. In a CIC, the homeowner's property interests are more segregated, as defined by the CIC's governing documents. There is also an additional party-in-interest: the homeowner's association. Importantly for our topic, a purchaser of property in a CIC is afforded different statutory protections applicable only in the common interest context.<sup>1</sup>

Effective advocacy in the realm of CICs requires a working understanding of governing statutes and the controlling documents that define the community and affect common law rights and obligations.

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<sup>1</sup> Note that while condominiums are specifically defined in the most significant governing statute, there is no separate definition of a townhome. *See* Minn. Stat. § 515B.1-103.

## I. Governing Law of Common Interest Communities

A number of statutory provisions must be consulted in evaluating the rights and interests of property owners in CICs.

### A. Minnesota Common Interest Ownership Act

The starting point for analysis of construction defect disputes involving a CIC is the Minnesota Common Interest Ownership Act: Minn. Chapt. 515B (MCIOA). This chapter is modeled on the Uniform Common Interest Ownership Act. The MCIOA applies to all CICs created on or after June 1, 1994. Minn. Stat. § 515B.1-102(a).<sup>2</sup>

A predecessor statute, the Uniform Condominium Act (UCA), Minn. Chapt. § 515A, applies to all condominiums created between August 1, 1980 and July 1, 1994. Because of the 10 year period set forth in the statute of repose (Minn. Stat. § 541.051) and the limitations period applicable to claims arising under the UCA, the number of claims to which the UCA might apply is rapidly waning. Condominiums and other CICs created prior to the effective date of the MCIOA may still elect to become subject to the MCIOA. *See* Minn. Stat. § 515B.1-102(b), (d), and (e).

The two basic property types in a CIC are units and common elements. A “unit” is a physical portion of a CIC intended for separate ownership, or separate occupancy pursuant to a proprietary lease, the boundaries of which are described in the CIC’s declaration. Minn. Stat. § 515B.1-103(34). “Common elements” are all portions of the CIC other than units.<sup>3</sup> Minn. Stat. § 515B.1-103(34).

The MCIOA extends a number of statutory protections and warranties to both the units and the common elements. In addition to specific warranty protections the MCIOA creates a six-year statute of limitations for warranty claims arising under the MCIOA<sup>4</sup> and the right to recover attorneys’ fees and costs of litigation.<sup>5</sup>

### B. Minn. Stat. § 327A

Because we are considering residential real estate, it is important to point out that the statutory new home warranties applicable to single-family residential property also apply in the CIC context. The Section 327A definition of “dwelling” is broad enough to include units in a

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<sup>2</sup> A condominium is “created” when its declaration is recorded. Minn. Stat. § 515B.2-101(a)(1). A townhome is shorthand for a planned CIC with common elements, and is created by recording both a declaration and a conveyance of the common elements subject to that declaration to the association. Minn. Stat. § 515B.2-101(a)(2).

<sup>3</sup> As we shall see *infra* at Part IV, there is another type of property referred to in the warranty provisions of Minn. Stat. § 515B.4-113 that is not expressly defined in the statute.

<sup>4</sup> *See* Minn. Stat. § 515B.4-115(b).

<sup>5</sup> Minn. Stat. § 515B.4-116(b).

CIC.<sup>6</sup> Like many areas of the MCIOA, the dearth of controlling case law leaves the interplay between 327A and the MCIOA subject to interpretation. We will examine issues of applicability and interplay between Chapter 327A and the MCIOA in Part V. D. below.

## **II. Governing Documents of Common Interest Communities**

Familiarity with the following documents and their role in defining the rights and interests of CIC property owners is critical to effective advocacy in the construction defect context.

### **A. Declaration**

The declaration is the instrument that, upon recordation, creates the CIC. Minn. Stat. § 515B.I-103(16); Minn. Stat. § 515B.2-101(a). The type of CIC is delineated by the ownership interests created and must be stated at the top of the first page of the declaration. Minn. Stat. § 515B.2-105(a)(1). This is one of the first legal documents to consider when approaching a potential construction defect claim because the declaration sets the stage for everything that will follow.

The declarant is, among other things, the person who executes a declaration creating a CIC. *See* Minn. Stat. § 515B.I-103(15). In most instances, the declarant will be the developer who originally creates the association and develops the property comprising the CIC. The declarant is bound by statute to extend both “express” and “implied” warranties to the purchaser of a unit. *See* Minn. Stat. §§ 515B.4-112 and .4-113.

### **B. Articles of Incorporation and Bylaws**

When a CIC is created, a unit owners’ association is incorporated to act on behalf of the members. *See* Minn. Stat. § 515B.3-101. The association must be organized as a Minnesota profit or non-profit corporation.<sup>7</sup> *Id.* The typical CIC association is organized under Chapter 317A as a non-profit corporation, but the articles of incorporation should be consulted to establish this.

The bylaws serve as the regulatory code for regulation and management of the association’s internal affairs. Each CIC must have bylaws, and the bylaws must comply with both the chapter under which the association is incorporated and with the requirements in the MCIOA. Minn. Stat. § 515B.3-106(a). The powers of the association are enumerated in the statute, but those powers are subject to the provisions of the declaration and the bylaws (with certain restrictions). Minn. Stat. § 515B.3-102(a) & (b). Thus, the bylaws and the declaration may alter the default statutory scheme. A review of the declaration, articles of incorporation and

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<sup>6</sup> A “dwelling” is defined at Minn. Stat. 327A.01, subd. 3. This issue is further explored at Part IV.C. below.

<sup>7</sup> A cooperative may be organized under Chapter 308A (which is dedicated to cooperatives). Minn. Stat. § 515B.3-101.

bylaws is essential to understanding the type of CIC involved and to determining the specific rights, powers, and duties of the association in a particular CIC.

### **C. Purchase Agreement, Separate Warranty Documents, Other Instruments**

As with other residential real estate transactions a purchase agreement between the vendor and the vendee generally exists to define rights and responsibilities of the parties. Additionally, separate warranty programs are frequently employed in the sale of CIC property from the declarant to an original purchaser. Commercially salable warranty programs, such as those offered by the Residential Warranty Corporation or the 2-10 Corporation may serve to supplement or modify warranties provided by statute.

The MCIOA allows for modification of the implied warranties and of the default limitations period for bringing actions for defective construction. But, the purchase agreement and the commercial warranty programs, without more, are typically insufficient to accomplish modification. To effect a modification of either the limitations period or of a specific implied warranty the purchaser must sign an instrument separate from the purchase agreement setting forth the specific modification.<sup>8</sup> It is important, when initially evaluating a potential claim under the MCIOA, to determine whether such modifying instruments exist and whether they meet the requirements set forth in the statute.

### **D. Disclosure Statement**

One of the statutory protections given to purchasers of property in a CIC is the requirement that the declarant provide the purchaser with a disclosure statement. Minn. Stat. § 515B.4-101(b). The disclosure statement must set forth specific information as detailed in Minn. Stat. § 515BA-102(a).<sup>9</sup> The disclosure statement must fully and accurately disclose, among other things,

(11) the terms of any warranties provided by the declarant, including copies of chapter 327A, and sections 515B.4-112 through 515B.4-115...;

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(13) a statement disclosing... any unsatisfied judgments or lawsuits to which the association is a party, and the status of those lawsuits which are material to the common interest community or the unit being purchased;

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(22) a copy of the declaration and any amendments, any other recorded covenants, copies of incorporation, bylaws, and any rules or regulations of the association, any agreement excluding or modifying any implied warranties,

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<sup>8</sup> See Minn. Stat. § 515B.4-115(b) for modification of the limitations period; see Minn. Stat. § 515B.114(a) for modification of particular implied warranties in the residential context.

<sup>9</sup> In the case of resale of a unit, the purchaser is entitled to a resale disclosure statement that contains detailed disclosures of information from the seller as well as from the association. See Minn. Stat. § 515B4-102(a); see also *Neuman v. Insbruck North Townhouse, Assoc.*, 2001 WL 910297 (Minn. App. 2001).

any agreement reducing the statute of limitations for the enforcement of warranties....

Minn. Stat. § 515B.4-102(a) (2002).

The declarant is liable to a purchaser for any false or misleading statement, or for any omission of a material fact from a disclosure statement. Minn. Stat. § 515B.4-101(b). The required disclosures highlighted above touch on a number of issues that will be discussed further in this article.

### **III. The Association**

The unit owners' association is governed by a board of directors. Minn. Stat. § 515B.3-103 (a). At its inception, the association is typically controlled by the developer/declarant. During the period of developer control, the developer or its designates may appoint and remove officers and directors of the association. Minn. Stat. § 515B.3-103(c).<sup>10</sup> Declarant control of the board is diminished as units are sold, and is limited to a maximum period of 3 years or conveyance of 75 percent of the units to owners other than the declarant. *See* Minn. Stat. § 515B.3-103 (c) & (d). Turnover of the board from declarant control to unit owner control is an important event in terms of governance of the association. It also has significant ramifications for construction defect litigation, especially regarding limitations periods for MCIOA claims as discussed below at Parts V. and VI. below.

### **IV. Whose Claim Is It?**

Under the MCIOA, the homeowners' association has the power to sue on its own behalf, as well as on behalf of two or more individual homeowners. Minn. Stat. § 515B.3-102(a)(4). This section provides:

(a) [e]xcept as provided in subsection (b), and subject to the provisions of the declaration or bylaws, the association shall have the power to:

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(4) institute, defend, or intervene in litigation or administrative proceedings (i) in its own name on behalf of itself or two or more unit owners on matters affecting the common elements or other matters affecting the common interest community or, (ii) with the consent of the owners of the affected units on matters affecting only those units;

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(b) Notwithstanding subsection (a) the declaration or bylaws may not impose limitations on the power of the association to deal with the declarant which

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<sup>10</sup> The officers and directors of the association are bound by fiduciary duties. In the performance of their duties, the officers and directors are required to exercise (i) if appointed by the declarant, the care required of fiduciaries of the unit owners and (ii) if elected by the unit owners, the care required of a director by section 302A.251 or 317A.251, as applicable. Minn. Stat. § 515B.3-103(a).

are more restrictive than the limitations imposed on the power of the association to deal with other persons.

Minn. Stat. § 515B.3-102(a)(4) (2004).

Thus, under the MCIOA, the association will virtually always have standing to bring claims as the real party interest for construction defect claims, even with respect to discrete problems affecting isolated units.<sup>11</sup> The association merely needs consent of the affected unit owner(s) to bring discrete claims on behalf of particular unit owners. The best practice is to secure such consent in writing. The particular facts giving rise to standing should be separately alleged in the complaint where the association is bringing such claims on behalf of unit owners.

Whether suit is brought on behalf of the Association only, on behalf of unit owners only, or both, will also be important considerations when resolving the claims, whether by judgment, arbitration order, or settlement.

## **V. What Warranties Apply?**

In addition to warranties that are set forth in documents provided by the builder, or separate commercially salable warranty programs mentioned in Part II. C. above, Minnesota law sets forth extensive warranties applicable to property in a CIC.

### **A. Express Warranties: Minn. Stat. § 515B.4-112**

The MCIOA provides for both express and implied warranties for CICs. Express warranties under the MCIOA may be created in several different ways:

- (a) Express warranties made by a declarant or an affiliate of a declarant to a purchaser of a unit, if reasonably relied upon by the purchaser, are created as follows:
  - (1) Any affirmation of fact or promise which relates to the unit; use of the unit; rights appurtenant to the unit; improvements to the common interest community that would directly benefit the purchaser or the unit; or the right to use or have the benefit of facilities which are not a part of the common interest community, creates an express warranty that the unit and related rights and uses will conform to the affirmation or promise.

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<sup>11</sup> This resolves an issue that arose with respect to townhome associations created prior to the effective date of the MCIOA. The individual homeowners separately owned elements often claimed defective, such as walls, roofs, exterior cladding, etc. In the pre-MCIOA world, an association attempting to bring claims on behalf of homeowners so situated was subject to an affirmative defense that the association was not the real party in interest unless it obtained an assignment of claims from each unit owner.

- (2) Any model or description of the physical characteristics of a unit or the common interest community, including plans and specifications of or for a unit or other improvements located in the common interest community, creates an express warranty that the unit and the common interest community will conform to the model or description. A notice prominently displayed on a model or included in a description shall prevent a purchaser from reasonably relying upon the model or description to the extent of the disclaimer set forth in the notice.
  - (3) Any description of the quantity or extent of the real estate comprising the common interest community, including plats or surveys, creates an express warranty that the common interest community will conform to the description, subject to customary tolerances.
- (b) Neither the form of the word “warranty” or “guaranty”, nor a specific intention to make a warranty, are necessary to create an express warranty of quality, but a statement purporting to be merely an opinion or commendation of the real estate or its value does not create a warranty.
  - (c) Any conveyance of a unit transfers to the purchaser all express warranties.

Minn. Stat. § 515B.4-112 (2003).

Often statements contained in sales literature are claimed by plaintiffs to be express warranties, and by developers and builders to be opinions or commendations. Each case will turn on its own facts. The essential point is to obtain copies of all sales literature and to analyze whether statements made therein may create express warranties under the statute.

Any express warranties made to a purchaser under the MCIOA are transferable to subsequent purchasers. Minn. Stat. § 515B.4-112(c). It is very important that all original purchase agreements be consulted when determining whether to bring an express warranty claim. Units in CICs often undergo significant turnover within five years of construction. It may thus also be worthwhile to seek out and interview original purchasers of units now experiencing problems, as any express warranty claims belong to the present unit owner even though the underlying affirmations were made to the original purchaser.

#### **B. Implied Warranties: Minn. Stat. § 515B.4-113**

The MCIOA implied warranties are quite broad, and introduce an ambiguity in the scope of applicability due to the use of an undefined term. The implied warranty provision reads:

- (a) A declarant warrants to a purchaser that a unit will be in at least as good condition at the earlier of the time of the conveyance or delivery of possession as it was at the time of contracting, reasonable wear and tear excepted.

(b) A declarant warrants to a purchaser that:

- (1) a unit and the common elements in the common interest community are suitable for the ordinary uses of real estates of its type; and
- (2) *any improvements subject to use rights by the purchaser*, made or contracted for by the declarant, or made by any person in contemplation of the creation of the common interest community, will be (i) free from defective materials and (ii) constructed in accordance with applicable law, according to sound engineering and construction standards, and in a workmanlike manner.

(c) In addition, a declarant warrants to a purchaser of a unit which under the declaration is available for residential use that the residential use will not violate applicable law at the earlier of the time of conveyance or delivery of possession.

Minn. Stat. § 515B.4-113 (2002) (emphasis added).

Subdivision (a) provides a warranty of “good condition” with regard to a unit. Subdivision (b)(1) provides a warranty of “suitability” with respect to a “unit” and “common elements.” Subdivision (b)(2) provides material and workmanship warranties with respect to “improvements subject to use rights.” This introduces an ambiguity in the scope of the implied material and workmanship warranties because, whereas “units” and “common elements” are defined in the statute, “improvements subject to use rights” is not defined. *See* Minn. Stat. 515B.1-103.

On the one hand it has been argued that the term “improvements subject to use rights” is meant to be expansive, encompassing both units and common elements. On the other hand, it has been argued that the term is more restrictive because under rules for statutory construction, the legislature would not employ different terms in a statute unless it intended those terms to have different effects. *See Vlahos v. R&I Const. of Bloomington, Inc.*, 676 N.W.2d 672, 677 n.4 (Minn. 2004) (explaining that the legislature would not use different terms in different subdivisions of a statute if it had intended those terms to have the same effect). The legislative history of this provision suggests that “improvements subject to use rights” means something different than “units” or “common elements” because the former UCA statute did<sup>12</sup> unambiguously extend the warranty of materials and quality to units and common elements.<sup>12</sup> “Improvements subject to use rights by the purchaser” is a new and different term, and the

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<sup>12</sup> Minn. Stat. 515A34-112(b) reads:

A declarant warrants... that a unit and the common elements... will be:

- (1) free from defective materials; and
- (2) constructed in accordance with applicable law, according to sound engineering and construction standards, and in a workmanlike manner.

Comparing the UCA text to the MCIOA text, it is apparent that the MCIOA drafters imposed a new structure on the statute and injected a new formulation for describing the property to which the warranty of quality would apply.

