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**WARRANTY AND CONSTRUCTION DEFECT CLAIMS  
FOR COMMON INTEREST COMMUNITIES**

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## **I. Introduction**

If it is true that condominium ownership is the illusion of real property ownership, then it is axiomatic that warranty and construction defect claims against condominium developers and builders are a harsh reality. Associations also must be aware of the potential for such claims from individual unit owners as well as the imputation of notice of construction defects through agents of the associations.

This presentation will cover the statutory framework for liability under Chapter 515B, as well as the related warranty liabilities arising under Chapter 327A which applies to residential units. We will also address the affect of the statute of repose and limitation of M.S.A. § 541.051 on the various statutory and common law causes of action relevant to this discussion. In addition, we will cover disputes between the individual unit owners and the association. This presentation does not attempt to create a detailed road map except as necessary to discuss construction liability. The reader should consult the applicable statutes and secondary sources interpreting the bases for liability for further information.

## **II. The Minnesota Common Interest Ownership Act—Chapter 515B**

A. Definitions. Some general background is in order. Chapter 515B is derived from the Uniform Common Interest Community Act and from Minnesota Statutes Chapter 515A. Chapter 515B applies to all common interest

communities ("CICs") created in Minnesota on or after June 1, 1994. The statute defines a CIC as "contiguous or noncontiguous real estate within Minnesota that is subject to an instrument which obligates persons owning a separately described parcel of the real estate, by reason of their ownership or occupancy, to pay for (i) real estate taxes levied against; (ii) insurance premiums payable with respect to; (iii) maintenance of; or (iv) construction, maintenance, repair or replacement of improvements located on one or more parcels or parts of the real estate other than the parcel or part that the person owns or occupies." M.S.A. § 515b.1-103(10). The statute applies not only to multi-family, owner-occupied residential housing, such as condominiums, planned communities and cooperatives, but also to mixed-use projects.

As to preexisting CICs, Chapter 515B applies automatically to condominiums created under Chapter 515A (effective on and after August 1, 1980), except as follows:

1. Chapter 515B applies only "with respect to acts and circumstances occurring on and after June 1, 1994" as to Chapter 515A condominiums;
2. Chapter 515B does not invalidate the declarations, bylaws or condominium plats of Chapter 515A condominiums; and

3. Chapter 515A governs the rights and obligations both of a Chapter 515A declarant and of unit owners against that declarant. M.S.A. § 515B.1-102(b)(1).

Chapter 515B applies only in certain regards to Chapter 515 (effective on and after May 28, 1971) condominiums. It affects various important aspects of CIC titling, recording and taxation; applicability of local ordinances, regulations and building codes; regulation of affairs; and powers of unit owners' associations, among other topics. M.S.A. § 515B.1-102(b)(2). Although many of these sections affect the question of whether a Chapter 515 condominium association should opt in to Chapter 515B, as a practical matter it is highly unlikely that the rights created in the statute will have much effect on such condominiums. In any event, Chapter 515B applies only to events and circumstances occurring on and after its effective date.

Chapter 515B does not apply to preexisting planned communities or cooperatives. M.S.A. § 515B.1-102(b)(3). Such entities may elect to be subject to the new statute under subsection (d) thereof.

Another point of interest are the definitions of "declarant," "affiliate of a declarant," "controls," and "is controlled by." M.S.A. § 515B.1-103(15) and (2). A detailed recitation of the term "declarant" is not necessary here; suffice it to say

that a declarant is, except for secured parties, persons who essentially organize the CIC. The statute does not include within the definition of declarant those who hold an interest in the CIC, but will not transfer that interest to unit owners, and lessors in leasehold CICs who have no special declarant rights and are not affiliated with anyone who does. A declarant is also defined as a person or "persons acting in concert" who have offered, before creation of the CIC, to transfer their interest in a unit neither created nor transferred.

Of more interest, especially in light of Chapter 515B's express warranty provision at section 515B.4-112, are the definitions related to affiliation and control. The new statute continues both the substance of Chapter 515A's definitions and its rule of liberal interpretation. M.S.A. § 515B.1-114. The statute also defines declarant as any person who "controls, is controlled by, or is under common control with a declarant." M.S.A. § 515B.1-103(2). Control exists, in either direction, under four situations:

1. the person is a general partner, officer, director, or employer of the declarant;
2. the person, directly or indirectly, or acting in concert with others, or through subsidiaries, "owns, controls, holds with

power to vote, or holds proxies representing more than a 20 percent voting interest in the declarant”;

3. the person controls "in any manner the election of a majority" of the declarant's directors; or
4. the person has contributed more than 20 percent of the declarant's capital.

Id., subd. (A). See subd. (B) for identical language establishing control between a declarant and another person.

B. Warranties Express and Implied. Chapter 515B creates specific express and implied warranties by a declarant to a purchaser of a unit. M.S.A. § 515b.4-112 and 115. The former can be made not only by the declarant but also by an affiliate of the declarant. This provision recognizes the important fact that contractors, real estate agents, and developers—i.e., declarants—are often related by stock, blood, or other means of control.

The express warranties arise as follows:

1. any affirmation or promise relating to the unit, its use, rights appurtenant thereto, improvements to the CIC that would directly benefit the unit's purchaser, or the right to use or benefit from facilities not part of the CIC, creates an express warranty that such unit and its related rights and uses conform to the affirmation or promise;
2. any model or description of a unit's or CIC's "physical characteristics," including plans and specifications of a unit or other improvements in the CIC, creates an express warranty that such unit and CIC conform to the model or description; however, a notice "prominently displayed on a model or included in a description shall prevent a purchaser from reasonably relying" thereon to the extent of the notice's disclaimer;
3. a description of quantity or extent of the CIC's real estate, including plats and surveys, creates an express warranty that the CIC conforms to the description, subject to customary tolerances.

These warranties arise whether the words "guaranty" or "warranty" are used, or not. This is consistent with the remedial, consumer protection purposes of the statute. The statute consequently affords the purchaser some protection from the promises that declarants and/or their affiliates make during the promotional phase of project development.

Chapter 515B does create a safe haven for promotional materials: "[A] statement purporting to be merely an opinion or commendation of the real estate or its value does not create a warranty." M.S.A. 515B.4-112(b). Given the remedial nature of the statute, as well as the relatively narrow language of the haven, one wonders how safe it actually is. It is certainly more so in the case of written opinion or commendation, and less so in the case of oral fluff. Also, what exactly does the term "real estate" mean? The term is defined in section 515B.1-103(27) to include "structures, fixtures, and other improvements and interests that by custom, usage or law pass with a conveyance of land though not described in the contract of sale or instrument of conveyance." Given the statutory purpose, and these questions, the declarant and its affiliates should probably restrain themselves in describing the unit and other improvements, except in the most general terms— "This development is in an excellent neighborhood"; "It has great access to schools, shopping, and the highway."

As to implied warranties, Chapter 515B does not affect any existing remedies under Chapter 327A concerning statutory warranties for housing or any other cause of action, whether statutory or under common law. M.S.A. 515B.4-113(g). Unlike express warranties, a cause of action under the implied statutory warranties does not contain an element of reasonable reliance. Id., subd. (a), (b), and (c). Implied warranties include the following:

1. the unit will be in at least as good a condition at the earlier of conveyance or delivery of possession as on the contract date, reasonable wear and tear excepted:
2. the unit and the CIC's common elements are suitable for the ordinary uses of real estate of its type:
3. all improvements subject to the purchaser's right to use, made or contracted for by the declarant, or made by any person in contemplation of the CIC's creation, will:
  - (a) be free of defective materials; and
  - (b) constructed in accordance with applicable law, according to sound engineering and construction standards, and in a workmanlike manner; and

4. where the unit may be used as a residence, such use will not violate applicable law at the earlier of conveyance or delivery of possession.

Id. The last three of these warranties are the statutory jumping-off point for claims for construction defects. While these warranties do not reach affiliates of the declarant, the statute does say that improvements made or contracted for by such an affiliate are made or contracted for by the declarant. M.S.A. § 515B.4-113(e). Not surprisingly, the statute also bars general disclaimers of implied warranties, but does allow the parties to negotiate the disclaimer of a "specified defect or specified failure to comply with applicable law, if the defect or failure entered into and became part of the basis of the bargain." M.S.A. § 515B.4-114(a). The purchaser must sign the disclaimer in a document other than the purchase agreement. Id.

The declarant has somewhat wider leeway with nonresidential units. It may exclude implied warranties either by agreement among the parties to the transaction or by specific expression of disclaimer. M.S.A. § 515B.4-114(b). Acceptable disclaimers are "as is" or "with all faults" or "other language that in common understanding calls the purchaser's attention to the exclusion of warranties." Id.

Last, the statute provides for a six-year statute of limitations for breach of either express or implied warranties. M.S.A. § 515B.4-115. The declarant may reduce this time to no less than two years if, as to a residential unit, the purchaser signs a document to that effect separate from the purchase agreement. Id.

Although the Minnesota Supreme Court, in Hyland Hill North Condominium Association, Inc. v. Hyland Hill Co., 549 N.W.2d 617, 622 (1996), applied the six-year statute of limitations provision of M.S.A. § 515A.4-114, when it held that the longer limitations period applied opposed to the two-year statute of limitations under M.S.A. § 541.051, based on the premise that "if two statutory provisions conflict, then the more specific controls over the more general," there is nothing to indicate that the Court's holding would not apply to the provisions of M.S.A. § 515B.4-114. This would be true, however, only if a potential claimant is asserting a breach of the warranties of Chapter 515B. See id. at 622-23.

C. Disclosure. Section 515B.4-102 generally sets forth the manner in which a declarant must disclose terms affecting the CIC, including warranties, copies of Chapter 327A (the housing warranty statute) and sections 515B.4-112 through 515B.4-115, and a statement of any limitations on the enforcement of warranties or on damages. Id. subd. (a)(11). This subdivision in part vacates the

effect of Tara Hills Condominium Ass'n v. Gaughan, 399 N.W.2d 638 (Minn. App. 1987). This case raised the question whether a disclosure statement was adequate that merely referred to the statutory warranties under Chapter 515A without expressly listing them. The Court of Appeals agreed with the declarant's argument that the disclosure was adequate as written ("The Declarant warrants the buildings as set forth in Minnesota Statutes Annotated Sections 515A.4-111 and 515A.4-112.") and that it would be "unnecessary and unmanageable" to repeat them in the disclosure. Tara Hills Condominium Ass'n v. Gaughan, 399 N.W.2d 638, 642 (Minn. App. 1987). The legislature apparently agreed with the plaintiff's claim that "a mere reference to the statute is insufficient to satisfy the requirement" of full disclosure. In any event, the statute is now clear as to what must be done.

Disclosures also arise when a previously owned unit is resold. Although the court addressed the requirements of the disclosure certificate required under M.S.A. § 515B.4-107, the following case provides guidance on the importance of all the proper disclosures required under the MCIOA. In Neuman v. Innsbruck North Townhomes Association, 2001 Minn. App. LEXIS 929, \*5 (2001), the Minnesota Court of Appeals, in an unpublished decision, held that pursuant to M.S.A. § 515B.4-107, a townhome association was liable to a purchaser for the special assessment for new siding on the townhome because the association failed to include the planned special assessment on the resale disclosure certificate. The Neuman court stated, "We hold that under the plain language of

MCIOA [M.S.A. § 515B.4-107], unpaid special assessments encompasses those special assessments that have been approved but not yet levied and are among the items that MCIOA requires a townhouse association to disclose in a resale disclosure certificate." Id. at \*6. The court concluded, however, that the purchaser had been orally informed of a \$6,000.00 special assessment for the new siding, and, therefore, would not grant the purchaser a windfall, and awarded \$2,080.00, representing the difference between the actual \$8,080.00 assessment and the oral disclosure of a maximum of \$6,000.00. Id. at \*8.

### **III. Liability Under the Statute—Minnesota Cases**

Two cases, both from the Court of Appeals, are reported in Minnesota as arising under Chapter 515A. The earlier is Tara Hills Condominium Ass'n v. Gaughan, 399 N.W.2d 638 (Minn. App. 1987), referred to above. The case is a dead letter as to the issue discussed above and as to the requirement of Chapter 515A that the declarant disclose amenities. The legislature, perhaps realizing that the court's definition of "amenities" might cause more problems than it cured, dropped the requirement of Chapter 515A that the declarant disclose amenities. The case's other holdings live on. Thus, a disclosure statement which "parallels" the statutory requirements and which is "timely provided" – i.e., before conveyance of the unit under section 515B.4-106(a) – would still seem to suffice. Tara Hills Condominium Assn v. Gaughan, 399 N.W.2d 638, 641 (Minn. App.

1987). Also, its holding that defects must be disclosed if they affect title to the property survives the legislative changes between Chapter 515A and Chapter 515B recorded at section 515B.4-102(a)(8). Tara Hills Condominium Ass'n v. Gaughan, 399 N.W.2d 638, 643 (Minn. App. 1987).

The other case is Chapman Place Ass'n v. Prokasky, 507 N.W.2d 858 (Minn. App. 1993). The first issue in this case was whether a negligent contractor could have the damages against it reduced to the extent that units were bought after defects in the common elements became apparent. The court held that Chapter 515A provided purchasers of condominium units "express statutory protection," Chapman Place Ass'n v. Prokasky, 507 N.W.2d 858, 863 (Minn. App. 1993), which included giving purchasers express and implied warranties, allowing the association to sue on behalf of unit owners for damages to the common elements, and passing the declarant's warranties along to the unit purchasers. These protections survive in Chapter 515B in substantially the same terms as in the former law. Furthermore, because the defects affected common elements, the court decided that apportionment would not provide an adequate remedy to the unit owners and would give the contractor a windfall. Chapman Place Ass'n v. Prokasky, 507 N.W.2d 858, 864 (Minn. App. 1993).

The second issue was whether the contractor could reduce the award against it because of a liability release signed in favor it and its owner by the

mortgagee. The release was part of an agreement in which the mortgagee accepted a deed in lieu of foreclosure on seven unsold units from the declarant. The jury found that the contractor's owner, who also held a 25 percent interest in the declarant and was a member of the unit association's board of directors, did not act in the owners' best interests when he signed the release. In affirming the trial court's conclusions of law based on that finding, the Court of Appeals relied on its power under section 515A.1-112(a) to invalidate unconscionable contracts and on the declaration of the particular condominium which barred the declarant from taking action adverse to the association or owners. Chapman Place Ass'n v. Prokasky, 507 N.W.2d 858, 864 (Minn. App. 1993).

Chapter 515B keeps the invalidation language and, in a new section, specifically states that the declarant and any of its representatives who act as officers or directors of the association, during any period of declarant control, are "subject to all fiduciary obligations and obligations of good faith applicable to any persons serving a corporation in that capacity." M.S.A. §515b.3-120(a)(2).

#### **IV. Liabilities of Builders and Developers Arising Out of Statutory Warranties of Housing.**

The rights and liabilities contained in the Minnesota Common Interest Ownership Act supplement, and do not abrogate the rights of residential vendees

against vendors, or of home owners against home improvement contractors. Minn. Stat. § 515B.4-114(g). The statute specifically provides that all statutory housing warranties under Minn. Stat. Chapter 327A are preserved.

Minn. Stat. Chapter 327A establishes the types warranties provided by a builder of either a new home or of improvements to an existing home to owners (and subsequent owners) of the property. Different types of warranties have different durations. For the most part, the statute eliminates the defense of contractual privity for the duration of the warranty. See, e.g., Minn. Stat. § 327A.02, subd. 2 and subd. 11; see also Vlahos v. R & I Constr. of Bloomington, Inc., 658 N.W.2d 917 (Minn. Ct. App. 2003), review granted 2003 Minn. LEXIS 331 (Minn. 2003). The statute also creates legally enforceable causes of action in favor of vendees and owners and against vendors and contractors.

A. Warranties On Newly-Constructed Dwellings:

Minn. Stat. § 327A.01 defines the term "dwelling" as "a new building, not previously occupied, constructed for the purpose of habitation." Minn. Stat. § 327A.02 establishes the following vendor's warranties and durations as to dwellings:

1. ***a one-year warranty that the dwelling is free from defects caused by faulty workmanship and defective materials due to noncompliance with building standards.***

This warranty is not limited to compliance with the applicable building code. Rather, the term "building standards" is defined with reference to community standards, as follows: *"the structural, mechanical, electrical and quality standards of the home building industry for the geographic area in which the dwelling is situated."* § Minn. Stat. 327A.01 subd.

2. Any express warranties made by the vendor as defined under MCIOA § 4-112(b) are arguably material to establishing this community standard.

2. ***a two-year warranty that the dwelling is free from defects caused by faulty installation of plumbing, electrical, heating and cooling systems; and***

Again, the warranty pertaining to electrical and mechanical systems would not be limited to the applicable codes, but rather measured against a community standard. The

primary difference here is that the warranty of these systems is longer.

**3. a ten-year warranty that the dwelling is free from major construction defects.**

The statute defines a major construction defect as "*actual damage to the load-bearing portion of the dwelling or the home improvement, including damage due to subsidence, expansion or lateral movement of the soil, which affects the loadbearing function and which vitally affects or is imminently likely to vitally affect use of the dwelling or the home improvement for residential purposes.*" Minn. Stat. § 327A.01 subd. 5. Damage caused by natural disasters is excepted from the warranty.

This warranty obviously addresses structural defects. The structural defects at issue, however, are arguably only those which render the structure uninhabitable, or which, if left unattended, would result in the structure's becoming uninhabitable within a short period of time. The fact issues raised by the statutory language are fertile grounds for litigation. They give rise to a predictable "battle of the experts,"

wherein the vendor's expert opines that the home has neither sustained damage to its load-bearing members nor been rendered uninhabitable, and the vendee's expert opines that the home was or is about to fall over. In Vlahos v. R & I Constr. of Bloomington, Inc., 658 N.W.2d 917 (Minn. Ct. App. 2003), the Court held that problems in the home, including water damage to walls, ceilings, and floor trusses which allegedly affected the home's load-bearing function, were not problems with finished construction itself but rather occurred after water penetration damaged original construction, and thus the problems were not "major construction defects" covered by the statutory warranty. In other words, the Court of Appeals determined that the statutory warranty for a major construction defect on a home attaches to the construction as completed; the warranty does not extend to defects of a significant nature occasioned by outside forces arising after completion of construction.

The resolution of these factual issues has a direct bearing on the duration of the warranty. If the structural defect is minor (or more appropriately "not major") the warranty lasts for one year; if major, it lasts for ten. From the practitioner's standpoint, this means that expert testimony will be necessary to avoid a defendant's motion for