

Construction warranties warrant closer inspection

A bill passed by the 2005 Oregon Legislature presents a significant change for contractors and property owners.

The bill authorizes contractors that build new commercial or residential structures to sign written warranty agreements with the original owners. Once recorded, the provisions of the warranties are binding on the original owners - and subsequent purchasers of property. This is a noteworthy change, and an understanding of the terms of the warranties may be an important piece of the buying/selling puzzle in real estate transactions.

It has long been common practice for a contractor and owner to agree on the extent and duration of the contractor's responsibility to repair problems that surface after the owner occupies the structure. The warranty became the agreement of the parties and was enforceable in a court of law.

Except in unusual circumstances, courts have ruled that an owner gave up any right to assert the contractor was negligent in its construction methods if there was a written warranty. Many contractors agreed in warranty to repair defects that arose during the first several years of the life of a structure, even if the construction methods were not negligent. In exchange, once the duration of the warrant lapsed, the contractor had no further legal responsibility to make repairs.

Before the 2005 legislation, the

warranty agreement was not binding on a subsequent purchaser. If a problem surfaced after the warranty had expired, the new owner could assert the



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contractor was negligent in the construction of the structure. A claim for negligence could be brought at any time within two years after the discovery of the alleged negligence, up to 10 years from completion of the structure.

Today, contractors find themselves defending negligence claims long after the warranty period has elapsed. This situation is problematic for all parties. As properties age, the distinctions between repairs caused by poor construction methods and repairs caused by normal wear and tear or owner neglect become cloudy.

The effect of these claims has contributed to an insurance crisis in the construction industry.

Contractors' liability insurance premiums have increased dramatically over the last several years. Many insurers have stopped writing policies for contractors altogether. Oregon law requires all contractors to carry liability coverage as a condition for obtaining a license. If a contractor cannot get or afford the

required insurance, the contractor is out of business.

One element contributing to the insurance crisis is the cost to defend claims of alleged negligence. Because construction lawsuits tend to be complicated, it is not uncommon for the expense to defend a claim to exceed the expense to remedy the defects. For this reason, insurers often pay a claim even though liability is seriously in doubt.

The 2005 legislation addresses this problem by allowing contractors and owners to negotiate the parameters of contractors' responsibilities to make repairs, with the resulting agreements being binding on subsequent purchasers of property. By having the parameters defined, it is believed, insurers can better determine liability risks, which will have a positive effect on both the cost of premiums and the availability of insurance.

Contractors benefit from not being liable for claims of negligence and from having more certainty of the scope of their responsibilities to make repairs. More affordable insurance premiums will likely follow.

The benefits for owners are more subtle. Certainly, if they acquire properties while warranties are still in effect, new owners will enjoy warranty benefits.

Additionally, having warranty agreements be public records

will give subsequent owners the contact information of contractors. If problems do surface, owners can communicate directly with contractors and attempt to resolve any issues without the need for attorneys or insurance adjusters.

Of course, the downside is that if a legitimate, contractor-caused defect is discovered after the expiration of a warranty period, an owner has no claim against the contractor.

An original owner must now carefully consider the effect of a warranty agreement, both in terms of what it covers and how the limitations may affect the future value of the property. If the warranty is too narrowly drafted, it could have a chilling effect on the property's resale.

Subsequent buyers need to carefully review warranty agreements to determine what rights, if any, are still in effect. If they have expired, greater care in the inspection of properties will be necessary.

For contractors and owners alike, seeking competent legal advice regarding construction warranty agreements is always important.

Thomas S. Hillier is a partner in the Portland office of the law firm Davis Wright Tremaine LLP. He assisted the Oregon Home Builders Association in drafting the warranty legislation. His experience includes purchases, sales, exchanges and financing of commercial and residential real estate projects, commercial leasing and construction liens. He can be reached at tomhillier@dwt.com or 503-778-5317.