Incomplete Repairs

New Remedies for Disputes in Residential Construction

By Dean B. Thomson and Michael T. Burke

Minnesota's newest Notice and Opportunity to Repair Law offers remedies to help homeowners and homebuilders resolve their construction-related disputes without litigation but additional changes to the law are needed before the repairs to the previous statute can be considered complete.

Not only is a family's home its "castle," it is often their largest asset. After moving into their new home, the family is, not surprisingly, more than upset when they think their new dream home has design and construction problems. Often, they feel angry and initiate litigation against the potentially liable parties: the developer or seller, the general contractor, the designer, and the involved subcontractors. Many of these defendants have insurance and are represented by insurance defense counsel. Before the homeowners know it, they are in the middle of complex, multiparty and expensive commercial litigation.

As traumatic as this is for the homeowner, it is no better for the developer and its design and construction team. They want to build for satisfied customers, not litigate with their clients, some of whom may have unrealistic or unjustified demands. To reduce the growing industry of residential construction litigation, Minnesota passed legislation[1] in 2010, and effective January 1, 2011, that diverts homeowners and homebuilders into a program intended to lead not to litigation, but to the repair outside the courtroom of valid residential construction problems.[2]

History of the Statute

The 2010 Notice and Opportunity to Repair (NOR) legislation was not Minnesota's first effort to address the increase in residential construction litigation. In 2006, the state passed a similar law that required the vendee (the buyer of the new home) and the vendor (the developer/seller of the new construction) to meet and attempt to agree on and to perform the scope of repairs demanded by the vendee.[3] The goal was to give the builder and the homeowner a chance to "cool off," establish a method by which the parties could resolve their defect claims, and as a result avoid litigation.[4] While the idea was good, the statute did not adequately direct how the parties should meet and confer to resolve their dispute, nor did the statute provide any effective consequence or penalty for not complying with its requirements.[5]

Several other states' NOR statutes provide remedies if the parties fail to engage in the required process. For example, Colorado's Revised Statute 13-20-803.5(9) requires the parties to a residential construction dispute to participate in pretrial procedures and "any action commenced by a claimant who fails to comply with the requirements of this section shall be stayed, which stay shall remain in effect until the claimant has complied with the requirements of this section." Recognizing that the lack of a remedy in Minnesota's 2006 NOR law limited its effectiveness, the stakeholders in the industry drafted legislative amendments that led to the version of the statute that took effect January 1 of this year.

The 2010 NOR Act

As in the 2006 version, the 2010 act is part of what is commonly referred to as the Minnesota's Homeowner's Warranty Act (HOW). HOW requires that the vendor (the homebuilder/seller) provide three types of warranties to the vendee (the home purchaser): a one year warranty that the dwelling will be free from defects caused by faulty workmanship or materials, a two-year warranty against defects caused by faulty mechanical and electrical systems, and a ten-year warranty that the building will be free from major construction defects due to noncompliance with building standards.[6] While HOW's remedies have significant limitations,[7] they also provide significant extended rights to vendees, and in addition to claims for breach of contract and negligence, claims for breach of the HOW warranties are usually part of every homeowner's complaint.

Rather than leave vendees to enforce their HOW warranties in court, the new NOR provisions require that the parties first participate in investigation and stepped negotiations. The act states that a cause of action for breach of the HOW warranties or for any other action based in "contract, tort, or other law for any injury to real or personal property or bodily injury or wrongful death arising out of the alleged loss or damage must not be commenced" until the earlier of (1) the completion of the home warranty dispute resolution process established by the new amendments or (2) 60 days after the vendor's written offer of repair is provided to the vendee.[8] To ensure that the parties are not prejudiced by this suspension of litigation pending negotiations and repair, the NOR amendments provide that the applicable statutes of limitations and repose for these actions are tolled from the date the written notice provided by the vendee is postmarked or received by the vendor.[9]

To initiate a claim under HOW, the vendee must report the alleged loss or damage to the vendor in writing within six months after the vendee discovers or should have discovered the loss or damage, or the vendee loses its HOW claim.[10] Once the notice is received, the vendee must allow the vendor to inspect the dwelling for the purpose of preparing an offer to repair the alleged loss or damages, and the vendor must perform its visual or invasive examination within 30 days of receiving notice from the vendee.[11] Any damage caused by the inspection must be promptly repaired by the inspecting party to its condition prior to inspection.[12]

Within 15 days after completing its inspection, the vendor must provide the vendee with a written offer to repair, which must include at a minimum the scope of the proposed repair work and a schedule for the start and finish of the project.[13] If both parties agree to the proposed scope, the vendor must perform the proposed repair, and upon completion, the vendor must provide the vendee with written notice that the agreed upon work has been completed and that the vendee may have a right to pursue a warranty claim under §327A if the repairs were not properly performed.[14] If the parties cannot agree on a scope of repair, then they must proceed to the "homeowner warranty dispute resolution" process discussed below. On the other hand, if the vendor fails to perform an inspection within 30 days of receiving notice of a problem from the vendee, fails to make an offer of repair within 15 days after inspection, or simply fails to perform an agreed upon scope of repair, then the vendee may commence an action in court.[15]

If the parties fail to come to terms on a proposed scope of repair, either party may start the NOR's new "home warranty dispute resolution" process by written application to the commissioner of the Department of Labor and Industry (DOLI) which must include the contact information for each participating party.[16] Within ten days, the commissioner shall provide each party a list of three neutrals selected from a list of qualified neutrals that have been assembled from an application process administered by the department.[17] Within five business days after receipt of the list of neutrals, the parties must select one of the candidates to serve as their neutral, and if they cannot agree, then each party must strike one candidate leaving one remaining who will serve as their neutral.[18] Within 30 days of its selection, the neutral shall convene a conference with each party in attendance at which the parties will present their respective positions regarding the dispute. Seven days prior to the conference, each party must provide both the neutral and the other party with all information and documentation necessary to understand the dispute.

After reviewing the materials provided, the neutral must mail a nonbinding written determination to the parties within ten days of the conference, which must include, to the extent possible, findings and recommendations on the appropriate scope and amount of necessary repairs, if any.[19] The written determination issued and all communications relating to the dispute resolution process are deemed confidential settlement communications pursuant to Minn. R. Ev. 408, and no party may use any offer of repair, counter offer, or written determination as evidence of liability in a subsequent litigation between the parties, nor shall the neutral be called to testify regarding the dispute resolution proceedings.[20] The parties must share the hourly cost of the neutral equally, but the neutral cannot bill for more than six hours of time for evaluation of documents, meeting with the parties, and issuing a written determination unless agreed to in writing by both parties.[21] The parties can also agree to use another alternative dispute resolution process in lieu of the new statutory process as long as they provide written notice of their agreement and a description of the process to the commissioner no later than the date the parties would otherwise have been required to select a neutral under the statute.[22]

Remaining Issues

The intent of the new NOR provisions is admirable: it is to both parties' advantage to be diverted toward negotiating a workable business resolution rather than spending their energy and assets on polarizing litigation. The concept of early neutral evaluation (ENE) upon which the new NOR is based has been used for years in commercial construction with great success. For example, standard commercial construction contract forms require the parties to present their disputes to an "Independent Decision Maker" for a nonbinding decision as a precondition to litigation or arbitration,[23] and contracts for especially complicated projects frequently specify the use of dispute review boards of one or three neutrals that give real time, nonbinding decisions on disputes.[24] There is no reason to think that the ENE process in the new NOR legislation will not have similar success, with one caveat. The Minnesota dispute resolution process limits the neutral's involvement to six hours unless the parties jointly agree to extend it. For disputes involving multiple claims—and residential construction disputes are rarely limited to one issue—it is unrealistic to expect a neutral to schedule the hearing, review materials beforehand, listen to testimony and receive evidence, possibly inspect the home, and issue a written decision containing findings and recommendations on the scope of necessary repairs all within six hours. This time limitation was imposed so as not to burden the homeowner with too much expense, but if the ENE process does not work, the homeowner is going to spend many thousands more litigating its dispute, so limiting the time a neutral can spend trying to resolve the dispute is a false economy. We may hope the parties will agree to pay for additional neutral time if needed on complicated disputes rather than hold themselves to the arbitrary six-hour limit. The legislature should also consider amending the statute to allow the neutral, in his or her discretion, to spend more time on the dispute up to 16 hours.

Unlike the 2006 statute, the new NOR does have penalties for noncompliance, but most are directed at homeowners. Homeowners must participate in the NOR process or they cannot initiate suit. By contrast, if the homebuilder doesn't participate by inspecting the damages or making an offer to repair,

the homeowner's only remedy is to sue, a remedy it already had. If the goal is to get both parties into an alternative forum to resolve their dispute, the legislature should create a consequence for the nonparticipating party such as a shift of future litigation costs and disbursements, increased interest, a statutory penalty, or some other reasonable remedy to encourage equal compliance from both parties.

The quality of the neutrals used will significantly affect whether this diversion program achieves its goal. The parties can, of course, select their own neutral, but if they do not know of potential candidates, they can ask DOLI to provide a list of neutrals. As required by the statute, DOLI has established an application and qualification process, but to date, of the 27 candidates who have applied and been accepted as neutrals, approximately 52 percent are attorneys.[25] Certainly, the skills and experience of attorneys are relevant to the NOR process, especially in focusing the parties on the relevant issues and facts to present, managing the conference, and issuing findings and conclusions. On the other hand, neutrals with knowledge of design and construction means and methods are also needed, especially for more technical disputes. Given the downturn in the design and construction economy, there should be neutrals with industry experience available, and DOLI should continue to solicit their applications. While some attorneys have significant design and construction knowledge, DOLI should also consider providing basic technical education to existing members of its neutral pool to increase their capabilities.

Unintended Consequences

The new statutory amendments also changed the definition of "vendor," the unintended effect of which will impose uncontrollable liability on commercial contractors. The prior definition of vendor was a "person, firm, or corporation which constructs dwellings *for the purpose of sale*." The new statute, however, changes the definition to any "person, firm, or corporation that constructs dwellings." Under the prior statute, if a developer who wanted to build and sell a house separately hired a contractor to construct the home, the contractor was not a vendor. Although the contractor "constructed" the dwelling, it did not do so for the "purpose of sale"; instead, the contractor built the home for a price for the developer. The developer was the one who built the home for purpose of sale; therefore, the developer was the vendor. In most residential construction of single-family homes, the distinction between contractor and developer did not have a practical effect because most residential contractors were one and the same as the developer—the builder not only owned the lot, it designed and built the house and eventually sold it to the homebuyer. Therefore, the change in the definition of vendor from one who "constructs dwellings for the purpose of sale" to one who "constructs dwellings" is not consequential for developer/builders of single-family homes.

This change will, however, have a troubling impact on contractors who build multifamily residential projects such as townhomes and condominiums because on most multifamily residential projects, the developer and contractor are not the same. Instead, the developer separately owns the land, hires a separate architect to design the project, and employs an independent builder to construct what the architect designed. The developer/owner controls the design and the "value engineering" changes that are made to reduce the cost of the building in order to make a higher profit. In this context, it is not appropriate to change the definition of vendor so that the contractor is the vendor. Unlike the typical situation in single-family home construction, the multifamily residential contractor is not the one who signs the purchase contract with the homebuilder, nor is it the one that controls the design of the project. Put differently, there is no policy justification for making the contractor rather than the developer the vendor; the developer of a multifamily residential project makes the development profit and all project design decisions, so it should be the entity responsible for the statutory warranty. Indeed, it is difficult to understand how the developer's contractor can safely negotiate a repair settlement with the vendee when it was not party to the purchase contract because the vendee may still have unresolved contractual rights with the owner/developer that may drag the contractor back into a later contractual dispute. Most troubling about this definitional change is that it makes the contractor responsible for design errors or decisions that it did not control. If the breach of the HOW warranty is due to a design defect caused by the developer's architect or the developer's decision to cheapen the project, there is no reason to impose a ten-year structural defect warranty on the contractor who could not control the risk. The contractor's only remedy will be to seek equitable contribution and indemnity from the developer and the developer's architect, but that remedy will be difficult to establish and enforce in expedited statutory NOR negotiations.

The effect of the definitional change was recognized by the subcontracting community because, when it was proposed, the subcontractor associations successfully lobbied to insert a sentence saying that "Vendor does not include a subcontractor or material supplier involved in the construction of a dwelling." From a policy standpoint, if both a general contractor and a subcontractor perform construction work and neither is under contract with the vendee, then there is no reason for the general contractor to be the only one responsible for the warranty.[26] Regrettably, this final change to the definition of vendor occurred in a late-night conference committee and did not get the consideration that it deserved.[27]

Fortunately, the enabling legislation also required DOLI's commissioner to report to the chairs and ranking minority members of civil law committees of the legislature by February 1, 2014 on the number of cases using the new NOR procedures. We may hope that the legislature will take that report as an opportunity to modify the legislation to make it more effective and correct its unintended consequences. ▲

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Notes

[1] The legislation is found primarily at Minn. Stat. §§327A.02 and .051, but other related parts are located at §302A.781 subd. 4, §322B.863 subd. 4, §326B.809(b), §327A.01 subds. 7 and 12, §327A.03(a), §327A.081(c).

[2] Minnesota's new NOR act is one of many that have been enacted throughout the nation. *See* William Quatman and Herber O. Gonzalez, "Right-To-Cure Laws Try to Cool Off Condo's Hottest Claims," 27 *The Construction Lawyer*, 13 (No. 3, Summer, 2007).

[3] Minn. Stat. §327A.04 (2006).

[4] *See*, Robyn Moschet, 75 *The Hennepin Lawyer* 16 (Nov. 2006); *see generally*, Darin Allen, "Construction Defects Litigation and the "Right to Cure" Revolution," 2006-03 *Construction Briefings* 2 (2006).

[5] *See*, Moschet, *supra*, fn. 4.

[6] "Major construction defect" means actual damage to the load-bearing portion of the dwelling or the home improvement, including damage to subsidence, expansion, or lateral movement of the soil, which affects the load-bearing function and which vitally affects or is imminently likely to vitally affect use of the dwelling. Minn. Stat. §327A.01 subd. 5. "Building standards" means the materials and installation standards of the State Building Code. Minn. Stat. §327A.01 subd. 1.

[7] For example, "secondary loss or damage such as personal injury or property damage" are excluded from HOW under Minn. Stat. §327A.03.

[8] Minn. Stat. §§327A.02 subds. 4 and 7.

[9] Minn. Stat. §327A.02 subd. 4. To further ensure that the homeowner is not unduly delayed in pursuing its claim in court if necessary, the applicable statutes are tolled until the latest of either the completion of the home warranty dispute procedure or 180 days.

[10] Minn. Stat. §327A.03(a). One of the collateral provisions to the NOR amendments added a clause to this subdivision stating that written notice was not necessary if "the vendee or owner establishes that the vendor or home improvement contractor had actual notice of the loss or damage."

[11] Minn. Stat. §327A.02 subd. 4.

[12] *Id.*

[13] Minn. Stat. §327A subd. 5(a). The vendee can also obtain quotes from other repair contractors and for another scope of repair than offered by the vendor. Minn. Stat. §327A.02 subd. 5(b).

[14] Minn. Stat. §§327A subd. 4(c) and subd 5(c) and (d).

[15] Minn. Stat. §327A subd. 6.

[16] Minn. Stat. §327A.051 subd. 2.

[17] Minn. Stat. §327A.051 subd. 1. The commissioner must establish an application process for interested neutral candidates "taking into consideration the education, experience, training, potential conflicts of interest, and that the purpose of the process is to assist parties in determining an agreeable scope of repair *or other resolution of their dispute*." *Id.* (emphasis added).

[18] Minn. Stat. §327A.051 subd. 2(c).

[19] Minn. Stat. §327A.051 subd. 3(c).

[20] Minn. Stat. §327A.051 subd. 5.

[21] Minn. Stat. §327A.051 subd 3(d).

[22] Minn. Stat. §327A.051 subd 4.

[23] *See* American Institute of Architects Document A201 §15.2 (2007 ed.).

[24] *See*, Harvey J. Kirsh, "Dispute Review Boards and Adjudication: Two Cutting-Edge ADR Processes in International Construction," 3 *JACCL* 75 (Winter 2009).

[25] Conversation with Charlie Durenburger, DOLI's administrator of the NOR neutral program, September 6, 2011.

[26] There is no need to have only one participant in the NOR negotiations. Broadening the term vendor to include all allegedly responsible parties would obligate them to negotiate and would increase the likelihood of assembling an adequate repair offer.

[27] Some have argued that the change in definition of vendor from developer to contractor may have been meant to take advantage of the fact that if a contractor is unable to satisfy a judgment, the homeowner has recourse against the Contractor's Recovery Fund (Fund) for up to $75,000 per claim. Minn. Stat. §326B.89. Of course, possible recourse against the Fund is no reason to allocate responsibility to a party unable to control the risk.

SUMMARY OF MINNESOTA NOTICE and OPPORTUNITY TO REPAIR (NOR)