

## Chapter 05

# Warranties – An Important Method of Preventing Litigation\*



Over the years, warranties have become an increasingly important factor in the building industry, especially for single-family homes where they have served a dual purpose. Warranties were originally conceived as a marketing tool whereby a builder offered a warranty as a means of distinguishing his/her product from the competitor's home. More recently, warranties have grown into an even more important tool as a means of preventing – or at least minimizing – the potential for construction defect litigation.

While the subject of warranties is a broad one, warranties associated with the building industry can be grouped into two basic categories:

1. **Product and system warranties.** These warranties are almost invariably offered by manufacturers for a one-year period, although extended warranties are available at an additional cost. Warranties on products (e.g., a major appliance) or on systems (e.g., the heating, ventilation, and air conditioning system) are often provided to builders of new homes who pass them on to the buyer of the home. They can also be purchased separately by homeowners.
2. **Structural warranties.** These are warranties on the building structure itself (and sometimes on the ground stability under that structure). The warranty, or a portion of the warranty, may range in duration from one to ten years, as will be discussed later in this chapter.

\* The primary source for information in this chapter is "Warranties for Builders and Remodelers", as further identified in the Resources section at the end of this chapter.

Since the purpose of this manual is to educate builders and developers on various means of preventing construction defect litigation, the balance of this chapter will focus on structural warranties. Within this broad definition, the subject of warranties has many complexities and often overlapping features. This will be shown. Builders are well advised to seek expert counsel from their insurance agents and attorneys, especially since the rules concerning warranties vary from one state to another.

**This chapter covers the following subjects:**

- 5.01 Types of Warranties
- 5.02 Disclaimers
- 5.03 The Warranty Document
- 5.04 Sources of Warranties
- 5.05 Notice and Opportunity to Repair
- 5.06 Warranties Mandated by HUD
- 5.07 The Magnuson-Moss Warranty Act
- 5.08 Conclusion
- 5.09 Resources

## 5.01 Types of Warranties

There are three basic types of warranties, as well as various sub-divisions therein, as discussed below:

### 1. Implied Warranties

In the years prior to World War II, the ancient doctrine of “caveat emptor” (buyer beware) applied to the home industry. However, one aspect of the return of veterans after the war was the concept of owning one’s home as the American Dream. Builders responded accordingly and have marketed home ownership as achievement of the American Dream ever since. Appealing to these voters, government entities began to view the assurance of new home quality as an important public policy consideration. The courts began to replace “caveat emptor” with a new doctrine called “implied warranty.” This imposed requirements on new homes for habitability and workmanlike construction.

Today, all states with the sole exception of Utah recognize implied warranties for new homes. These warranties are of two types. The implied warranty of habitability provides that a home must be safe and sound to actually be lived in and to serve its function as a residence. The implied warranty of workmanlike construction takes the next step and provides that the workmanship must meet the standards of quality that prevail at the time and place of construction. These implied warranties pertain only to latent defects, which are problems with the work or building materials that are not discovered or reasonably discoverable at the time of closing.

## **There are four additional considerations with respect to implied warranties.**

### **Briefly, they are:**

Building code violations are a separate issue. A house can meet all building code requirements and still have latent defects that are subject to implied warranty requirements.

Originally implied warranties applied only to the first purchaser under a doctrine called “privacy of contract” wherein only the builder and purchaser had a direct contractual relationship. While not all states have abandoned privacy of contract, the trend in state courts is in that direction based on public policy considerations that a new home should be habitable and of workmanlike construction regardless of who might be the present owner.

1. Remodelers are not generally subject to implied warranty considerations. However, Illinois has now extended its implied warranty requirements to cover a major addition to an existing home and that may be the start of another expansion of implied warranty coverage.
2. Trade contractors are generally exempt from implied warranty requirements. However, the general contractor is still liable for the work, even if the trade contractor is not.

## **2. Statutory Warranties**

In addition to implied warranties, some states have adopted statutory warranties. As of 2006, the only state to do so in the Western portion of the United States is Washington.

In general terms, statutory warranties set the builder’s and homeowner’s obligations, the limits of coverage, and the remedies in those states with such legislation. A typical example is New Jersey, where the New Home Warranty and Builders’ Registration Act provides the homeowner with a one year warranty that the home “shall be free from defects caused by faulty workmanship and defective building materials due to noncompliance with the building standards”; two years covering the faulty installation of plumbing, electrical, heating, and cooling systems; and ten years on major construction defects.

Statutory warranties may apply to both home improvements and new construction. And they may extend to subsequent homeowners, depending upon the particular state in question.

All builders are advised to check to see whether the state(s) in which they operate have a statutory warranty, and, if so, their obligations therein.

## **3. Express Warranties**

An express warranty is an oral or written promise of performance by the builder or remodeler that is made expressly to the home buyer or homeowner. In an express warranty, the contractor pledges that the work will meet certain standards and, if it does

not, that the warrantor will stand behind the work by making repairs and/or replacing defective components.

Obviously, an oral warranty may lead to considerable disagreement between the builder and home buyer/owner concerning the terms of the warranty or even whether a warranty was offered at all. In the absence of any written document, not only may the parties disagree about any terms and conditions, but also such matters are open to the interpretation of the court if a dispute should reach that level. Further, in the absence of a properly written warranty, any statements by the builder, remodeler, or even by an employee or a sales person, about the quality of the work, fixing a problem after completion, or some related subject raises a problem of an express warranty being inadvertently extended to the consumer. Using an express limited written warranty that disclaims all verbal statements protects the builder from the uncertainties and potential conflicts or verbal statements, as discussed below.

Generally, a written express warranty is part of a contract between the builder and the customer. The extent of the builder's responsibility, as well as the duration of that responsibility, depends upon the specific terms to the express warranty being provided. That subject, too, will be covered in more detail later in this chapter.

**There are two additional aspects of an express warranty that should be noted:**

1. **Exclusive warranty.** The written express warranty document constitutes a promise by the builder to the customer. However, there may be other promises and/or legally imposed responsibilities that could supplement and/or amend the express warranty. For example, promises concerning service, quality, and other subjects may be contained in advertisements, the builder's correspondence with the customer, or even from discussions with existing or potential customers. This situation can be avoided if the written express warranty is acknowledged to be the sole and exclusive warranty provided by the warrantor. Thus, other written and verbal promises can not be interpreted as a supplement to, or modification of, the written express warranty document.
2. **Limited warranty.** Most contracts contain limitations on the duration of coverage, extent of coverage, extent of liability for damages, and available methods for resolving disputes. Written express warranties are no exception and hence the warranty agreement becomes, and should be described as, a limited warranty.
  - **Duration of coverage.** Generally, one year is considered standard for defects in workmanship and materials. However, certain systems may be warranted for a longer period, such as two years for mechanical, electrical, and plumbing components. And a five to ten year period is common for foundation or load bearing components.
  - **Extent of coverage.** An express limited warranty will generally restrict coverage to the replacement of repair of defective materials or workmanship. It may go further to limit coverage to latent (hidden) defects that are not apparent at the time of

closing. It should also specifically state the items which are not covered, which may include: appliances and systems covered by manufactures' warranties; exterior features such as landscaping or driveways; damage caused by the owner or a third party; damages resulting from an act of God (e.g., floods, fires); and damages resulting from the owner's failure to service and maintain.

In order to more accurately define the standards of quality and workmanship and hence the extent of coverage thereof, many builders are using publications from the National Association of Home Builders and or local state associations.

- **Extent of damages.** In some cases, damages resulting from a defect in workmanship or materials could lead to additional damages beyond the repair of the defect itself. For example, a roof leak could result in damages to household furnishings. In addition to these consequential damages, there are often indirect damage claims such as lodging expense while repairs are made, lost wages from time away from work, medical bills if injuries are involved, cost of inspections, legal fees, and even payments for mental anguish.

The express limited warranty provides an opportunity to specifically exclude or place monetary limits on both consequential and indirect damages that result from a defect covered by the express warranty.

- **Methods of dispute resolution.** Even though the repair and replacement provisions of the warranty provide a mechanism for resolving disputes between the warrantor and the customer, additional disputes may still arise over such issues as the adequacy of the repairs, the extent of warranty coverage, and the like. An express limited warranty can designate the procedures to be followed prior to entering into a formal dispute resolution mode. And, it can specify the ultimate method of dispute resolution to be employed, such as mediation or arbitration. Thus, the express limited warranty provides an excellent opportunity to avoid litigation at several steps in the process.

## 5.02 Disclaimers

Under certain conditions, builders and remodelers may wish to disclaim all warranties or certain portions of warranties. Some of these situations are outlined below:

1. **Total disclaimer.** For example, if a remodeler was called upon to finish someone else's work or to accomplish work in situations with serious difficulties in evaluating pre-existing conditions, he/she might wish to disclaim all warranties. Or, a contractor might wish to disclaim all warranties in order to offer a rock-bottom price in a new home. Acceptance of the work "as is" is an example of a disclaimer of all warranties.
2. **Implied warranties.** Contractors may wish to disclaim the implied warranties that apply to the sale of new homes. As noted previously, all states except Utah have implied warranty statutes on the books, but those statutes may be vague and unclear in

their wording and courts may differ in their interpretation. Contractors, particularly those who offer an express limited warranty, may wish to protect themselves from the vagaries of implied warranties by disclaiming all implied warranties and hence eliminating this uncertainty.

3. **Duration of liability.** The duration of a contractor's liability under implied warranties is a particularly important situation and hence is addressed here as a separate subject. Obviously, builders should avoid an open-ended liability for an indefinite period of time. Often, implied warranties contain no specific time limitations and thus leave the contractor in a vulnerable position and or subject to the statute of limitations (if it exists) in the state in which the work was performed.

The duration of the statute of limitations can vary widely from one state to another, both in terms of time limitations and subjects covered. Many states have special statutes of limitations for construction defect claims. But even in these states, there is no uniformity. Additionally, even with a specific statute of limitations, there are differences on when the time period commences (e.g., at the time of closing versus at the time when the defect is discovered).

And, to complicate matters, even if a contractor has a written limited warranty with a specified period, that provision may be superseded by an implied warranty with a longer duration, unless the written express warranty contains a specific disclaimer covering implied warranties. Again, there is no consistency between one state and another in the specific language needed to provide adequate protection and hence the services of a qualified local attorney are clearly a necessary step in preparing the disclaimer provisions.

### 5.03 The Warranty Document

A warranty is a type of contract. Often, it is included in, or incorporated by reference, in another contract – the agreement between the contractor and the homeowner or home buyer. As stated previously, the warranty is a promise by the contractor to the consumer to repair defects in material and workmanship subject to certain terms and conditions. It is not an insurance policy that guarantees payment if certain terms and conditions are met.

As in the case of any other contract, it is essential that the terms and conditions be clearly expressed in writing. At a minimum, the warranty should include the following major elements\*:

- Names and addresses of the builder and consumer
- Scope of the warranty
  - What is covered
  - What is not covered

\* See "Warranties for Builders and Remodelers" for more detail and sample forms.

- What constitutes a defect
- Term of the warranty
- Remedies
- Claims procedure
- No additional warranty (disclaimers)
- Transferability
- Owner's acknowledgment of receipt of warranty
- Manufacturers' warranties

## 5.04 Sources of Warranties

Some contractors provide a warranty of their own making, derived from a number of different sources. Some are documents originally prepared and/or modified by the organization's attorney. Others are documents passed along from one contractor to another. And a third source is sample documents handed out at seminars and symposiums on the subject of warranties. Some contractors with their own warranties have made the claim that "they have stood the test of time," but that really may mean that the contractor has been fortunate in not having a serious legal test of the validity of his/her warranty program.

While some of the warranties provided by individual contractors may have been carefully crafted by competent attorneys, the fact remains that so-called "first party" warranties are becoming increasingly risky in the construction industry for several reasons. The first is that there are continuing changes in the laws in the various states and many have significantly differing features. The second is that both implied and statutory warranties are not only unclear and/or potentially dangerous to contractors, but also they may "trump" even carefully written limited express warranties. And, the third is that contractors are all too often the target in an increasingly litigious society.

In this situation, contractors have sought, or have been forced to seek, warranty protection by third party companies. For a number of years, there have been a handful of third party warranty companies that have marketed their products to builders as a marketing tool to aid in selling their homes, as a protection for defects in workmanship and materials and as a means of providing an alternative dispute resolution mechanism. In some cases, warranties have been automatically included in the sale of a new home and in others a warranty has been an option available at additional cost to the buyer.

These third-party companies take two different forms:

- Warranty programs tied to insurance companies
- Warranty programs offered independent of insurance companies.

The availability of these third party companies varies, depending on the coverage and strength of their marketing operations and the approval of their associated insurance companies to market in specific states and other factors. All of these companies have placed heavy emphasis on marketing to and through local associations chartered by the National Association of Home Builders.

In recent years, contractors have adopted, or have been required to adopt, warranty programs for a fourth reason: as a means of reducing or minimizing increasing liability insurance premium costs. This has meant that insurance agents have become an increasingly important factor in the selection and marketing of warranty programs.

## 5.05 Notice and Opportunity to Repair

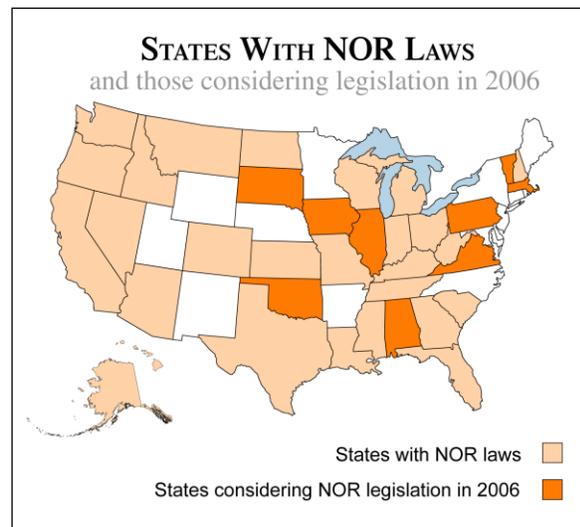
In recent years, many builders found themselves on the receiving end of a notice of a lawsuit for construction defects without any opportunity to correct the deficiency, in some cases without any notice that a defect even existed. The number of lawsuits escalated rapidly and many of the decisions resulted in substantial costs to the builders. In fact, the situation got so bad that some insurance companies dropped out of the market entirely, especially for multi-family units but sometimes even larger single-family developments.

As a partial response to the situation, many builders, builder organizations, and property owners pushed for a legislative solution. The result was that over half of the states in the country now have a legislative remedy most commonly known as Notice and Opportunity to Repair (NOR).

NOR statutes provide an alternative method of resolving disputes, through means other than litigation. These statutes most often require that the builder be given adequate notice of the existence of a claimed defect and allowed to inspect the site. The builder is then given a period of time to repair the defect or to pay money in lieu of correcting the defect. Most state statutes also contain time frames by which the builder must respond to the notice of a defect and to make the repairs.

Some states also require the builder to give the homeowner notice in the sales contract and/or at closing of the existence of NOR legislation and any time limitations involved therein. Some states even require that mandatory language be inserted in the contract documents.

In states that do not have NOR legislation, builders are advised to add a provision in their contracts that the customer must provide written notice of any pending warranty or defect claim and must allow the builder to inspect the property and to make repairs.



An NOR provision should also be included in contract language that specifies the process for making a claim of a construction defect and taking action on that claim. The NOR process is a first-step before proceeding to other alternative dispute resolution mechanisms such as mediation or arbitration.

## 5.06 Warranties Mandated by HUD



The U.S. Department of Housing and Urban Development (HUD) requires builders to provide warranty coverage whenever the buyer utilizes a HUD-insured, single-family mortgage. Examples are a VA or FHA mortgage loan. The type of warranty required by HUD depends on the loan-to-value ratio.

For low ratio loans, the builder must issue a one-year warranty of completion, in which the builder warrants that the dwelling has been constructed in substantial conformity to plans and specifications. The builder warrants the property for defects in both workmanship and materials. Also, for this one-year period, HUD requires that the purchaser give written notice of claimed defects. The HUD warranty survives conveyance of title, which means it is applicable to subsequent purchasers.

High ratio loans (above 90 percent of the appraised value of new construction) required a HUD approved ten-year warranty plan. A builder, a warranty or insurance company, a risk-retention group, or a state that guarantees the builder's performance may issue a HUD approved plan. All such plans must have insurance backing, unless they are supported by the full faith and credit of the state.

Within the ten-year period, the plan must provide coverage of varying durations for specific elements. Thus, during the first year the plan must provide for a warranty against defects in workmanship and materials. It must also comply with the Magnuson-Moss Warranty Act (see next section below).

Through the second year, the plan must provide coverage against defects in wiring, piping and ductwork in the electrical, plumbing, heating, cooling, ventilating, and mechanical systems. Through the fourth year in some areas designated by HUD, the plan must warrant basement slabs.

And, through the tenth year the plan must warrant against structural defects, as defined by HUD.

## 5.07 The Magnuson-Moss Warranty Act

In 1975, Congress enacted the Magnuson-Moss Warranty Act in response to extensive abuses by merchants concerning express and implied warranties and disclaimers. Congress designated the Federal Trade Commission as the agency to regulate business under the act.



The Act applies to consumer products but does not require that builders or remodelers provide their customers with a warranty. It does, however, regulate the form of whatever warranty a builder or remodeler may voluntarily choose to provide concerning consumer products. It does not regulate new or remodeled homes but does apply to the following items included in new and remodeled houses: appliances, manufactured equipment, air conditioners, furnaces, water heaters, and anything else defined as a consumer product under the Act.

Several items of concern for builders and remodelers are:

- Building materials purchased at a home improvement or building supply store could be considered consumer products. However, if they are incorporated into a home and cannot practically be distinguished, they are considered part of the realty and hence not covered by the Act.
- Builder and remodelers need to exert care in how they extend manufacturer's warranties for items like appliances, which are consumer products, but are placed in the home and not incorporated into the structure.

In this regard, contractors have three alternatives:

1. Give no written warranty at all. Obviously, this alternative is becoming increasingly unfeasible.
2. Exclude consumer products from any warranty being provided. In today's increasingly complex homes, the list of items excluded would be so extensive and would run counter to consumer expectations that appliances, furnaces, heating systems, and the like do have manufacturer's warranties.
3. Provide a warranty that conforms to Magnuson-Moss requirements. For these requirements, see the Code of Federal Regulations (C.F.R. Title 16, Part 701 or 16 C.F.R. Part 701.3 – written warranty terms.)

## 5.08 Conclusion

Warranties have become an increasingly important tool in the continuum of steps available to builder and remodelers to avoid construction defect litigation. To provide adequate safeguards, builders should provide an express, limited written warranty that:

- Addresses any statutory warranty requirements in states with such provisions.
- Contains disclaimers covering (a) implied warranties in all states except Utah and (b) any other claims or statements not specifically covered in the warranty document.
- Recognizes the Magnuson-Moss Warranty Act and takes the course of action deemed appropriate by the builder and legal counsel.

## 5.09 Resources

Some of the sources for additional information on the subject of warranties are:

- **National Association of Home Builders (NAHB):**  
“Warranties for Builders and Remodelers” by Jaffe, Crump & Watson.  
Item 00231, ISBN 0-86718,  
available at <http://www.builderbooks.com/>  
or call 1-800-223-2665
- **Federal Trade Commission (FTC):**  
“A Businessperson’s Guide to Federal Warranty Law”  
available at <http://www.ftc.gov/bcp/online/pubs/buspubs/warranty.htm>
- **FTC information on the Magnuson-Moss Act**  
available at its web site: <http://www.ftc.gov/>
- **U.S. Department of Housing and Urban Development (HUD):**  
One-year warranty of completion form, HUD-92544, available at  
[http://www.hudclips.org/sub\\_nonhud/cgi/pdfforms/92544.pdf](http://www.hudclips.org/sub_nonhud/cgi/pdfforms/92544.pdf)
- **Smith, Carol “Warranty Service for Home Builders”, 2003, Washington, DC;**  
available at <http://www.builderbooks.com/>

## CHAPTER 05: WARRANTIES: AN IMPORTANT METHOD OF PREVENTING LITIGATION

1. A structural warranty covers:
  - a) Heating ventilating and air conditioning systems
  - b) Major appliances installed by the builder
  - c) Major appliances installed by out-vendors
  - d) The building itself**
  - e) All of the above
  
2. The basic type(s) of warranty is (are):
  - a) Implied warranties
  - b) Express warranties
  - c) Statutory warranties
  - d) All of the above**
  
3. All states in the Western section of the country recognize implied warranties except:
  - a) California
  - b) Hawaii
  - c) Utah**
  - d) Montana
  - e) Washington
  
4. As of 2006, the only state in the Western section of the country that has adopted have statutory warranties was:
  - a) California
  - b) Nevada
  - c) Washington**
  - d) Colorado
  - e) Alaska
  
5. A warranty that eliminates promises made in meetings with builders, advertising, letters from the builder, general brochures and the like is called:
  - a) Statutory warranty
  - b) Limited warranty
  - c) Disclaimer warranty
  - d) Exclusive warranty**
  - e) None of the above

6. To be truly effective, a limited warranty contains provisions concerning which of the following subjects:
  - a) Extent of liability for damages
  - b) Method of solving disputes
  - c) Duration of coverage
  - d) Extent of coverage
  - e) **All of the above**
  
7. Under certain circumstances a builder might disclaim all but which one of the following:
  - a) Duration of liability
  - b) Implied warranties by the state
  - c) Any warranties from other builders or suppliers
  - d) **Warranty for his/her own workmanship**
  - e) None of the above
  
8. A warranty is a type of contract that cover should cover all but which one of the following:
  - a) What constitutes a defect
  - b) Claims procedures
  - c) Owner's acknowledgement of receipt of warranty
  - d) **Start and end date of the contract**
  - e) Term of the warranty
  
9. In today's market, the best type of warranty is one that comes from:
  - a) A builder's seminar on warranties
  - b) Another builder with many years of experience in the industry
  - c) **A third party warranty company**
  - d) The company's attorney
  - e) All of the above
  
10. First party warranties are becoming increasingly risky in the construction industry because:
  - a) Implied warranties may supersede written express warranties
  - b) State laws are continually changing
  - c) Warranty programs reduce the risk of lawsuits
  - d) Contractors are increasingly a target for lawsuits
  - e) **All of the above**

11. Within the subject of warranties, the letters “NOR” mean:
- a) No Owner Required
  - b) Not Our Requirement
  - c) Notice Of Responsibility
  - d) Notice of Refusal
  - e) **Notice and Opportunity to Repair**
12. The U.S. Department of Housing and Urban Development requires the builder to provide warranty coverage whenever the:
- a) House price is below the market average
  - b) Buyer is a first time buyer
  - c) **Buyer uses an FHA or VA mortgage loan**
  - d) Buyer uses a zero-down mortgage
  - e) Buyer uses an Adjustable Rate Mortgage (ARM)
13. The Magnuson-Moss Warranty Act regulates the form of whatever warranty a builder or remodeler may provide for all but which one of the following:
- a) Air conditioners, if installed
  - b) **New or remodeled houses**
  - c) Furnaces
  - d) Water heaters
  - e) Other consumer products
14. It is recommended that builders provide a written warranty that is:
- a) Statutory, exclusive, limited
  - b) **Express, limited, addresses statutory requirements**
  - c) Limited, addresses statutory requirements, with disclaimers
  - d) Implied, express, exclusive
  - e) Limited, exclusive, with disclaimers