

HOUSE BILL REPORT

HB 3131

As Reported by House Committee On:
Judiciary

Title: An act relating to providing for insured warranty standards for condominiums.

Brief Description: Providing for insured warranty standards for condominiums.

Sponsors: Representatives Tom, Priest and Lantz.

Brief History:

Committee Activity:

Judiciary: 2/5/04 [DP].

Brief Summary of Bill

- Creates a program of qualified warranty insurance for condominium builders to use in lieu of being covered by the Condominium Act implied warranties;
- Sets minimum standards and permissible inclusions and exclusions for qualified warranty insurance;
- Allows for mandatory binding arbitration to settle disputes under a qualified warranty policy.

HOUSE COMMITTEE ON JUDICIARY

Majority Report: Do pass. Signed by 9 members: Representatives Lantz, Chair; Moeller, Vice Chair; Carrell, Ranking Minority Member; McMahan, Assistant Ranking Minority Member; Campbell, Flannigan, Kirby, Lovick and Newhouse.

Staff: Bill Perry (786-7123).

Background:

The Washington Condominium Act (WCA) controls the creation, construction, sale, financing, management, and termination of condominiums.

A condominium consists of real property that has individually owned units and also has commonly held elements in which all the individual unit owners have an undivided common interest. A condominium may be created for any of a number of purposes, including residential use. A condominium is created by the recording of a "declaration." The person creating a condominium is referred to as the "declarant." The declarant or other seller of a

condominium is required to prepare a "public offering statement" which must be delivered to a purchaser before sale. The public offering statement must contain a variety of information about the condominium, the declarant, and the management of the condominium.

The WCA also creates specific rights and responsibilities. The WCA creates implied warranties and authorizes the use of express warranties, regarding the quality of materials and construction in a condominium. It gives certain rights to owners and their associations regarding these warranties.

Warranties.

Express warranties are assertions that are made by a declarant with respect to the condominium and that are relied upon by a buyer.

Implied warranties are statutorily created in the WCA. Implied warranties by the seller of a condominium include warranties of quality that:

- the units and common areas are suitable for the ordinary uses of real estate of that type;
- any construction is free from defective materials; and
- construction has been done in accordance with sound engineering and construction standards and has been done in a workmanlike manner and in compliance with applicable laws.

Implied warranties in non-residential condominiums may be waived by the written agreement of the parties or by a general disclaimer such as declaring that the sale of a unit is to be "as is" or "with all faults." Implied warranties in the sale of a residential unit, however, may not be waived by such a general disclaimer. A disclaimer of implied warranties regarding a residential unit must:

- be signed by the purchaser;
- specify the defect or noncompliance with the law that is the subject of the waived warranty; and
- be with respect to a defect or failure to comply that became a part of the basis of the bargain between the seller and buyer.

Under a 2001 decision, *Marina Cove Condominium Owners Association v. Isabella Estates*, the Washington State Court of Appeals held that a defect may be disclaimed even if the defect is in fact not known to exist at the time of the disclaimer so long as the disclaiming of the defect has become a part of the bargain for the sale of the condominium.

Courts have applied a common law rule regarding the determination of damages for a breach of a warranty under the WCA. Damages may be awarded for the cost of repairing a defect unless that cost is disproportionate to the loss in value of the condo caused by the defect, in which case damages will be awarded for the loss in value.

Arbitration.

The *Marina Cove* decision also held that binding arbitration clauses in condominium agreements are unenforceable under the WCA. A separate statute outside the WCA does authorize the use of binding arbitration if parties to a dispute agree to it. Under this procedure, the decision of an arbitrator, if appealed, is reviewable by a court only for procedural errors. However, in *Marina Cove*, the Court ruled that this kind of binding arbitration cannot be used in condominium disputes. The Court reached this conclusion based on its reading of the WCA. The Court noted that the WCA states that the Act is "enforceable by judicial proceedings" and that provisions of the WCA may not be varied by agreement of the parties unless the WCA expressly allows such a variance. Since there is no allowance for waiving the right to a judicial determination of a dispute under the act, the Court held that arbitration clauses are unenforceable.

Limitation of Actions.

Actions for a breach of a warranty under the WCA must be brought within four years of the accrual of the cause of action. Generally, that accrual with respect to an individual condo unit occurs upon the purchaser taking possession, and with respect to common areas upon the later of occupancy of a unit, or completion of the common area.

The four year statute of limitations may not be reduced by agreement of the parties.

Current Problems in the Condominium Industry.

Condominium construction in the state has recently all but stopped. It is difficult if not impossible for builders to get liability insurance for condo construction. Condo owners have experienced problems with the construction of their units, particularly with respect to water penetration.

Summary of Bill:

A warranty insurance program is established as an alternative to the implied warranty provisions of the WCA. If a condominium declarant purchases warranty insurance that meets certain requirements, the declarant and any construction professional are no longer liable to a condo unit owner for breach of a warranty under the WCA. Instead, the condo owner's recourse for a warranty breach is to file a claim under the warranty insurance policy.

Furthermore, if a construction professional agrees to indemnify the insurer for loss due to construction defects, the liability of the construction professional is limited to the insurance limits of the warranty.

Minimum Coverage Terms for a Qualified Warranty.

The warranty insurance program is available only in the case of a "qualified warranty." A "qualified warranty" must meet certain requirements before it will be an alternative to the WCA. The warranty insurance must have at least:

- Two years of materials and labor coverage that consists of:

- 12 months of coverage for any defect in a unit, and for any violation of the building code that constitutes an unreasonable health or safety risk or causes material damage;
- 15 months of the same coverage for common elements; and
- 24 months of coverage for: (1) defects in the electrical, plumbing, heating, ventilation and air conditioning systems, exterior cladding, caulking, windows and doors; (2) any defect making the unit unfit to live in; and (3) any violation of the building code constituting an unreasonable health or safety risk or causing material damage.
- Five years of coverage for defects in the condo's building envelope, including a defect permitting water penetration that is likely to cause material damage.
- Ten years of coverage for structural defects that result in failure of a load-bearing part or that materially affect the residential use of the condo.

A qualified warranty must also allow for reimbursement of an owner's living expenses during any repairs. All repairs must be warrantied themselves for the longer of the remainder of the qualified warranty period or one year from completion of the repair.

Permitted Terms under a Qualified Warranty.

Several provisions are allowed but not required in a qualified warranty. These include:

- subrogating to the insurer an owner's rights against the declarant;
- excluding from coverage express warranties of the declarant;
- reducing coverage to the extent of any warranty disclaimer under the WCA;
- requiring the owner to allow inspections of the unit by the insurer or declarant and to provide available information about a claim;
- excluding from coverage any damage caused by the owner's refusal to allow inspection or to provide information; and
- allowing only the owners' association to prosecute claims involving common elements of the condo.

A qualified warranty may require an owner to mitigate damages by giving timely notice of a defect or taking all reasonable steps to restrict damages if a defect requires immediate attention.

Permitted Exclusions from a Qualified warranty.

A qualified warranty may exclude coverage for landscaping, commercial use areas, roads, site grading and surface drainage not required by the building code, municipal services, septic systems, water quality and quantity, and wells. However, a qualified warranty may not exclude driveways, recreational areas, parking structures or required retaining walls.

A qualified warranty may also exclude certain defects from coverage. Defects that may be excluded are those: caused by normal wear and tear and shrinkage; occurring during use of the unit for nonresidential purposes; caused by owner supplied materials or labor, or by improper owner maintenance, or by acts of nature.

A qualified warranty may also exclude bodily injury, damage to personal property, contaminated soil, land subsidence, and diminution in the condo's value.

All exclusions must be stated in the qualified warranty.

Permitted Monetary Limits.

A qualified warranty may limit coverage to the lesser of a unit's original purchase price or \$100,000, adjusted annually for consumer price index changes.

Prohibited Terms.

A qualified warranty may not require an owner to sign a release before repairs are made or pay a deductible for any repair.

Notice and Handling of Claims.

An owner must give the insurer a reasonably detailed description of a claim within a reasonable time after discovery of a defect. Upon receipt of a claim, the insurer must make all reasonable efforts to avoid delays in responding, and repairs must be undertaken in a timely manner.

If the insurer decides the claim is not covered by the warranty, the insurer must notify the owner in writing of the rejection. The insurer must also explain the reasons for the decision and must set out the rights of the parties under the warranty.

Mediation and Arbitration of Warranty Disputes.

Either party to a disputed warranty claim may demand mediation. Procedures are provided for the appointment of a mediator and the scheduling and conduct of mediation sessions. The cost of mediation is to be split equally by the parties unless they agree otherwise. None of the information acquired during a mediation and no offer or admission made may be disclosed in any other proceeding. Mediation is ended when all disputes are resolved, or when the mediator determines further mediation will not be productive, or when the mediation session is completed and there is no agreement to continue.

A qualified warranty may require binding arbitration of disputes. Minimum procedural standards are provided. Arbitration must be conducted in a manner that permits full, fair, and expeditious presentation of the case. All reasonable efforts must be made to complete the process within six months. Unless the parties agree otherwise, arbitration is conducted under the existing Washington law on arbitration which generally allows a court to set aside an arbitration award only if the substantial rights of a party were prejudiced by:

- Procurement of the award by corruption or fraud;
- Evident partiality or corruption of the arbitrator;
- Misconduct by the arbitrator in refusing to postpone a hearing or to hear evidence; or
- The arbitrator exceeding his or her powers, or imperfectly executing them to the extent of not making a final and definite award.

Insurer Acceptance of a Declarant.

An insurer is not required to offer a warranty policy to any person. An insurer is authorized to make specified inquiries of and about a declarant who is applying for a qualified warranty. Information the insurer may seek about the applicant includes: financial history and resources; technical skill and experience in condo construction and business management; past conduct regarding business practices; capitalization of the project; and sufficiency of personnel and resources. In addition, the insurer may require an applicant to: provide security; comply with specified construction standards; use specified systems, consultants or personnel; maintain insurance or bonding; obtain third-party inspections and verifications; and provide ongoing monitoring after construction.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect 90 days after adjournment of session in which bill is passed.

Testimony For: This bill addresses both aspects of the condominium crisis, the absence of builder insurance, and the problems with construction defects. The bill is a free market approach to providing incentives for builders to buy insurance and for insurers to see that homeowners get a quality home. Condos are today's affordable housing, and the experience in British Columbia with a similar program shows that this bill can help restore the condominium market.

The bill will increase predictability for insurers. There are insurers who provide this kind of policy elsewhere and who would be ready to enter the market here. The bill will also separate the issues of liability for construction defects from other issues of liability such as personal injury and property damage.

(With concerns) The prescriptive details in the bill may make insurance policies too expensive. The bill may be tilted in favor of builders and insurers and away from homeowners. Because the bill eliminates the possibility of contingency fees, it will be impossible for some small condo associations to seek remedies. Although the bill is optional, it will become mandatory if it is the only alternative to a system in which builders are unable to get insurance at all.

Testimony Against: None.

Persons Testifying: (In support) Representative Tom, prime sponsor; Representative Priest, sponsor; Vincent DePillis, Real Property Law Group; Doug Correa, RDH Building Engineering; Angela Song, Washington Association of Realtors; and Nick Federici, Washington Low-Income Housing Alliance.

(With concerns) Mel Sorensen, Contractors, Bonding and Insurance Company and Property and Casualty Insurers Association; Sandi Swarthout, Todd Hobert and David Merchant, Washington Homeowners Coalition; Genesee Adkins, 1000 Friends of Washington; Scott

Hildebrand, Master Builders Association of King and Snohomish Counties; and Tim Harris, Building Industry Association of Washington.

Persons Signed In To Testify But Not Testifying: None.