

SENATE BILL REPORT

2ESSB 5536

As Passed Senate, February 12, 2004

Title: An act relating to condominiums.

Brief Description: Resolving claims relating to condominium construction.

Sponsors: Senate Committee on Judiciary (originally sponsored by Senators Finkbeiner, Reardon, Roach, Hale, Horn, Benton, Morton, Hewitt, Schmidt, Kastama, Sheahan, Mulliken, Johnson, Parlette, Stevens, West and Esser).

Brief History:

Committee Activity: Judiciary: 2/14/03, 2/20/03 [DPS].

Passed Senate: 3/11/03, 41-8; 2/12/04, 46-3.

SENATE COMMITTEE ON JUDICIARY

Majority Report: That Substitute Senate Bill No. 5536 be substituted therefor, and the substitute bill do pass.

Signed by Senators McCaslin, Chair; Esser, Vice Chair; Brandland, Hargrove, Haugen, Johnson and Kline.

Staff: Aldo Melchiori (786-7439)

Background: The Condominium Act creates a system of warranties of quality, both implied and express. Implied warranties may be waived in writing, except that, in the case of a residential unit, any waiver must be specific as to the defect waived and must be "a part of the basis of the bargain." In addition to implied warranties by a vendor or dealer, any seller of a unit makes an express warranty of quality by any written statement relating to the condition of the unit or the legality of its use or by any model or written description that purports to show the unit's physical characteristics. Under the act, any right or obligation is enforceable by judicial proceeding. Nothing in the act prevents parties from mediating or otherwise settling their disputes as they wish, but the act restricts the parties' ability to contractually foreclose enforcement by judicial proceeding.

Summary of Bill: Any right or obligation declared by the act may be enforced by arbitration or judicial proceeding. Arbitration is available if the parties agree to arbitrate. At the time of sale, a separate document must disclose that the purchaser may agree to arbitrate any right or obligation declared in the act, but that by doing so the purchaser is waiving his or her constitutional right to seek a de novo trial by jury. The hearing must be completed within six months of the initial demand, notice, or service of list of defects.

Appeals are tried in superior court and may be based only on procedural errors or regarding material facts that were unknown at the time of the arbitration in spite of due diligence during the investigation. There is no supplemental discovery unless specifically allowed by the

court. The record may also be supplemented at the courts discretion. The right to appeal includes a right to a jury.

The prevailing party at either arbitration or trial is entitled to attorney fees and costs. An offer of compromise replaces the arbitrator's award for the purposes determining the prevailing party.

Implied warranties are only applicable if the failure materially affects structural integrity or safety, reduces the fair market value of the unit on the initial purchase date had the defect been disclosed, or materially affects use for an intended purpose. No disclaimer of implied warranties is effective unless specifically described, known to exist at time of disclosure, and the disclaimer is clearly part of the basis of the bargain. An express warranty may not reduce implied warranty protections. The public offering statement must include a brief statement of whether any document or express warranty replaces or modifies an implied warranty. All warranties transfer to subsequent owners.

The declaration of condominium or bylaws of the condominium must include a statement of the board's decision-making standards. Resale certificates must disclose the status of any legal proceedings in which the association is a plaintiff or defendant.

After January 1, 2006, all improvements must have independent third party construction inspections. Condominiums certified after inspection are presumed to be constructed soundly, in a workmanlike manner, and in compliance with all laws. Qualifications for inspectors are specified. Qualified inspectors are immune from suit for inspections unless damage is caused solely by the inspector's negligence or willful misconduct.

Appropriation: None.

Fiscal Note: Not requested.

Effective Date: The bill takes effect July 1, 2004.

Testimony For: Affordable insurance for builders is very difficult to obtain, especially for builders constructing condominiums. Doing nothing will hurt low and moderate income home buyers because the high cost of insurance raises home prices or prevents their construction. Dense housing, required by the Growth Management Act, will become hard to obtain. Insurers need more certainty to restart the industry.

Testimony Against: The bill is not narrowly tailored to preserve the rights of consumers or to resolve the builders' insurance issues. Consumers are not experienced in negotiating contract provisions. People want to buy homes that comply with building codes, not ones that are merely habitable. Consumers need the current protections for the primary investment of their lives.

Testified: PRO: Ron Meyers, Condominium Alliance; Tony To, Condominium Alliance; Pete Middlebrooks, Condominium Alliance; Scott Hildebrand, Master Builder's Association; Suzanne Dale Estey, King County Executive Office. CONCERNS: Larry Shannon, WSTLA; Genesee Adkins, 1000 Friends of Washington. CON: Carl Wilson; David Merchant, Washington Homeowner's Coalition; Marion Morgenstern, Washington State Community Associations Institute; Mo McBroom, Washington Public Interest Research Group.

House Amendment(s): Implied warranties extend to the extent of defective materials, sound engineering and construction, workmanship, and compliance with all laws. The condo owner must show that the defect adversely effected the performance of the condo. An adverse effect must be more than technical, and must be significant to a reasonable person. It need not render the condo uninhabitable or unfit for use. Proof of breach is not proof of damages. Damages for a breach are cost of repairs, unless cost of repair is grossly disproportionate to the loss in market value, then damages is limited to loss in market value.

A seven-member committee (three Senate, three House, one Governor-appointed) is created to study third party water penetration inspections and arbitration as an alternative to court action. Due date is December 31, 2004.

The declaration of condominium or bylaws of the condominium must include a statement of the board's decision-making standards. Resale certificates must disclose the status of any legal proceedings in which the association is a plaintiff or defendant.

A warranty insurance program is established as an alternative to the implied warranty provisions of the WCA. The public offering statement must include a statement as to whether a qualified warranty applies to the condo and the history of claims. 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. If a construction professional agrees to indemnify the insurer for loss due to construction defects caused by the construction professional, the liability of the construction professional is limited to the insurance limits of the 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; and 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 themselves be warranted by the insurer for the longer of the remainder of the qualified warranty period or one year from completion of the repair.

Several provisions are allowed but not required in a qualified warranty. These include: requiring owners to cooperate with an insurer who has paid a claim and is suing the declarant or a construction professional; 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.

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. A qualified warranty may limit per unit coverage to the lesser of a unit's original purchase price or \$100,000, and may limit coverage for common elements to \$150,000 per unit. These limits are to be adjusted annually for consumer price index changes.

A qualified warranty may not require an owner to sign a release before repairs are made or pay a deductible in excess of \$500 for any repair to a unit, or in excess of the lesser of \$500 per unit or \$10,000 for any repair to common elements.

Either the owner or the insurer may demand mediation of a claim dispute. Procedures are provided for the appointment of a mediator and for the conduct of mediation. A warranty policy may include mandatory binding arbitration for resolution of claims under the policy. The policy may not permit joinder in the arbitration of persons other than those who are parties to the policy. In any proceeding to enforce the terms of a warranty policy, the court or arbitrator must award attorneys' fees to a substantially prevailing party. The awarded fees may not exceed the reasonable hourly value of the attorney's work.

No insurer is required to offer a warranty policy. In deciding whether to sell a policy to a declarant, the insurer may make inquiries of and about the declarant, including: whether the declarant has the necessary resources, technical expertise, experience, business practices, and the ability to provide after-sale customer service for the proposed condo; whether the declarant has the necessary capitalization for the proposed condo; and whether any proposed general contractor for the project meets the insurer's requirements. The insurer may also require that the declarant: provide security for the project; comply with specific construction standards; not build some types of condos or use some types of construction; use specified types of systems, consultants or personnel; provide independent review of plans; provide third-party verification or certification of construction requirements; provide inspection during construction and ongoing monitoring after construction; maintain insurance, bonding or other security in favor of the insurer and potential owners; and provide the insurer with a list of construction professionals and trades employed in the project.