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New Home Warranty

An Open Question Seeking an Answer

RESIDENTIAL NEW CONSTRUCTION

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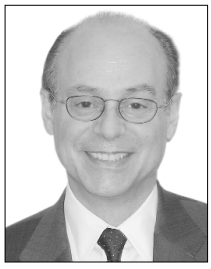

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IN 1998, in *Fumarelli v. Marsam Construction, Inc.*[1] the New York Court of Appeals decided that the statutory housing merchant implied warranty contained in Article 36-B of the General Business Law[2] "effects a complete substitute for the common law remedy" that the Court itself first proclaimed ten years earlier in *Caceci v. DiCanio Construction Corp.*[3] Nevertheless, despite the sweeping statement, in *Fumarelli*, that Article 36-B "eclipses the holding in *Caceci*," it remains "an open question whether the Court intended 'its *Fumarelli* holding to strip common law protection from transactions to which Article 36-B does not expressly apply.' "[4]

How this "open question" is answered ultimately is a matter of great importance for consumers who pay big bucks for high-rise cooperative and condominium apartments where construction defects often turn the dream of promised luxury living into a living nightmare reality.[5]

Although the *Fumarelli* opinion does not mention it, the statutory warranties provided in Article 36-B expressly apply only to new home cooperatives and condominiums in multi-unit residential structures of five stories or less.[6] Contracts of sale for those new homes automatically contain the following implied warranties: (a) that, for one year after the passing of title (the warranty date), "the home will be free from defects due to a failure to have been constructed in a skillful manner;"[7] (b) that, for two years after the warranty date, "the plumbing, electrical, heating, cooling and ventilation systems of the home will be free from defects due to a failure by the builder to have installed such systems in a skillful manner;"[8] and, (c) that, for six years after the warranty date, "the home will be free from material defects."[9]

Modifying Implied Warranty

Nevertheless, sellers of new home cooperatives and condominiums of five stories or less may opt to draft written contracts that modify or totally exclude the housing merchant implied warranty. But, if a seller does so, the seller must then offer the buyer an express limited warranty that satisfies certain minimum requirements[10] and that does not specify any exception, exclusion, or standard "which does not meet or exceed a relevant specific standard of the applicable building code,"[11] or "that fails to ensure that a home is habitable, by permitting conditions to exist which render the home unsafe."[12]

If *Fumarelli's* holding, that Article 36-B is a "complete substitute for the common law remedy," does indeed effect the removal of all common law protection from transactions to which the statute does not expressly apply, then, when negotiating the purchase of their new homes, buyers of new or newly converted high rise, cooperatives and condominiums, that have not yet been constructed or lived in, do not even have the protections afforded by the statute, and they may be subject to the regime of caveat emptor. Under caveat emptor, such buyers are at the mercy of builder-sponsors who are under increasing pressure to cut corners in construction as they attempt to meet the rising demand for housing in New York City, particularly in Manhattan.

Therefore, builder-sponsors have great incentive to impose contract terms that insulate themselves against liability for nearly all construction defects that may surface after buyers move into their new homes. Consequently, in a seller's housing market, purchase agreements are presented to buyers on a "take it or leave it basis," and, typically, they may (a) exclude implied warranties altogether, (b) provide extremely narrow definitions for "material defects," (c) specify unreasonably short periods in which to notify the seller of any defects, and/or (d) exclude all claims for consequential damages caused by the seller's construction or repairs.

Lack of Decisions

Purchase agreements containing some or all of such terms, if deemed contracts of adhesion, could be held unconscionable and therefore unenforceable if adjudicated by a court.[13] Alternatively, on the facts of a given case, a court might find that a seller has actually waived one or more of such terms of the contract.[14] In either situation, *Fumarelli* notwithstanding, the issue, whether or not the common law housing merchant implied warranty survives for cooperatives and condominiums in buildings of six stories or more, would be starkly presented for decision. However, despite the boom in high-rise "luxury" apartment building construction in New York City in recent years, there is at present no ruling from any court that addresses this specific issue.

The lack of any court decisions is indeed surprising. First, because it has been reported that, from 1999 to 2003, nearly 4,000 new cooperative and condominium units were built in Manhattan, with an additional 445 condominiums gutted and renovated between 2001 and 2003. And, the demand for housing in New York City continues to rise. The Real Estate Board of New York reported record sales of cooperatives and condominiums in Manhattan in the first quarter of 2004 — nearly double the number of sales in the first quarter of 2003.[15] Secondly, the number of reported instances of consumers dissatisfied with their "new home" high-rise cooperatives and condominiums suggests that shoddy workmanship and defective construction are endemic to many, if not most, high rise buildings erected in recent years.

In past housing booms, the large numbers of housing units built tended to spawn substantial numbers of cases brought for defective construction. Over time, New York courts, perceiving the inequity of the rule of caveat emptor as applied to home construction contracts, chipped away at the doctrine. Finally, the Court of Appeals, in *Caceci*, acknowledged that, "with respect to homes contracted for sale prior to construction … the two parties involved in the purchase of such a home generally do not bargain as equals in relation to potential latent defects from faulty performance," and the Court held that "responsibility and liability in [such] cases … should, as a matter of sound contract principles, policy, and fairness, be placed on the party best able to prevent and bear the loss."[16]

Fumarelli did not repudiate the holding in *Caceci*.[17] Indeed, in *Fumarelli*, the Court of Appeals stated that Article 36-B "is a full, effective, and realistic substitute for the protections and rationale recognized in [*Caceci*]." Therefore, it is all the more remarkable that no court has yet been required to decide whether the common law housing merchant implied warranty is still viable in new home contracts involving buildings of six or more stories — contracts that clearly do not enjoy the warranty protections afforded by Article 36-B.

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Sharp Contrast

The lack of a judicial determination of this issue stands in sharp contrast to other questions concerning Article 36-B that have been raised and decided by New York courts. For example, it has been held that: (1) GBL §777-a, which establishes the measure of damages in Article 36-B suits as "the reasonable cost of repair or replacement and property damage to the home proximately caused by the breach of warranty" does "not create a penalty or minimum measure of damages that would bar such claims from class action certification."[18] (2) As a condition precedent to a breach of warranty claim, as required by GBL §777-a(4)a, a builder must receive written notice of the claim prior to the commencement of the buyer's suit and no later than 30 days after the expiration of the warranty period, and failure to meet either of these requirements is ground for dismissal of a buyer's Article 36-B cause of action.[19] (3) An Article 36-B breach of warranty suit will not be dismissed for failure to give the required notice where the facts show that the seller has effectively waived the notice requirement.[20] (4) Whether repairs proposed by a builder met the terms of a limited warranty that complied with GBL 777-b raised factual issues that defeated the builder's motion for summary judgment.[21] (5) Where a seller of premises contracted to construct a house on the premises and to deliver a limited warranty to the plaintiff-buyer, but no signed written warranty was ever given, "the terms of the seller-builder's warranty [did] not apply to [the] transaction and the sale of the premises [was] subject to the [Article 36-B] statutory warranty."[22] (6) Article 36-B has been held both to apply[23] and to not apply[24] to contracts for the construction of new homes on property owned by the buyer where there is no passing of title.

How to account then for the dearth of decisions respecting the applicability of the common law housing merchant implied warranty to contracts for cooperatives and condominiums in buildings of six or more stories? Of course, one reason may simply be that *Fumarelli* is perceived by litigants as having "settled the law" in this area, which was the goal that the Court of Appeals sought to achieve in ruling that Article 36-B "eclipsed" *Caceci's* holding. However, the irony is that, by overlooking the statutory definition of a "new home," *Fumarelli* has left open the "six or more stories" issue and has not settled the law. Indeed, even more ironically, the fact that the law is not settled may be the very reason why no court has been required to settle the question.

Although there have been cases in which the plaintiffs have raised the issue, a more plausible and probable reason for the lack of a decision on this question is that litigants, and particularly builder-sellers of "luxury" cooperative and condominium "lemon" apartments, have too much at stake to litigate the question and thereby risk having a *Caceci* regime reestablished. In that situation, the potential liability that developers, builders and sponsors of high-rise cooperatives and condominiums could incur would be enormously prohibitive. Consequently, sellers are inclined to settle with their buyers at some point short of having a court decide the common law warranty issue against them.[25]

Staying Out of Court

Buyers too have incentives to avoid having a court decide the question against them. First and foremost is the desire to avoid the high legal costs they would incur by litigating. Even when legal costs are shared among several co-op or condo residents, such costs may strain individual resources over the lengthy course of any litigation, and the costs are likely to be resented, particularly when the dispute may appear unending. Secondly, by litigating (even if it leads ultimately to a favorable decision for them), buyers may have to wait years while the wheels of justice turn slowly, and any opportunity to have their legitimate complaints addressed relatively early by the developer in a reasonable compromise is lost — without any resolution of their complaints before the end of the litigation, or without any resolution at all should they lose their case.

Until the issue is decided, it is in the interests of buyers and sellers to continue to seek reasonable compromises of the disputes that inevitably arise between them.

While sellers and buyers may ultimately be willing to settle their differences to avoid the possibility of adverse court rulings that could have far-reaching and long-standing effects on their respective interests, such settlements between co-op/condo residents and their developer-builder-sponsors are not easily achieved. There is often hard bargaining involved, and no compromise that effectively addresses legitimate buyer complaints is ever achieved unless the residents first arm themselves with all of the facts concerning the defects in their building and are prepared to show the developer that they know their legal rights and are ready to litigate if necessary.

Awaiting Resolution

Until such time when a court decides whether or not the common law housing merchant implied warranty survives to protect consumer purchasers of cooperative or condominium apartments in buildings of six or more stories, it is in the interests of both buyers and sellers of such apartments to continue to seek reasonable compromises of the disputes that will inevitably arise between them. However, it is also inevitable that, when properly presented in a litigation that cannot be settled, a court will someday indeed decide this open question. When that day comes, it is to be hoped that the law on housing merchant implied warranties will truly and finally be settled at last.

1. 92 NY2d 298, 703 NE2d 251 (1998).
2. GBL §§777, et seq.
3. 72 NY2d 52, 526 NE2d 266 (1988).
4. *Gorsky v. Triou's Custom Homes, Inc.*, 194 Misc2d 736, 743 n.4, 755 NYS2d 197, 203 n.4 (Sup. Ct., Wayne Co., 2002) (citing Bailey & Desiderio, Are Buyers of New Condos and Co-ops Subject to Caveat Emptor?, New York Law Journal, Sept. 6, 2001, p.4) (See article at www.alblawfirm.com).
5. See, e.g., New York Times, "Megadollar Homes, Megapainful Headaches," Jan. 8, 2004.
6. GBL §777 (5).
7. GBL §777-a (1) (a).
8. GBL §777-a (1) (b).
9. GBL §777-b (1) (c).
10. GBL §777-b (3).
11. GBL §777-b (3)(e)(i).
12. GBL §777-b (3)(e)(ii).
13. Cf., e.g., *Weidman v, Tomaselli*, 81 Misc2d 328, 365 NYS2d 681 (County Ct., Rockland Co., 1975).
14. See, e.g., *Randazzo v. Zylberberg*, 2004 NY Misc LEXIS 836 (2d Dept. 2004).
15. REBNY REPORTS, June 1, 2004, http://www,rebny.com/releases/june_2004.
16. 72 NY2d at 59.
17. 92 NY2d at 302.
18. *Zehnder v. Ginsburg & Ginsburg*, 172 Misc2d 57, 656 NYS2d 135 (Sup.Ct., Westchester Co., 1997).
19. *Taggart v. Martano*, 282 AD2d 521, 723 NYS2d 211 (2d Dept. 2001).
20. *Randazzo v. Zylberberg*, supra, at n 14.
21. *Hirshorn v. Little Lake Estates*, 251 AD2d 377, 674 NYS2d 109 (2d Dept, 1998).
22. *Vela v. DGR Building Corp.*, NYLJ, 8/7/02, p. 28, col. 4.
23. *Gorsky v. Triou's Custom Homes, Inc.*, supra, at n 4.
24. *Biggs v. O'Neill*, 309 AD2d 1110, 766 NYS2d 391 (3d Dept. 2003); *Watt v. Irish*, 184 Misc2d 413, 708 NYS2d 264 (Sup.Ct., Columbia Co., 2000).
25. In a matter litigated by the authors' law firm, the defendant developer of a high rise cooperative withdrew its summary judgment motion when the plaintiff raised the common law warranty issue in opposition to the motion.

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