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Construction Update: Arizona Court Allows Purchaser of Commercial Building to Enforce Warranties Given By Original Contractor

By Christopher L. Callahan, John E. Kofron and Stephen P. Brower

It has long been an open issue whether the law in Arizona permits owners, other than the original owner, of commercial buildings to sue builders or contractors for construction defects. On April 8, 2008, an Arizona appellate court decided that a builder of commercial property could be liable to a subsequent purchaser for construction defects if the original owner expressly assigned its warranty rights to the purchaser. This decision appears to have the effect of extending the liability of commercial contractors for implied warranties given to the original owner, and has implications for transactions involving the purchase of commercial buildings.

In *Highland Village Partners, L.L.C. v. Bradbury & Stamm Construction Co.*, a builder constructed a series of apartment buildings in Flagstaff for College Partners. Eight years later, College Partners sold the apartments to Highland Village. The purchase contract contained the following assignment language:

[College Partners assigns] all presently effective warranties or guaranties in College Partners' possession from any contractors, subcontractors, suppliers, servicemen or materialmen in connection with . . . any construction, renovation, repairs or alterations of the improvements or any tenant improvements [as well as] all contracts with general contractors, subcontractors, and/or specialty contractors for the improvements which [sic] are in the possession and/or under the control of Seller.

Initially, the court acknowledged that an "implied-warranty-of-good-workmanship claim is one grounded in contract and therefore, with exception, can only be asserted by a party to the contract." Even so, the court held that a subsequent purchaser may bring a warranty claim against the builder/contractor if the purchaser receives a valid assignment of the original owner's construction warranties. In reaching this conclusion, the court reasoned that an assignment is valid unless (a) it unfairly prejudices the builder/contractor, (b) it is prohibited by statute, or (c) it is precluded by contract.

The builder argued that allowing assignment of implied warranty claims decreases the owner's incentive to promptly sue the builder for construction defects. The court found this argument unpersuasive stating that this disincentive is mitigated by: (i) Arizona's statute of repose (similar to a statute of limitations); (ii) the doctrine of laches (delay in pursuing a legal claim); and (iii) the ability of the parties to contract out of future assignments. Regarding this last option, the court stated "a builder may protect itself from an owner who may choose to sit on its warranty rights in anticipation of a sale by including a non-assignability clause in the parties' contract."

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The holding in this case has significant implications for both commercial builders/contractors and persons engaged in the purchase and sale of improved commercial real estate. From the standpoint of a commercial contractor, it is essential if it wishes to limit its downstream liability for construction warranties to include provisions expressly prohibiting the assignment of warranties in its construction contract. Conversely, the prospective purchaser of improved real property will want to review the original construction contracts, as part of its due diligence, to determine if the implied/express warranties are assignable.

Because this opinion is too new to have been subjected to judicial scrutiny, contractors and owners should be cautious in relying on its principles. Contractors should not assume that courts will uniformly uphold non-assignability clauses. Similarly, subsequent purchasers cannot be sure that an assignment of warranty rights guarantees them the right to sue the builder/contractor for construction defects. Even so, in the wake of this decision, builders/contractors and purchasers should carefully consider its potential far-reaching affect on commercial construction defect litigation.

A full copy of the decision in Highland Village Partners, L.L.C. v. Bradbury & Stamm Construction Co. can be found at <http://www.cofad1.state.az.us/opinionfiles/cv/cv07-0194.pdf>.

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