

Issues & Answers

REAL ESTATE ALERT

Construction Defect Legislation Effective August 22, 2002

By Scott W. Hyder and Jay S. Kramer

The Arizona legislature recently passed legislation that requires homebuyers (including successors) and homeowners' associations to give homebuilders notice and an opportunity to repair allegedly defective work before commencing a court action (see A.R.S. Sections 12-1361 through 1366 and 33-2003). The legislation becomes effective August 22, 2002. The legislation does not require the parties to submit to mediation or arbitration (although the claims may be subject to mandatory mediation under court rules). It is also unclear whether the law (including satisfaction of the requirements for the exemptions) applies to construction defect claims arising out of purchase contracts signed prior to August 22, 2002 or home sales closed prior to August 22, 2002.

EXEMPTIONS AVAILABLE IN CERTAIN CIRCUMSTANCES

The provisions of the construction defect statutes apply unless the homebuilder's purchase contract or the planned community's CC&Rs contain "commercially reasonable alternative dispute resolution procedures". If the alternative dispute resolution procedures are in a purchase contract, the procedures must be conspicuously printed on the face page of the purchase contract in bold and capital letters.

However, if the alternative dispute resolution procedures are in the CC&Rs, no disclosure of these procedures is required in the purchase contract in order for them to be effective. If the alternative dispute resolution procedures are only included in the purchase contract, only the initial purchaser will be bound by the provisions. Such provisions will not apply to disputes involving homeowners' associations (and the new statutory procedures will apply to these disputes). If the alternative dispute resolution procedures are in the CC&Rs, the declarant, the homebuilder, the homebuyer and the successor purchasers should all be bound by the same dispute resolution procedures.

If the homebuilder elects to rely on the alternative dispute resolution procedures in the CC&Rs, we believe that it is prudent for the homebuilder to include on the face page of its purchase contract (or in a separate document) an acknowledgment to be signed by the homebuyer that it has read and fully understands the alternative dispute resolution procedures in the CC&Rs (noting the applicable section and page numbers for the dispute resolution procedures), that the homebuyer intends for these procedures to apply to and govern construction defect disputes, and that the dispute resolution

procedures are commercially reasonable (note that this acknowledgment will only bind the homebuyer and not subsequent purchasers). If the homebuilder is initially preparing the CC&Rs or has the opportunity to modify the CC&Rs, in addition to any substantive dispute resolution procedures, it should consider including a so-called "severability clause" within the dispute resolution procedures that may permit the court to enforce those portions of the dispute resolution procedures that are commercially reasonable while ignoring those portions of the dispute resolution procedures that the court finds are not commercially reasonable.

If the dispute resolution procedures in the CC&Rs are inadequate, incomplete or absent altogether and the homebuilder does not want to rely on the dispute resolution procedures in the construction defect statutes, the homebuilder must include its alternative dispute procedures (or supplemental alternative dispute procedures) on the face page of its purchase contract (we do not believe that as the statutes are presently written it is sufficient to refer on the face page of the purchase contract to a section within the purchase contract).

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If a homebuilder includes its dispute resolution procedures on the face page of its purchase contract and there are dispute resolution procedures in the CC&Rs that address construction defects, both sets of procedures should be consistent in order to avoid a conflict. However, the alternative dispute resolution procedures in the purchase contract will only be binding on the homebuyer and will not bind subsequent purchasers or any other third parties.

CONSTRUCTION DEFECT LEGISLATION REQUIREMENTS

Because the construction defect law provides limited benefits to the homebuilder and because many planned communities and homebuilders have their own dispute resolution procedures (or warranty programs) that are intended to apply to a number of types of disputes,

including disputes involving construction defects, many homebuilders will probably choose to comply with the exemption requirements listed above. However, if a homebuilder elects not to comply with the exemption requirements, the law **requires** a homebuilder to include a provision in its residential purchase contracts that informs the homebuyer of the right to file a complaint against the homebuilder with the Arizona Registrar of Contractors for a period of two years after the sale. The statute provides the exact language and the required text formatting for this provision. The statute also requires the homebuyer to initial the provision. If the homebuilder does not comply with the exemption requirements, it **must** revise its purchase contracts to include the required information.

If the homebuilder wants to be exempt from the new law, the legal ramifications are unclear if a court later determines

that the homebuilder's alternative dispute resolution procedures were not "commercially reasonable". In such case, the homebuilder may want the statutory construction defect procedures to apply. A homebuilder should consider including in its purchase contract the required statutory disclosure that the homebuyer has the right to file complaints with the Registrar of Contractors, even if the homebuilder intends for the CC&Rs or its own dispute resolution procedures to apply. In addition to bolstering the homebuilders' position that its dispute resolution procedure is "commercially reasonable", the inclusion of the required statutory disclosure arguably allows the notice and cure provisions of the new law to apply if a court determines that the homebuilder's alternative dispute resolution procedures are not "commercially reasonable." ■

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