

Real Estate Title Insurance & *Construction Law*

Buyer Beware of Defects in New Construction

Why the remedy under the homeowner warranty program is no remedy at all

By Gene Markin

Since its inception, the New Jersey Home Warranty and Builders' Registration Act, N.J.S.A. 46:3B-1 to -20, has proven to be more of a trap for new homeowners than the safety net it was purported to be. The purpose of the act is to establish a program requiring that newly constructed homes conform to certain construction and quality standards, as well as to provide buyers of new homes with insurance-backed warranty protection in the event such standards are not met. While the intent of the act is to provide homeowners with a prompt, convenient and cost-

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saving means of resolving disputes concerning construction defects, in reality, its effect has been, in many cases, to strip homeowners of any meaningful means of recovery for discovered construction defects.

Pursuant to the act, all builders must be registered with the New Jersey Department of Consumer Affairs in order to engage in the business of constructing and selling new homes. The act further requires that builders provide owners with a new home warranty by either participating in the New Home Warranty Security Fund or an acceptable alternative program. The builders are then required to provide new homeowners with a warranty that affords coverage and protection against defects, falling within three time-sensitive categories:

- (1) During the *first year* after the warranty date, warranty coverage extends to defects caused by faulty workmanship and defective materials (this includes plumbing, electrical and mechanical systems, appliances, fixtures and equipment, and major structural defects);
- (2) During the *first two years* after the warranty date, warranty cov-

erage extends to defects caused by faulty installation of plumbing, electrical, heating and cooling delivery systems, however, with respect to appliances, this warranty does not exceed the length and scope of the warranty offered by the manufacturer; and
(3) During the *first 10 years* after the warranty date, warranty coverage extends to only major construction defects.

Simply stated, the warranty covers all ordinary defects in the first year, then faulty installation of systems (plumbing, electrical, heating and cooling) in the second year, and then dwindles down to providing coverage for only major defects in the third through 10th years. Due to the stringent definition of "major construction defects," the warranty affords no coverage unless the house is practically collapsing and/or is uninhabitable. Common issues such as leaks, cracks, mold, excessive settling and system malfunctions are not covered. Invariably, the warranties will also contain numerous exclusions that chip away at the actual attainable coverage.

Thus, the homeowner warranties provided by the builder generally con-

tain a labyrinth of exclusions and qualifications that invariably set the stage for disputes and disagreements over what is or is not covered.

Filing a Claim

The act provides a multistep process for filing a claim. First, the homeowner has to notify the builder of whatever defects exist and allow the builder a reasonable amount of time, usually 30 days, to make the necessary repairs. If the builder fails to make the requisite repairs, the homeowner may submit claims for defects covered by the warranty to the commissioner of the Department of Consumer Affairs (DCA) (or through whatever program is servicing the homeowner's warranty). The commissioner is then required to investigate the claim and determine its validity, after affording the parties an opportunity to be heard at a hearing. Methods of claim resolution include independent third-party mediation and legally binding arbitration.

Remedy Preclusion

Nevertheless, as innocuous as the claims process sounds, the act contains what can only be described as a death knell for homeowners who choose to proceed through the warranty program. Section 46:3B-9, known as the "election-of-remedies" provision, states that "*initiation of procedures to enforce a remedy shall constitute an election which shall bar the owner from all other remedies.*"

The significance of this provision cannot be overemphasized. Should a homeowner decide to pursue a claim for defects under the warranty, he or she is thereafter *statutorily barred and precluded from bringing a lawsuit against the builder*. This means that the homeowner must pick, at the outset, whether to proceed under the act (i.e., through mediation and arbitration), or pursue a legal remedy through the court system. It is an either-or proposition.

As the Appellate Division explained, once a homeowner opts for binding arbitration pursuant to the act, all of the homeowner's potential claims for damages against the builder, including common-law fraud and alleged violations of

the Consumer Fraud Act, are subsumed by the homeowner's election of remedies under the act. Furthermore, even initiation of the claims process is enough to trigger the election-of-remedies provision and bar the homeowner from all other remedies.

When is the election-of-remedies provision triggered?

Recently, the Appellate Division had the occasion to decide whether simply submitting a claim to the DCA, in accordance with the act, barred the plaintiffs from pursuing a lawsuit against the builder. The Appellate Division found that it did, stating that by submitting their claim to the DCA, the plaintiffs made an election of remedies that precluded them from pursuing a lawsuit for defects to their newly-constructed home. See *Maloney, et al. v. Ali, et al.*, A-0950-10T4 (October 17, 2011).

In *Maloney*, the plaintiffs contracted with the defendants for the construction and purchase of a single-family home. After living in the home for about a year, the plaintiffs submitted a claim to the DCA under their new-home warranty. The plaintiffs included a copy of a home inspection report and identified certain defects that had not been addressed by the builder. Thereafter, the DCA informed the plaintiffs that their claim had been closed because they had not submitted a concise list of the defects they were complaining about. Moreover, the DCA stated that many of the defects listed were only covered in the first year of the warranty, and the warranty was in its second year.

The plaintiffs did not proceed any further with the DCA and instead filed an action in Superior Court two years later. They asserted claims for breach of contract, breach of the covenant of good faith and fair dealing, negligence, promissory estoppel, unjust enrichment and consumer fraud. Soon after, the defendants filed a motion for summary judgment, arguing that the plaintiffs' lawsuit was barred by the election-of-remedies provision. The trial court granted the defendants' motion. The Appellate Division affirmed, finding that the act of submitting a claim to the DCA under their new-home warranty triggered the

election-of-remedies provision. Thus, because the filing of a claim against the warranty constituted the election of a remedy, the plaintiffs were statutorily precluded from pursuing any other remedy, such as a lawsuit.

Important Considerations for New Home Buyers

Considering the stringent ramifications of proceeding under the warranty program, the take-away is *buyer beware*. While the act is in place to protect buyers of newly built homes, in practice, it actually greatly limits a buyer's potential for recovery for damages arising out of construction defects. The real-world application of the act serves to exacerbate the divide between homeowners and builders when there is a dispute over defects.

The remedy it offers — mediation and arbitration — is no remedy at all because once invoked it becomes the sole and exclusive remedy available to the homeowner. The homeowner has lost the option to bring a lawsuit and the best result that can be achieved through the warranty program is a determination that the defects claimed are covered under the warranty. However, in such a case, the builder, who supposedly created the defects, is then required to come back and make the appropriate fixes. Thus, a successful outcome through the warranty program does not appear to be as attractive as a successful lawsuit where the homeowner is awarded money damages.

In light of the onerous and prohibitive consequences of proceeding under the warranty program, there are a number of practical steps that homeowners can take:

- Document and record all discovered defects and suspected defects (photographs and video);
- Provide prompt and detailed notice to your builder and/or warranty service representative of your builder;
- *Do not* be hostile, combative or adversarial in communicating with the builder;
- Maintain a file of all written communications with the builder and/or warranty company;
- When necessary, consult with inde-

pendent engineers, architects, construction professionals and/or attorneys in order to evaluate the extent of defects, adequacy of proposed fixes and potential legal claims;

- *Do not* perform any repair, replacement or other corrective work yourself unless absolutely necessary, and, in that case, make sure to provide notice to your builder and/or warranty service adminis-

trator; and

- *Carefully consider* all options before deciding to avail yourself of the dispute resolution procedures afforded by the warranty program. ■