THE MYTH OF THE ONE-YEAR WARRANTY AND OTHER CONSTRUCTION WARRANTY ISSUES

By Susan Linden McGreevy

If your memory stretches back far enough, you may recall learning in law school that a warranty is an "assurance or promise of a particular outcome upon which another party may rely." Warranties have become an ingrained, accepted part of commercial transactions in the United States, from the purchase of a toaster or a set of tires to the acquisition of corporations and shopping centers.

When it comes to the sale of goods, governed by the Uniform Commercial Code, the power of warranties is taken seriously. Two sections of the UCC, UCC §§ 2–314(1) (warranty of merchantability) and 2–315 (warranty of fitness for particular purpose), are well understood by manufacturers, who do all they can to structure their exposure through the use of "limited" warranties or disclaimers of warranties. Even these limitations and disclaimers are controlled by other sections of the UCC. Practitioners working in the product liability arena are well-versed in the nuances of implied versus express warranties, intended versus incidental beneficiaries, and the myriad of other legal issues commonly encountered in pressing or defending such claims.

Yet, for reasons not entirely apparent, in no area are warranties more misunderstood and misapplied than in the area of construction—particularly in what could be called the "Myth of the One-Year Warranty." As a result, contracts and surety bonds are improperly

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drafted, inappropriate insurance is required and furnished, and owners frequently end up with huge investments that are not warranted to last as long as the last set of tires they bought for their SUVs.

The "Standard" Construction Warranty

The American Institute of Architects A201 "General Conditions of the Contract for Construction" (1997) correctly states the standard construction warranty. The contractor agrees that

- materials and equipment used by the contractor will be new and of good quality unless otherwise required;
- the work will be free from defects other than those inherent in the work as specified; and
- the work will conform to the requirements of the contract documents.

A201 ¶ 3.5.1. None of this is particularly remarkable. It is, probably, the least that a purchaser of a structure would expect—that the contractor who does not live up to these minimum requirements will be in breach of warranty. The "teeth" come in what is *not* stated. Note that *there is no time limit in this paragraph whatsoever.*

How Long Does the Warranty Extend?

Reaching again back into the law school textbook, every lawyer knows that a suit for breach of a contractual warranty must be brought within the statute of limitations, as extended by the "discovery rule," or as limited by a statute of repose in a particular state. So, how long is this for a construction defect? The answer is . . . it depends.

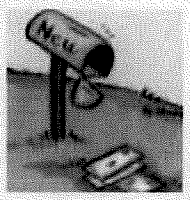
If AIA-type language has been used, there is no one time period for warranty exposure. The exposure to suit could be for a short or a very long time. This uncertainty is because the expected useful life of some construction materials is many years longer than other materials. For example:

- carpet cannot be expected to last as long as the steel frame or block walls, and
- caulking does not have the same typical lifespan as concrete.

Similarly, the grade of material and specific application will affect the useful life:

- residential-grade HVAC equipment will not hold up as well in industrial applications, and
- asphalt on a private residential driveway will last far longer than the same material on an interstate.

All these (as well as many other) factors must be taken into account by a trier of fact (jury, judge, or arbitrator) to make the preliminary determination of how long the product should have lasted, to then decide whether the warranty was breached.



A construction buyer expects to get a substantial product that will be around a long time.

A good example of how long exposure can exist is *Business Men's Assurance Co. of America v. Graham*, 984 S.W.2d 501 (Mo. 1999). The BMA tower in Kansas City was a renowned design of the Skidmore, Owings & Merrill architectural firm, a concrete and steel exterior frame that supported a column-free interior. The tower sits on a hilltop and is a major architectural feature of the skyline. The exterior frame is a grid clad with four-foot square marble panels. The design was completed in 1960, and the construction was completed in 1963.

In 1985, some of the marble panels started to fall off, causing the entire street level to be cordoned off. In 1986, the designers were sued. Eventually, a jury found that the mechanism for attaching the panels to the concrete behind them was defective, weakening in the wind like giant paperclips until they snapped off, and that, had they been designed correctly, they would have lasted for decades. The Missouri Supreme Court found that because the owner did not discover the latent defect until after 1981, the lawsuit was timely.

Shortening the Warranty

Apart from the defendants in that suit, no one could blame BMA for being dissatisfied that its architectural monument did not last more than 20 years. We are surrounded with structures that stand for centuries, if not millennia. Whether using a "standard form" or a custom-drafted document, a construction buyer expects to get a substantial product that will be around a long time.

Yet, there is a practice among drafters of construction documents in the United States of intentionally inserting "one-year" warranty language in contracts, under the impression that this is helping their clients. The drafters have, it seems, been lulled into believing the "Myth of the One-Year Warranty." In at least half (if not more) of the construction contracts the author has reviewed over the last five years, the drafter has deliberately added language to "clarify" that the builder must stand behind its work for "one year" (or maybe two). In fact, a recent construction publication's cover article on warranties started out by saying, "It is common, even customary, for construction contracts to include a 12-month warranty of material and workmanship." *The Contractor's Express Warranty Obligation*, Construction Claims Monthly (Bus. Publishers, Inc., Silver Spring, Md.), Jan. 2004, at 1.

In specifying short warranty periods, drafters are depriving themselves and their clients of the warranty protection they would otherwise enjoy and no doubt expect. If the drafter is asked why he or she is insisting on a one-year warranty, he or she will, to a man or woman, respond that this is "standard." If pressed further, the drafter typically cannot trace his or her belief back to any hornbook law. The only conclusion this author can come to is that drafters have heard it so often that they have come to accept it without question.

Confusion over the One-year Correction Period

One likely source of the confusion over warranty periods is the inclusion in just about every commercial construction contract of a clause requiring the contractor to return to the project to repair defects discovered within one year. In the AIA A201, a one-year *correction period* is found in ¶ 12.2.2.1. That paragraph requires the owner to notify the contractor of defects and give the contractor the opportunity to fix them itself. If the owner notices such a defect within 12 months, and either does not notify the contractor, or does not allow the contractor the opportunity to make the repairs, the warranty rights for that item are waived. If the contractor does not fix the problem, the owner may do so and collect its costs from the contractor.

This one-year correction period has, somehow, come to be referred to so often as a one-year *warranty*—or, to the dismay of every contracts professor, a one-year *guarantee*—that many developers, builders, and their counsel have come to believe that one year is as long as a construction warranty should last. Frequently, this is memorialized in the document by way of a "Special Condition," or "Supplementary Condition," or it is inserted in the front-end of the project manual by a well-intentioned designer and looks something like this:

- "Contractor warrants the Project will be habitable and constructed in a good and workmanlike manner and free from defects in material and workmanship for a period of one year following the date of Substantial Completion";
- "Defective Work found to exist within the two-year warranty period shall be removed immediately and replaced in an acceptable manner."

What owner or mortgagee or bond holder of a multi-million-dollar water treatment plant, high-rise office tower, hospital, or corporate headquarters wants to learn that it has bought no more than one year's use of the structure?

Special Warranty Problems

Drafters of prime contracts should not feel alone in their unwitting gift to general contractors. Lots of other thorny warranty issues are created, ignored, or exacerbated throughout the construction document process.

Subcontracts

It would be a rare situation indeed to find a subcontract that was drafted with the terms of a specific prime contract in mind. Subcontracts are generally "canned" documents (whether a standard form or custom drafted for the contractor) and contain some type of warranty clause. As a result, the odds that the warranties in the subcontract and the prime contract will fit together are lower than the odds of being hit by a meteor. In those cases in which the owner does not shorten the warranty obligation of the general contractor, the general contractor, in its zeal to make its subcontract language crystal clear, will often bind the subcontractor to a one-year warranty, "notwithstanding any other term to the contrary in the Prime Contract."

Manufacturer's Warranties

As noted above, most manufacturers "get it." They understand UCC issues. Aware of the staggering risk-management and accounting challenges associated with decades-long warranty exposure, manufacturers of many construction products sell their wares only with limited warranties. Whether it be an air handling unit, roof membrane, caulk, UV window tint, or paint, each product's sales literature will, somewhere, define exactly what the limits of representations are and what the buyer has to do to invoke its limited rights—such as paying for transporting the goods back to the manufacturer, election of remedies, and disavowal of consequential damage.

The rub here is that contractors, nearly without exception, sign agreements with owners that include broad warranties (at least in scope or remedy if not in time) that the manufacturers will not honor. Owners who specify more expensive brands of goods out of concerns for long-term maintenance or



durability might be surprised to learn that they have only the credit and responsiveness of their prime contractor to look to and almost certainly *not* that of the big-name manufacturer.

Extended Warranties

A number of owners, particularly public highway operators and purchasers of roofing work, have begun to specify periods of time, known as "extended warranties," from 2 years to 20 years, in their contracts. Of course, frequently what these owners have done is inadvertently *shortened* and not extended their warranty term, but they at least avoid a fight over how long a product ought to last by being specific. Again, if care is not taken in the drafting, the

benefit of the extended (or at least definite) warranty can be canceled out by other inconsistent terms.

Invitations to Lawsuits

Some parties and their counsel address the potential conflicts by adding language attempting to establish an order of precedence. Sometimes this works, but often it backfires. When the contractor specifies that the subcontractor must give a one-year warranty "in addition to any other warranties elsewhere in the contract documents," but incorporates by reference only the section of the project manual setting out the specific subcontractor's scope of work into the subcontract, what warranty governs? What if the prime contract contains specific extended warranties of equipment in the technical specifications, but the subcontract contains a one-year warranty, and there is an order of precedence clause that says that in case of conflict the terms of the subcontract control?

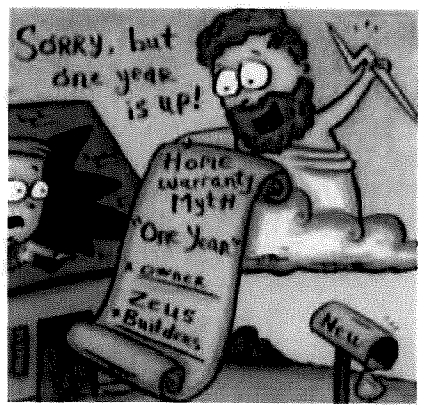
Technical Specification Sections

Specifications are drafted by the designer and are generally never seen by counsel, yet more and more often terms with legal significance—such as warranties—creep in. It is not uncommon to see one-year warranty language in the same project manual that includes 5- and 10-year warranties of equipment in its mechanical, electrical, or roofing sections. Without a clear order of precedence clause, which one controls? What if the bidding subcontractor never saw the one-year warranty term, but only the extended warranty term—can the subcontractor limit its warranty exposure to one year?

Surety Bonds

One of the major purposes in paying for a surety bond is to have a deeper pocket around in case the contractor defaults on its obligations, including its warranty obligation. Frequently, however, the bond states on its face that it expires a year or two after completion, thus relieving the surety of any obligation to honor a longer contractual warranty. When the bond is not so restricted, if the surety is potentially on the hook for decades, what are the chances that it will agree to furnish the bond? It could not adjust its books to close out a bond and might feel obligated to hold onto its security position respecting a contractor just to protect itself. The surety market has shrunk appreciably in the last few years, and very few sureties would knowingly agree to stand behind such an open-ended obligation. What protection has the owner purchased in this case?

Note that contractor default insurance, a product that is now used in larger projects, or the similar subcontractor default insurance employed by some large contractors, generally contains a window of time for claims that may conflict with true warranty exposure.



Insurance to Cover Warranty Obligations

The world of insurance also has changed significantly for construction. Amounts and types of coverage are more limited than ever. Latent construction defects are frequently discovered as a result of a casualty such as incorrectly installed piping causing water damage or incorrectly welded steel causing roof collapse. Obviously, the insurance does not do much good if it is not in force. "Claims-made" coverage is not likely to be extended to the length of time required to respond to the full range of most warranty exposures.

Points to Consider When Drafting Construction Documents

All of the challenges discussed above can be quantified, so that all parties understand what they are getting (or not getting), and many of the "surprises" can be avoided with the assistance of knowledgeable counsel.

- When drafting a prime contract:
  - —make sure that the warranty written is the one intended and that the client understands what it is giving or accepting;
  - —review the entire project manual for consistency;
  - —include a clear order of precedence clause to assure that the warranty wanted is the one that controls;
  - —draft or review the surety bond language and insurance language; and
  - —if the designer specifies equipment that is to have a particular warranty, make him or her confirm in writing with the manufacturer that it will be available.
- When drafting or reviewing a subcontract:
  - —request a copy of the prime contract, and the entire project manual, to ascertain their warranty requirements and order of precedence provisions;
  - —make sure the client knows whether the manufacturers of equipment it intends to use will give the warranties that are required; and
  - —advise the client to ascertain whether it can furnish the bonds and insurance coverage for the term of the warranty.

With the exception of already published public bid documents, warranty issues are generally negotiable, particularly if the other party is aware that the coverage is either not available or exorbitantly expensive. Above all, a lawyer should take care not to limit the client's warranty rights inadvertently by drafting or agreeing to language for a period falling short of the client's reasonable expectation of use of the project. ■