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Are Buyers of New Condos and Co-ops Subject to Caveat Emptor?

Before purchasing a condominium or cooperative apartment in a newly built high rise of six or more stories in New York, a prospective buyer needs to pay close attention to the warranty provisions of the sponsor's offering plan and purchase agreement.

Unless the agreement contains the sponsor's express warranty that the construction of the building or the apartment will be free from material defects, if a material defect is later discovered, the buyer may be confronted with a disclaimer of liability by the sponsor. Even if the defect is discovered before the closing, the sponsor may insist that the buyer proceed to closing or be deemed in default of the purchase agreement thereby forfeiting the down payment.

What, if any, legal rights the buyer has in such a situation is a question that has not yet been decided by the courts. Nevertheless, the issue is a likely subject of future litigation. Therefore, attorneys representing both buyers and sellers of new condominiums/co-ops need to consider the question and be prepared to address it — preferably in contract negotiations that seek to preclude the issue from arising, or in litigation, when that is unavoidable.

Although Article 36-B of the General Business Law[1] provides that "a housing merchant implied warranty is implied in the contract or agreement for the sale of a new home,"[2] the statute narrowly defines the term "new home" to mean "any single family house or for sale unit in a multi-unit residential structure *of five stories or less* in which title to the individual units is transferred to owners under a condominium or cooperative regime."[3]

Clear Dichotomy

This statutory scheme creates a clear dichotomy — between condominium/co-op structures of five stories or less and those of six or more stories — raising important questions concerning what, if any, warranty protections the law now provides for condominium/co-op structures in excess of five stories.

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Under GBL § 777-a, buyers of condominium/co-op apartments in a newly built structure of five stories or less automatically receive the following protections when purchasing their "new home":

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- For one year after the date of the passing of title (the warranty date), an implied warranty that "the home will be free from defects due to a failure to have been constructed in a skillful manner;"[4]
- For two years after the warranty date, an implied warranty that "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;"[5] and
- For six years after the warranty date, an implied warranty that "the home will be free from material defects."[6]

However, Article 36-B also gives the sellers of condominiums/co-ops in buildings of five stories or less the option of drafting written contracts that modify or totally exclude the housing merchant implied warranty. Nevertheless, if a seller does modify or exclude the implied warranty, the seller is then obliged to offer the buyer an express limited warranty that must comply with certain minimum requirements specified in the statute.[7]

In addition, the express limited warranty offered by the seller may not specify any exception, exclusion, or standard "which does not meet or exceed a relevant specific standard of the applicable building code"[8] or "that fails to ensure that a home is habitable, by permitting conditions to exist which render the home unsafe."[9]

Implied Warranty Case Law

Shortly before the enactment of the statutory housing merchant implied warranty contained in Article 36-B, the state Court of Appeals decided *Caceci v. Di Canio Construction Corp.*[10] In *Caceci*, the Court recognized the existence of a common law housing merchant implied warranty in contracts between builder-vendors and purchasers of new houses. In doing so, the Court held that the doctrine of caveat emptor ("that the buyer must beware"), which traditionally governs the sale of personal and real property, would no longer apply to contracts for the construction and sale of new homes in New York.

In holding that the caveat emptor doctrine should no longer apply in such cases, the Court said 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."

A decade after its decision in *Caceci*, the Court was asked to decide whether the common law housing merchant warranty survived the enactment of the statutory housing merchant implied warranty and whether the two implied warranties could coexist.

'Fumarelli'

In *Fumarelli v. Marsam Development, Inc.*,[11] the Court framed the issue as "whether the statutory housing merchant implied warranty, found in [Article 36-B], is a full substitute for the antecedent common-law housing merchant warranty recognized in [*Caceci*]."[12]

The Court answered by saying Article 36-B "eclipses" the holding in *Caceci* and "effects a complete substitute for the common-law remedy."

The Court found that the Legislature had

"sought to fill the field comprehensively with a uniform directory framework that would provide predictability concerning these matters, as sorted out and agreed to among contracting parties themselves."

The Court of Appeals undoubtedly believed that its *Fumarelli* decision was definitive and would serve the interests of judicial economy and legal clarity. However, the Court failed to note the narrow statutory definition of the term "new home." *Fumarelli*, therefore, raises several issues.

Did the Court recognize the possible dichotomy that the "new home" definition might cause between new condominium/ cooperative structures of five stories or less and those of six stories or more? If so, did the Court hold that Article 36-B supplants the common law warranty only as to structures of five stories or less? If not, did the Court inadvertently restore the doctrine of caveat emptor to condominium/co-op sales in structures of six stories or more? Alternatively, did the Court hold sub silencio that the Legislature intended caveat emptor to apply to condominium/ cooperative buildings in excess of five stories?

Given the Court's repudiation of the caveat emptor doctrine in *Caceci*, it is reasonable to argue the Court did not intend its *Fumarelli* holding to strip common law protection from transactions to which Article 36-B does not expressly apply. As the Court itself noted, when Article 36-B was drafted, the Legislature was aware of the holding in *Caceci*. Therefore, the Legislature could be deemed to have intended to limit the circumstances in which the statute would supplant the common law.

In addition, since the *Fumarelli* condominium townhouse fitted the statutory definition of a "new home," the strict holding of the case is limited to the facts that were before the Court, and one can infer that the Court did not intend *Fumarelli* to apply to situations not covered by the statute.

Moreover, the legislative history supports the view that the common law would otherwise apply to situations not covered by Article 36-B. The legislative bill jacket contains a letter from the New York State Builders Association stating that a building that is not a "new home" as defined in the bill "is governed by common law warranty rules, if any."[13]

Alternatively, it is also possible to argue that the Court's language in *Fumarelli* is so sweeping that the Court completely eliminated all common law implied warranty protections from the housing field — whether or not it overlooked the "new home" definition contained in GBL § 777(5). Indeed, because *Fumarelli* involved a " new home" within the statutory definition, the Court could otherwise have easily limited its holding to the case before it.

Finally, it can be argued that the Court viewed the narrowly defined "new home" definition as a conscious decision of the Legislature to allow contracting parties to sort out and agree among themselves what, if any, warranties should apply in transactions involving buildings of six or more stories. In this regard, the Court's failure to address the full implication of its holding may have been influenced by the fact that the seller in *Fumarelli* had complied with the exclusion provisions of Article 36-B and that the buyer had agreed to the seller's terms.

Indeed, the Court noted that the framework of Article 36-B encouraged "sorting out" of the warranty protections even in transactions that fit the "new home" definition.[14] Accordingly, if the Legislature deemed a "s orting out" process beneficial in situations covered by the statute, it would not be unreasonable for a court to conclude that the Legislature also intended to encourage the "sorting out" process in transactions discretely left outside the statute's coverage.

[T]he attorney's role in negotiating the contract of sale may determine whether the buyer or seller has any remedy or liability with respect to material defects in a new home.

Nevertheless, such a result would be problematic for buyers of condominium or cooperative "new homes."

Only buyers who are able to bargain for meaningful express warranties will obtain the protections that most new homeowners expect from sellers of high-rise condominium/cooperative apartments. Moreover, unless seller-sponsors of such apartments voluntarily include express warranties in their purchase agreements, buyers will face the situation where builder-vendors may invariably be shielded from liability for inadequate work, except in cases where there have been gross violations of the applicable building codes.

Conclusion

Until judicial or legislative intervention codifies the rights and remedies of buyers and sellers in buildings higher than five stories, the attorney's role in negotiating the contract of sale may determine whether the buyer or seller has any remedy or liability with respect to material defects in a new home.

To protect a buyer in a newly constructed building of five or more stories, the contract of sale should preserve the common law housing merchant implied warranty as stated in *Caceci*. The contract of sale should also include additional specific warranties to be conveyed to buyers of units in such buildings.

Attorneys representing sellers of units in buildings higher than five stories should strive to negotiate contracts of sale that expressly require waiver of all common law warranties, including the housing merchant implied warranty. However, to avoid a possible finding of unconscionability until it is definitely determined that *Fumarelli* allows such waivers, it is advisable that sellers offer the limited warranties provided in Article 36-B.

This may persuade a court to decide that a buyer's remedies against the seller of a defective home are limited to those provided by the parties' agreement. While these recommendations should assist many clients, it is likely that, until the law is settled in this area, the party with the stronger negotiating position will prevail.

(1) GBL §§ 777, et seq.
(2) GBL § 777-a (1)
(3) GBL § 777(5) (emphasis added). Neither the statutory language nor the available legislative history offer any ready explanation for the Legislature's choosing to limit the housing merchant implied warranty to new condo/co-op structures of five stories or less. It appears that the dichotomy between five and six story condo/co-op buildings was a compromise between competing interests that facilitated passage of the final bill.
(4) GBL § 777-a (1)(a).
(5) GBL § 777-a (1)(b).
(6) GBL § 777-a (1)(c).
(7) GBL § 777-b (3).
(8) GBL § 777-b (3)(e)(i).
(9) GBL § 777-b (3)(e)(ii).
(10) 72 NY2d 52, 526 N.E.2d 266 (1988).
(11) 92 NY2d 298, 703 N.E. 251 (1998).
(12) 92 NY2d, at 300-301.
(13) New York State Builders Association, Inc., Letter to Governor's Counsel, Bill Jacket, L 1988, ch 709, at 26. See also *Watt v. Irish*, 184 Misc2d 413, 708 NYS2d 264 (Sup. Ct., Columbia Co., 2000), which held that plaintiffs' claim for breach of contract, resulting from the construction of their home in a negligent manner, survived summary judgment because the case was governed by the six-year Statute of Limitations provided by CPLR 213.
(14) See footnote 11, supra.

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