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Good Governance Practices for Family Foundations

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I. Introduction

When assisting an individual with the formation or the maintenance of a private foundation, it is the attorney's responsibility to advise the client about the ongoing management of the foundation. This is especially important if a donor client or his or her family members will have an active role in the governance and management of the foundation; particularly, if the donor and/or his or her family members will receive compensation from the foundation for their services.

This article summarizes the duties of loyalty, due care and obedience imposed upon the directors of private foundations organized as nonprofit corporations under Washington law, and provides a general overview of the private foundation rules set forth in the Internal Revenue Code of 1986, as amended (the "Code"). Although the tax-exempt status of a private foundation is a function of federal law, state law defines the fiduciary duties of the foundation's Board of Directors, and the proper management of a private foundation requires a keen understanding of both sets of overlapping duties. The foundation and/or its Board members may face adverse tax consequences for failing to adhere to federal law requirements and the Board members may possibly face civil liability for failing to adhere to state law requirements.

II. Washington State Law Fiduciary Duties

The Washington Nonprofit Corporation Act (RCW Chapter 24.03) contains specific provisions dealing with the duties of the Board of Directors. The Board of Directors is the body responsible for the governance of a private foundation organized as a nonprofit corporation, and the Board of Directors is ultimately responsible (and liable) for the affairs of the foundation.³ The foundation, its directors, its officers, and the state attorney general may enforce the duties of loyalty, due care and obedience

discussed below.⁴ The Board's failure to fulfill these duties may result in civil penalties under state law and could constitute grounds for the imposition of excise taxes or even the loss of a foundation's tax-exempt status under federal law.

In addition to state and federal law, the foundation's articles of incorporation, bylaws, policies and procedures, and resolutions of the Board of Directors further define the duties of a director. The articles of incorporation usually will grant broad authority to the Board of Directors; however, this authority is often narrowed or explained in greater detail in the bylaws. Larger foundations also may have written operating policies and procedures that cover topics such as personnel, financial management, compensation and expense reimbursement. When drafting organizational documents for a private foundation, whether at the formation stage or after the foundation has been in existence for some time, it is important that all of the foundation's documents address the directors' duties in a consistent manner.

A. General Duty to Manage Corporate Affairs

The most basic duty of the Board of Directors under Washington law is to manage the affairs of the foundation. RCW 24.03.095. This duty requires the Board of Directors to take responsibility for the following items (though the importance of each item will vary depending on the size of the particular foundation and scope of its activities):

- Determining the foundation's mission, purposes and goals;
- Hiring staff, such as a program or executive director, defining his or her duties, setting his or her compensation and bonuses, reviewing his or her performance on a regular basis, and terminating the executive director, if necessary;

continued on next page

TABLE OF CONTENTS

| | | | |
|--|---|--|----|
| Good Governance Practices for Family Foundations | 1 | Recent Developments: Probate and Trust | 15 |
| The Implied Warranty of Habitability in New Home Sales | 7 | Contact Us | 16 |

continued from previous page

Good Governance Practices for Family Foundations

- Adopting operational policies and procedures;
- Ensuring adequate financial and human resources;
- Approving budgets and establishing appropriate fiscal policies and financial controls;
- Ensuring compliance with federal, state and local laws; and
- Ensuring legal and ethical integrity and accountability.

The Board of Directors also is responsible for assessing its own performance and the performance of its individual members. The Board should recruit and train new Board members as well as provide ongoing educational activities for the Board.

If a private foundation is to have a limited life span, the term of the foundation's existence and the process for its liquidation and dissolution should be clearly spelled out in its governing documents. If the foundation is to exist in perpetuity or for more than one generation, it is critical for the Board to develop an appropriate succession plan. Authority can be passed down from one generation to the next by bringing on younger family members as "honorary" or "junior" Board members and then training them over time to assume responsibility as regular members of the Board. It is important to address these issues in the foundation's bylaws in order to keep the management of the foundation efficient, innovative and focused on its charitable purpose.

In certain circumstances, it may be appropriate for directors to delegate duties to committees, non-director officers, employees or agents, though such delegation will not relieve any director from his or her responsibilities. The articles of incorporation or bylaws may provide that the Board of Directors may designate and appoint committees to have and exercise the authority of the Board in the management of the affairs of the foundation (typically referred to as an "executive committee"). See RCW 24.03.115. However, at least two directors must serve on an executive committee and the delegation of authority to a committee will not relieve the Board of Directors, or any individual director, of any responsibility imposed upon the Board or the individual director by law. RCW 24.03.113 - .115.

Practice Tip: Generally, the larger a foundation is, the more committees the foundation will have. If the private foundation will have a large endowment, it may be prudent to establish at least a nomination committee (to seek out and nominate future board members), a grant-making committee (to identify potential grantees and help distribute the foundation's funds), and an investment committee (to oversee the investment of foundation assets).

B. Duty of Loyalty

A director must perform his or her duties, including his or her duties as a member of any Board committee, in good faith and in a manner that he or she believes to be in the best interests of the foundation. RCW 24.03.127. The fiduciary duty of loyalty generally has the following three components:

- Directors must avoid conflicts of interest;
- Directors must not to usurp corporate opportunities; and
- Directors must maintain the confidentiality of private corporate affairs. *Arneman v. Arneman*, 43 Wn.2d 787, 264 P.2d 256 (1954).

The duty to avoid conflicts of interest requires directors to always act for the benefit of the foundation and to avoid self-dealing activities (discussed in more detail, below). If a director or his or her family may benefit, directly or indirectly, financially or otherwise, from the director's position on the Board, a conflict of interest exists.

Consistent with Washington law and the best practices recommended by the IRS, prior to a Board's discussion or consideration of a matter in which a director has a conflict of interest, the affected director should fully disclose his or her interest and then remove himself or herself from considering or voting on the issue.⁵ Any disclosures should be made in writing and should be recorded in the minutes of the meeting. The conflicted director's abstention should also be recorded in the minutes. So long as the proposed transaction does not constitute an act of self-dealing, the Board of Directors may ultimately approve a transaction in which a director has an actual or potential conflict of interest, provided that the disinterested directors determine that the decision is in the best interests of the foundation. However, in the private foundation context, it will be rare if there is ever a transaction considered where there exists a conflict of interest but there is no self-dealing involved.

Practice Tip: Transactions in which directors have conflicts of interest are under intense scrutiny by the IRS and Congress. Therefore, it is recommended that every Board of Directors adopt a "conflict of interest" policy. A sample conflict-of-interest policy with language "approved" by the IRS can be found on pages 25 and 26 of the instructions for the Form 1023 Application for Tax-Exempt Status (<http://www.irs.gov/pub/irs-pdf/i1023.pdf>).

The duty of loyalty also prohibits directors from usurping the opportunities of the foundation. Accordingly, a director must disclose business opportunities he or she wishes to pursue if such opportunity is related to the foundation's business or purpose.

continued on next page

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Good Governance Practices for Family Foundations

Directors also are required to maintain the confidentiality of foundation affairs. Information exchanged and discussed at Board meetings is confidential and should not be discussed with outside parties.

C. Duties of Due Care and Obedience

A director must perform his or her duties, including his or her duties as a member of any Board committee on which he or she serves, with the care, including reasonable inquiry, of an ordinarily prudent person acting in a like position under similar circumstances. RCW 24.03.127. Directors also owe a duty of obedience to the foundation. This duty requires directors to act in a lawful manner and in accordance with the mission of the foundation as it is stated in the foundation's organizational documents.

The duty of due care is an active duty, and it relates to the level of competence expected of directors. Directors cannot avoid liability by claiming ignorance of corporate affairs. Therefore, the duty of due care requires that:

- Directors attend Board meetings regularly and read minutes of meetings and reports presented by officers, agents and employees;
- Directors exercise independent judgment when voting, ask questions, participate in discussions and decision-making, and remain informed about the foundation's affairs, programs and activities; and
- Directors require that financial reports and budgets be produced. They must review financial information and evaluate the appropriateness of expenditures, including salaries and other forms of compensation.

It is important to remember that no single director has the authority to act alone on behalf of a foundation. Under Washington law, the act of a majority of the directors present at a meeting at which a quorum is present constitutes an act of the Board of Directors, unless the bylaws of the foundation requires a greater vote. RCW 24.03.110. If neither the bylaws nor the articles of incorporation state the number of directors required for a quorum, then a majority of the directors of the organization constitutes a quorum. *Id.* A foundation's bylaws or articles of incorporation may set a lesser number of directors for a quorum, provided, however, that this number may not be less than one-third of the directors. *Id.*

A director who is present at a meeting of the Board of Directors will be presumed to have assented to any action taken at the meeting. RCW 24.03.113. If the director does not approve of the action, he or she must make certain that his or her dissent or abstention is noted in the minutes of the meeting. In the alternative, the director may file a written dissent or abstention with the secretary during the meeting or immediately afterwards.

Washington law does not permit directors to vote by proxy. *See* RCW 24.03.110 (providing that the "act of a majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors" unless the articles or incorporation, bylaws or a statute requires the consensus of a greater number of directors). A Board of Directors may take action without a meeting, provided, however, that the action must be taken in the form of a written consent executed by all of a foundation's directors. RCW 24.03.465.

Washington law does not allow directors to hold "e-mail meetings"; however, written consents may be obtained via e-mail. *See* RCW 24.03.465 and RCW 24.03.005(18). Before notice of meetings may be sent via e-mail, each director must consent, in writing, to the use of electronically transmitted messages. RCW 24.03.009(1)(b). Action taken through written consent, transmitted via e-mail is valid so long as the transmission may be retained,

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Good Governance Practices for Family Foundations

retrieved, and reviewed by the sender and the recipient and may be directly reproduced in a tangible medium by the sender and the recipient. See RCW 24.03.005(12).

Practice Tip: Include provisions in the foundation's bylaws permitting communication via e-mail. Remember to obtain from each Board member his or her written consent to the use of electronic communications and his or her preferred e-mail address for foundation business.

In fulfilling his or her duties, a director is permitted by law to rely on information, opinions, reports, or statements (including financial statements and other financial data) prepared and presented by (1) officers and employees of the foundation whom the director believes to be reliable and competent; (2) counsel, public accountants, or other persons as to matters which the director believes to be within such individuals' professional or expert competence; or (3) a committee of the Board, acting within its designated authority, which the director believes merits confidence. RCW 24.03.127. However, reliance on such information does not excuse the director from exercising reasonable inquiry and acting as a prudent person.

Practice Tip: If a director who is a professional offers an opinion in his or her professional capacity, he or she should be aware that he or she may be held to a higher duty of care. Therefore, it is recommended that if the opinion or advice of a professional is needed, it might be appropriate to acquire such opinions or advice from an independent third party. Directors are required to know when expertise is required and then obtain it.

III. Federal Law – Private Foundation Rules

In an attempt to curb perceived abuses in the operation of private foundations, Congress enacted a set of "private foundation rules" in 1969, which are found in Sections 4940 through 4948 of the Internal Revenue Code of 1986, as amended. The private-foundation rules generally impose excise taxes on foundations that engage in certain types of prohibited activities. Penalties may apply to Board members and officers that participate in or approve these transactions. The private-foundation rules cover five categories of activities:

- **Self-Dealing:** certain transactions between a foundation and "disqualified persons" (e.g., substantial contributors to the foundation).
- **Failure to Distribute Income:** the failure to distribute a foundation's "net investment income" (this is in addition to a requirement to distribute annually a 5percent minimum of a foundation's total assets).
- **Excess Business Holdings:** where the foundation holds

stock (or other ownership interests) in a business interest in which a contributor (or the contributor's family) owns a substantial interest (i.e., only a family's own closely held stock is transferred to a foundation).

- **Jeopardy Investments:** where assets of the foundation have been invested in any investment that jeopardizes the tax-exempt purpose of the foundation (i.e., trading on margin or trading futures).
- **Taxable Expenditures:** where an expenditure made by the foundation is inconsistent with the organization's tax-exempt purpose (i.e., donating money to a political campaign).

A full discussion of the private-foundation rules is beyond the scope of this article. However, the following provides an overview of the rules regarding self-dealing transactions. It is important to remember that a violation of these self-dealing rules may not only result in the imposition of excise taxes under the Code, but also may constitute a violation of the various duties imposed by state law on the director.

A. Self-Dealing Rules

A private foundation is prohibited from engaging in self-dealing with any disqualified person. IRC § 4941. A "disqualified person" is defined by federal law as any substantial contributor to the foundation. IRC § 507(d)(2)(A). A "substantial contributor" is any person who contributes or bequeaths, in the aggregate, an amount greater than two percent of the total contributions and bequests received by the foundation and \$5,000. Treas. Reg. § 1.507-6(c).

Practice Tip: A donor will become a substantial contributor to the private foundation on the first date on which the foundation has received, in the aggregate, an amount that is more than the two percent/\$5,000 threshold. In other words, a foundation must track all of a donor's contributions for purposes of the self-dealing rules as the donor may not initially be a substantial contributor but may become one over time.

Disqualified persons also include any individual in a position to exercise substantial influence over the affairs of the foundation. IRC § 4958(f)(1)(A). Directors and officers are presumed to be in a position to exercise substantial influence over the foundation's affairs and therefore, are considered to be disqualified persons. Treas. Reg. § 53.4958-3(c)(1). Family members of directors are also disqualified persons. IRC § 4946(a)(1)(D). A corporation or partnership also may be a disqualified person if a foundation director (or his or her family members) owns more than 35 percent of the total voting power of the corporation or more than

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Good Governance Practices for Family Foundations

35 percent of the profit interests in the partnership. IRC § 4946(a)(1)(E),(F).

Most financial transactions between a private foundation and a disqualified person constitute acts of impermissible self-dealing, regardless of whether the transaction results in a benefit or detriment to the foundation. The following six categories of transactions are self-dealing, *per se*, under IRC § 4941(d)(1):

- The sale, exchange or lease of property;
- The lending of money or other extension of credit;⁶
- The furnishing of goods, services or facilities;
- The payment of compensation (or payment or reimbursement of expenses);
- The transfer to, or use by or for the benefit of, a disqualified person, of any income or assets of the foundation; and
- An agreement to pay a government official.

There are certain statutory exceptions to the foregoing rules. See IRC § 4941(d)(2). Consistent with these exceptions, the following types of transactions are not considered to be self-dealing:

- A disqualified person may make interest-free loans to a private foundation if the loaned funds are used exclusively for the foundation's exempt purposes.
- A disqualified person may offer a rent-free lease to a private foundation and may provide furnishings and equipment to the foundation without charge so long as the facility, furnishings and equipment are used exclusively for the foundation's exempt purposes.
- A private foundation may pay a disqualified person reasonable compensation and may pay or reimburse the expenses of a disqualified person if the amounts are reasonable and necessary to carry out the foundation's exempt purposes and if the total compensation paid is not excessive. IRC 4941(d)(2)(E); Treas. Reg. § 53.4941(d)-3(c).

Practice Tip: Though there are recognized exceptions to the self-dealing rules, any transaction between a disqualified person and the foundation that fall within one of these exceptions should still be adopted by the Board by a formal resolution and only after consulting with legal counsel. The resolution also should be adopted in accordance with the conflict of interest policy (see discussion, above).

B. Compensation of Directors

One aspect of foundation governance that is currently under intense scrutiny by the IRS is the reasonable compensation of a

foundation's Board members. While the Treasury Regulations of the Code contain the clearest guidelines for appropriate compensation for foundation directors, it is important to also ensure that the any compensation paid also complies with duties imposed by Washington state law described herein.

Compensation may be paid to individuals performing services for the foundation. If a donor or the donor's family members performs services for the foundation, then payment of compensation to such persons involves careful consideration under the self-dealing rules.

The compensation paid should be "reasonable" in order to comply with the exception to the self-dealing rules. Compensation is "reasonable" if it is equal to "such amount as would ordinarily be paid for like services by like enterprises under like circumstances." Treas. Reg. § 1.162-7(b)(3). The Treasury Regulations provide a set of procedures for evaluating the reasonableness of compensation. Pursuant to Treas. Reg. § 53.4958-6, compensation will be presumed to be reasonable if:

- Compensation is approved by those members of the Board who do not have a conflict of interest (or, in the alternative, by a committee of the Board composed entirely of individuals who do not have a conflict of interest) without the participation of the disqualified person;
- Prior to making its determination, the Board obtains and relies upon appropriate comparability data; and
- The Board (or committee) adequately documents the basis for its determination and the date upon which the determination was made concurrently with making its determination.

In evaluating the reasonableness of compensation, a Board of Directors may rely on data such as (1) compensation levels paid by similarly situated foundations for comparable work; (2) the availability of similar services in the geographic area; (3) current compensation surveys compiled by independent firms; and (4) written offers from organizations competing for the disqualified person's services. See Treas. Reg. § 53.4958-6(c)(2)(i).

To protect its directors from financial harm resulting from a civil lawsuit, a foundation may elect to purchase directors' and officers' (D&O) liability insurance when contemplating reasonable compensation. In general, indemnification clauses and the provision of this type of insurance do not constitute impermissible acts of self-dealing. See Treas. Reg. § 53.4941(d)-2(f)(3)(i). Furthermore, these "fringe benefits" generally should not be included in the directors' or officers' gross income. See Treas. Reg. § 1.132-5(r)(3)(ii).

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continued from previous page

Good Governance Practices for Family Foundations

Practice Tip: It is important to ensure that appropriate compensation for each paid position within the foundation is determined using the context of the job description, the expertise and background of the individual performing the work and the time spent performing the work. If a disqualified person is to be paid for his or her personal services to the foundation, it is critical to keep the documentation described herein, which should be incorporated into the formal resolution adopting the foundation's compensation structure.

IV. Conclusion

Private foundations serve vital roles in our community. In consideration for lessening the burdens on government and satisfying community and societal needs, foundations are allowed certain privileges not afforded to for-profit companies. However, it is important to remember that these privileges are extended only so long as the foundation and its Board uphold their obligations under the "social contract" with the IRS and state government.

The Boards of private foundations today are expected to ensure legal and tax compliance, enhance transparency and accountability, and improve governance practices. In an environment of increased public scrutiny and regulation of charitable organizations, it is the responsibility of a Board of Directors to ensure that a foundation operates within the bounds of law and in furtherance of its charitable purpose, and it is the responsibility of the lawyers advising these individuals to offer their clients the education needed to fulfill their duties.

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- 2 Katie S. Groblewski is an associate with Landerholm, Memovich, Lansverk & Whitesides, P.S. in Vancouver. Katie practices in the areas of estate planning, trust and estate administration, taxation and tax-exempt organizations.
- 3 A private foundation may be structured as a corporation or a charitable trust. The management structure of a foundation organized as a charitable trust will not be discussed in this article; however, the duties and obligations of the Trustee(s) are not unlike those discussed herein.
- 4 These duties of loyalty, due care and obedience are not enforceable by outside third parties.
- 5 A director may not vote on a matter in which he or she has a conflict of interest. *Nord v. Eastside Association*, 34 Wn. App. 796 (1983).
- 6 Note that State law also prohibits a foundation from making loans to its officers or directors. RCW 24.03.140.

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The Implied Warranty of Habitability in New Home Sales (Part 2 of 2)¹

by Joseph McCarthy, Kantor Taylor McCarthy P.C., Seattle

IV. The Statutory Implied Warranties for Condominium Homes

A. The Statutory Warranties Include Habitability, Merchantability and Code Compliance

The Condominium Act imposes a number of implied warranties of quality in the sale of condominium homes. The implied warranties are set forth in Section 445 of the Condominium Act, which states, in relevant part:

- (2) A declarant and any dealer impliedly warrants that a unit and the common elements in the condominium are suitable for the ordinary uses of real estate of its type and that any improvements made or contracted for by such declarant or dealer will be:
 - (a) Free from defective materials;
 - (b) Constructed in accordance with sound engineering and construction standards;
 - (c) Constructed in a workmanlike manner; and
 - (d) Constructed in compliance with all laws then applicable to such improvements.
- (6) Any conveyance of a unit transfers to the purchaser all of the declarant's implied warranties of quality.

Sub-section 2 of Section 445 imposes three separate implied warranties: suitability, merchantability and code compliance.

According to the Official Comments to the Condominium Act, the warranty of suitability is similar to, but broader than, the common law warranty of habitability.² Substantively, this may have been truer in 1990, when the Condominium Act was adopted, than it is now with the trend towards expansion of the common law warranty of habitability. Note, however, that the warranty of suitability applies to the entire condominium, unlike the warranties of merchantability and code compliance which only apply to the improvements constructed by or for the declarant. Thus, the statutory warranty of suitability/habitability is discernibly broader than the common-law warranty in its scope.

B. The Implied Warranties Flow to All Purchasers of the Unit

Section 6 of the Condominium Act makes it clear that the implied warranties flow to subsequent purchasers of the unit. The builder's liability exposure only ceases with the statute of repose and statute of limitations. As noted, below, the Condominium Act has a four-year statute of limitations and clear rules for accrual of causes of action. This is very different from the common law warranty which only flows to the first purchaser and which is subject to a three-year statute of limitations and, arguably, the construction statute of repose.

C. The Implied Warranties Are Not Limited to Commercial Builders

One other difference between the statutory condominium warranties and the common-law warranty should be pointed out. While the common-law warranty applies only to commercial builders, the condominium warranties apply to the "declarant." The declarant is the person who creates the condominium. RCW 64.34.020(13). There is no requirement that the declarant be a builder. Thus, the declarant in a conversion of an existing building is subject to the implied warranties. Note, as well, that there is no requirement that a declarant be in the business of creating condominiums.

D. What Standards Apply to the Implied Warranties?

The warranties of workmanship and code compliance have been of special concern to condominium developers, because they are so much broader than the warranty of fitness. Developers need to bring predictability to their warranty exposure. Having a statutory warranty that is decided by a jury is hardly predictable. Thus, developers sought to bring predictability to their transactions.

In *Park Avenue Condominium Owners Association v. Buchan Development, L.L.C.*,³ the developer argued that the warranties of workmanship and code compliance (and compliance with sound engineering and construction practice) amounted to a warranty of perfection and should only apply to "material" defects. *Park Avenue Condominium Owners Association v. Buchan Development, L.L.C.*, 117 Wn. App. 369 (2003). The court rejected that argument, holding that any code violation violated the warranty:

The warranty as to quality of construction for improvements made or contracted for by the declarant ... is broader than the warranty of suitability. Particularly, it imposes liability for defects which may not be so serious as to render the condominium suitable for ordinary purposes of real estate of its type.

Id. at 380.

In response to this ruling, the legislature amended the Condominium Act by adding the following language to RCW 64.34.445:

- (7) In a judicial proceeding for breach of any of the obligations arising under this section, the plaintiff must show that the alleged breach has adversely affected or will adversely affect the performance of that portion of the unit or common elements alleged to be in breach. As used in this subsection, an "adverse effect" must be more than technical and must be significant to a reasonable person. To establish an adverse effect, the person alleg-

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continued from previous page

The Implied Warranty of Habitability in New Home Sales

ing the breach is not required to prove that the breach renders the unit or common element uninhabitable or unfit for its intended purpose.

Laws of 2004, Chap 201, § 5. This language does not affect the warranty of fitness since those defects by definition adversely affect the usefulness of the home. As to the warranties of workmanship and code compliance, it overturns *Park Avenue* and requires that the defect have an impact on the owner.

V. Damages Available for Breach of the Implied Warranties

It is not clear what damages are available for breach of the common-law warranty. In *Hoye v. Century Builders*, the court stated that the measure of damages was the difference in value of the house caused by the damages. *Hoye v. Century Builders*, 52 Wn.2d 830, 835 (1958). Later, in *Allen v. Anderson*, the Court of Appeals stated: "The correct measure of damages for breach of warranty is the cost of repair, not the difference in value before or after." *Allen v. Anderson*, 16 Wn. App. 446, 449 (1976). In the *Gay*, *Luxon*, and *Eagle Point Condominium* cases, the Court of Appeals awarded damages for the cost of repairs for breach of the warranty of habitability. *Gay v. Cornwall*, 6 Wn. App. 595 (1972); *Luxon v. Caviezel*, 42 Wn. App. 261 (1985); *Eagle Point Condominium Owners Assn. v. Coy*, 102 Wn. App. 697 (2000). In *Brickler*, the court affirmed a jury award for breach of the common law warranty consisting of cost of repairs, diminution in value and loss of use of the home. *Brickler v. Myers Construction, Inc.*, 92 Wn. App. 269 (1998).

The damages available under the Condominium Act, however, appear more limited. The Condominium Act states:

The remedies provided by this chapter shall be liberally administered to the end that the aggrieved party is put in as good a position as if the other party had fully performed. However, consequential, special, or punitive damages may not be awarded except as specifically provided in this chapter or by any other rule of law.

RCW 64.34.100. It would appear that diminution in value and loss of use damages, such as allowed in *Brickler*, are not available under the Condominium Act.

In *Park Avenue*, the court held that the *Eastlake Construction* rule (the cost of repair should not be awarded if the cost is clearly disproportionate to the loss in value caused by the defective condition) applied to breach of implied warranty claims under the Condominium Act. This rule normally applies to breach-of-contract claims. The court held it should apply to breach of implied warranty as well. *Park Avenue*, 117 Wn. App. at 386. It is unclear whether this applies to common-law claims, but the court did not distinguish between the two.

The Condominium Act was amended after the *Park Avenue* case to codify the *Eastlake Construction* rule. RCW 64.34.445 (8) states:

Proof of breach of any obligation arising under this section is not proof of damages. Damages awarded for a breach of an obligation arising under this section are the cost of repairs. However, if it is established that the cost of such repairs is clearly disproportionate to the loss in market value caused by the breach, then damages shall be limited to the loss in market value.

Finally, it is worth remembering that in 1969 the *House* court affirmed a judgment for rescission and damages based on the implied warranty. *House v. Thornton*, 76 Wn.2d 428, 431 (1969). It does not appear that any decisions have subsequently addressed the availability of rescission as a remedy for breach of the implied warranty.

VI. The Availability of Attorneys' Fees for Breach

Our courts have made it clear that the implied warranty is a tort concept that arises from the sale,³ not a contract term arising from the contract.⁴ Therefore, it would seem there would be no attorneys' fees in a tort case. In *Brickler*, however, Division II of the Court of Appeals held that, "for purposes of attorneys' fees," the implied warranty arose from the contract. *Brickler*, 92 Wn. App. at 273.

In *Burbo*, Division III followed suit, citing *Brickler*. The court awarded attorneys' fees to the homeowner, stating:

Attorney fees are awarded only pursuant to contract, statute, or a recognized ground of equity.... The warranty of habitability exists independently of any express terms of the contract for sale. It arises by implication from the sale transaction itself. But the implied warranty of habitability is an implied-in-law term of the contract for sale for the purposes of attorney fees. Here, the purchase and sale agreement provides for attorney fees to the prevailing party in any dispute arising from the sale, including an implied warranty claim.

Burbo v. Harley C. Douglass, Inc., 125 Wn. App. 684, 701-02 (2005).

Thus, the common-law implied warranty is a tort, but the courts will look at the contract to determine if attorneys' fees are available. Perhaps developer's counsel should refine their attorneys' fee provisions to exclude implied warranty claims. It is unclear how a court would impose attorneys' fees in these tort claims without a contractual basis for the award. The Condominium Act RCW 64.34.455 allows for an award of

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The Implied Warranty of Habitability in New Home Sales

attorneys' fees to a prevailing party for breach of the Act, including the statutory implied warranties. *See Eagle Point*, 102 Wn. App. at 716.

VII. What Is the Applicable Statute of Limitations?

Are claims for breach of the implied warranty of habitability governed by the six-year statute of limitations for breach of written contract? That statute applies to an "action upon a contract in writing, or *liability* express or *implied* arising out of a written agreement." RCW 4.16.040(1). In *Donovan v. Pruitt*, the court held that the six-year statute did not apply because the implied warranty is founded on a common law duty of strict liability to the first purchaser-occupant, not the contract. It stated:

Plaintiffs contend the 6-year statute, RCW 4.16.040(1) applies because this is an "action upon a contract in writing or *liability* express or *implied* arising out of a written agreement." We disagree. . . . The warranty did not arise out of any document evidencing the sale; rather, it came into existence by operation of law by virtue of a common law duty of strict liability that the builder-seller owed to the first purchaser-occupant.

Donovan v. Pruitt, 36 Wn. App. 324 (1983).

In *Bicknell v. Garrett*, the court declared that not every liability contractual in nature is governed by this six-year statute. *Bicknell v. Garrett*, 1 Wn.2d 564 (1939). The court explained that the statute applies to: "Liabilities which are either expressly stated in a written agreement or which follow by natural and reasonable implication from the promissory language of the agreement, as distinguished from liabilities created by fictional processes of the law or imported into the agreement from some external source. . . ." *Donovan*, 36 Wn. App. at 327-28. Thus, even though the cause of action sounds in contract, it does not arise from the contract.

The *Donovan* Court did not decide whether the two-year or three-year statute of limitations applied, because the plaintiff failed both tests. Two years later, in *Vigil*, the parties conceded at trial that the three-year statute applied to the plaintiff's implied warranty claim. *Vigil v. Spokane County*, 42 Wn. App. 796, 799 (1986). The court added in dicta, however, that the three-year statute would apply.

In *Stuart v. Coldwell Banker*, the court held that the three-year statute of limitations of RCW 4.16.080(2) applied to claims for breach of the implied warranty. *Stuart v. Coldwell Banker Commercial Group, Inc.*, 109 Wn.2d 406 (1987). In *Stuart*, the owners of condominium units sued the builder-vendor for breach of implied warranty of habitability due to defects in the design of decks and walkways that exposed them to rot. A number of unit owners experienced problems with the decks, and made claims to the condominium association within the first years after buying

their units. The board attempted to deflect the owners' claims, but then decided to sue on behalf of the owners. The board filed suit almost five years after the last unit was sold by Coldwell Banker and more than three years after it had consulted an attorney about the situation. *Id.* at 409-10. It is important to note, however, that *Stuart* involved a multi-phase condominium where decks failed at different times. The court remanded the case with instructions to determine which owners, if any, discovered the elements of their claim within three years of commencing the action.

The statute of limitations is longer for condominiums. For claims arising under the Condominium Act, the applicable statute of limitations is four years. RCW 64.34.452(1).

VIII. Does the Statute of Repose Apply to Implied Warranty Claims?

A. When does the cause of action accrue?

A cause of action for breach of contract typically accrues at the time of breach. *See, e.g., Taylor v. Puget Sound Power & Light Co.*, 64 Wn.2d 534, 537-38 (1964). A cause of action for a tort accrues at the time of injury unless the plaintiff was ignorant of the injury at the time of the injury. In that case, the cause of action accrues at the time the plaintiff knew or should have known the essential elements of the cause of action. *White v. Johns-Manville Corp.*, 103 Wn.2d 344, 348 (1985).

But if there is a gap between the injurious act and the plaintiff's knowledge of the injury, the discovery rule may apply, in which case the statute of limitations accrues at the time the homeowners actually knew or reasonably should have known of the defects that comprised the elements of their causes of action. *Will v. Frontier Contractors, Inc.*, 121 Wn. App. 119, 124-25 (2004) (citing *Stuart v. Coldwell Banker Commercial Group, Inc.*, 109 Wn.2d 406, 415 (1987)). In *Will*, the court dismissed a cause of action for the implied warranty for flooding, because the plaintiff waited over three years from the flooding. The cause of action accrues when the plaintiff discovers or should have discovered the elements of the cause of action, not when he realizes he has a right to sue.

Under the Condominium Act, a claim relating to a unit accrues, regardless of the purchaser's lack of knowledge, on the date the first purchaser enters into possession.⁵ In regard to a common element, it accrues on the latest of the date the first unit was conveyed to a bona fide purchaser, the date the common element was completed, or the date the common element was added to the condominium. RCW 64.34.452(2)(b). If, however, an implied warranty extends to future performance or duration of any improvement or component, the cause of action accrues upon discovery of breach or the end of the warranty period, whichever is earlier. RCW 64.34.452(3).

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The Implied Warranty of Habitability in New Home Sales

B. Does the Statute of Repose Apply?

A statute of repose limits when a cause of action can accrue. Washington has a statute of repose for claims relating to construction. The statute states:

All claims or causes of action as set forth in RCW 4.16.300 shall accrue, and the applicable statute of limitation shall begin to run only during the period within six years after substantial completion of construction, or during the period within six years after the termination of the services enumerated in RCW 4.16.300, whichever is later. The phrase "substantial completion of construction" shall mean the state of completion reached when an improvement upon real property may be used or occupied for its intended use. Any cause of action which has not accrued within six years after such substantial completion of construction, or within six years after such termination of services, whichever is later, shall be barred: PROVIDED, That this limitation shall not be asserted as a defense by any owner, tenant or other person in possession and control of the improvement at the time such cause of action accrues.

RCW 4.16.310. If a cause of action has not accrued within the time period of the statute, it is barred. If it has accrued by that time, the statute of limitations begins to run from the date of accrual.

In *Donovan*, the court held that the statute of repose applied to a breach-of-implied-warranty claim, stating:

Those statutes declare unequivocally that they "apply to all claims or causes of action of any kind ..." against a person who constructed "any improvement upon real property."

Donovan, 36 Wn. App. at 326.⁶ Six years after *Donovan*, the Supreme Court delivered an opinion in *Pfeifer v. City of Bellingham* that calls the validity of *Donovan's* holding into question.

In *Pfeifer*, a builder constructed and sold condominium units. *Pfeifer v. City of Bellingham*, 112 Wn.2d 562 (1989). Seven years later a fire broke out, and the plaintiff, who leased a unit, was injured when she jumped out of her window. The plaintiff sued for negligent concealment of defects.⁷ The issue before the court was whether the statute of repose barred her claims. The court noted that the statute only applied to claims "arising from" the person having engaged in construction. It held that the statute of repose did not apply because the cause of action arose from the sale, not from the construction. *Id.* at 568. The reasoning of this case could be applied to the implied warranty since the courts have indicated that the warranty arises from the sale of the house.

One other point bears mention. The last sentence of RCW 4.16.300 states:

This section is specifically intended to benefit persons having performed work for which the persons must be registered or licensed under RCW 18.08.310, 18.27.020, 18.43.040, 18.96.020, or 19.28.041, and shall not apply to claims or causes of action against persons not required to be so registered or licensed.

RCW 4.16.300. The last sentence of this section was added in 1986 to prevent product manufacturers from escaping product liability.⁸ This sentence suggests that the statute does not apply to developers who are not licensed as contractors.

IX. Strategies for Builders to Manage Implied Warranty Exposures

A. Disclaimer of the Implied Warranties

1. Disclaimers of Implied Warranties Are Allowed but Disfavored

Our courts have held in a number of cases that disclaimers of implied warranties are allowable, but are disfavored. The cases require that the disclaimers be negotiated or "bargained for," that they be conspicuous and that they be particular.

The concept of "bargained for" is not an easy concept to apply in situations where the seller requires the buyer to use the seller's form. It does not mean that the seller or the buyer must concede a negotiating point. Neither the Uniform Commercial Code⁹ nor the Condominium Act¹⁰ require that. Instead it means that the disclaimer will not be effective where neither party referred to it in the portion of the contract they reviewed, discussed or signed.

Although it dealt with the sale of a new car, the case of *Berg v. Stromme* is informative for its discussion of the public policies governing waiver of the implied warranties:

Such waiver, even though printed, should not be allowed to arise from the fine print to haunt the buyer of a new car unless he has agreed to be bound by it with the same degree of explicitness that he bound himself to the other vital conditions of the contract of purchase.

Berg v. Stromme, 79 Wn.2d 184, 193-94 (1971). Adequate disclosure creates an effective disclaimer.

The seller does not have to budge from its refusal to make an implied warranty, but it must make the disclaimer conspicuous, specific and meaningful to the buyer.

Parties to an agreement may make any contract that comports with general law, and if a seller positively and expressly refuses to give any warranty, and the contract is not induced

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The Implied Warranty of Habitability in New Home Sales

by fraud, no warranty of any kind can be implied by law. . . . But to come within these principles, the burden is upon the dealer to show with particularity just what the buyer is waiving, that is, which particular defects or conditions the purchaser of a brand new automobile waives. . . . Thus, in the sale of a brand new automobile, there does exist an implied warranty of fitness. . . . The parties may agree to do more or to do less, but unless there is proof of explicit departure from this norm, the presumption is that the dealer intended to deliver and the buyer intended to receive a reasonably safe, efficient and comfortable brand new car.

Id. at 194-95. (citations omitted)

The case of *Olmsted v. Mulder* involved the sale of a house. *Olmsted v. Mulder*, 72 Wn. App. 169 (1993). The pre-printed purchase agreement contained warranties that the septic system was in good working order and that the well provided an adequate supply of household water. The seller added an addendum that stated: "Buyers to accept property as is." *Id.* at 172-73.

The court noted that an "as is" clause negates implied or express warranties, operates as a disclaimer, and is not favored. Therefore, the courts have added two conditions for effectiveness: the waiver must be explicitly negotiated or bargained for, and it must set forth with particularity the qualities or characteristics being disclaimed. *Id.* at 176. The court stated:

There is not a wealth of authority on the "bargained for" requirement. Normally, this requirement is applied 'to avoid giving effect to a seller's disclaimer . . . where that disclaimer is in a contract prepared by the seller and contained in fine print or boilerplate. The seller has the burden of demonstrating that such a disclaimer was known to the buyer and bargained for before it will be consider valid and given effect.

Id. at 176-77 (citing *Lyall v. DeYoung*, 42 Wn. App. 252, 257 (1985)). The court held that since the Olmsteds knew of the clause, this element was satisfied.

The court reached a different result on the particularity of the disclaimer. The express warranties as to the well and septic system were left unmolested in the contract. The disclaimer was only six words long. The disclaimer did not refer to the express warranties. The purchaser thought the disclaimer applied to the house itself. On these facts, the court found the disclaimer failed to meet the particularity test because it was consistent with the express warranties. *Id.*

Although *Olmsted* dealt with express warranties, similar reasoning could be applied to implied warranties to prevent the unbargained for denial of the ordinary things that a buyer expects to receive in a new home.

This does not mean, however, that the words "as is" are always insufficient. In *Warner v. Design and Build Homes, Inc.*, the Warners sued the builder of their new home after discovering substantial water intrusion, rot and mold. *Warner v. Design and Build Homes, Inc.*, 128 Wn. App. 34 (2005). The purchase agreement, which was drafted by their real estate agent, included a provision that the purchasers had inspected the property and agreed to buy it "in its present 'as is' condition." The agreement also contained an inspection addendum. *Id.* at 36. The Warners had the house inspected, asked for certain repairs, and rejected the recommendation to further inspect the conditions that ultimately caused them damage. *Id.* at 37.

The buyers conceded the bargained-for element of an effective disclaimer was met because their agent drafted the clause and they knew about it. *Id.* They argued, however, that the clause was not particular enough to be enforceable. The court cited the UCC for the principle that "as is" and similar phrases that, in common understanding, call the buyer's attention to the exclusion of warranties operate to exclude all implied warranties. It then held the "as is" clause to be unambiguous because a reasonable person would understand it to waive all implied warranties, including the implied warranty of habitability. "It is thus unnecessary to list warranties, none of which are being made." *Id.* at 41.

In contrast to the foregoing cases stands *Burbo*. The portion of the *Burbo* opinion dealing with disclaimer is extremely troubling to any developer, any developer's attorney, or any rational person. The purchase agreement contained a one-year limited warranty and a disclaimer of any implied warranties, including the warranty of habitability. *Burbo*, 125 Wn. App. at 693. Mr. Burbo signed the limited warranty agreement and knew that the limited warranty disclaimed implied warranties. *Id.* at 689. The disclaimer stated: "All warranties not provided for herein, including the implied warranties of habitability, merchantability and fitness for a particular purpose are hereby disclaimed."¹¹ The *Burbo* court held this disclaimer ineffective. It stated:

A seller's disclaimer of the implied warranty must be (1) conspicuous, (2) known to the buyer, and (3) specifically bargained for. [citing *Olmsted*]. In an action on the implied warranty, the seller must prove these elements [citing *Lyall v. DeYoung*, supra]. The disclaimer language here is not conspicuous. It is in the same small print as the rest of the agreement. And the disclaimer was not negotiated. It was a take-it-or-leave-it "deal breaker." Mr. Burbo said he saw the disclaimer. But it is, at least, debatable on this record whether he understood its implications.

Id. at 693.

It should be noted that *Olmsted* requires two criteria for effectiveness, not three. *Olmsted* does not contain the

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The Implied Warranty of Habitability in New Home Sales

“conspicuous” requirement. Moreover, *Burbo*’s holding that the disclaimer was not bargained for is directly contrary to the jurisprudence on this issue. The holding is extremely troubling because the court has misunderstood the “bargained for” requirement to be a requirement of point-by-point negotiation and give-and-take.¹² Under the *Burbo* holding no developer or seller can ever disclaim an implied warranty unless he has actually engaged in concessions and demands over the warranty. Disclaimer is not available to a developer who really wants it. It is only available to a developer willing to do without it. It contradicts the established law of implied warranties in this state.

2. Disclaimer in Regard to Condominiums Is Subject to Special Rules

The Condominium Act limits a declarant’s ability to disclaim the implied warranties in regard to home sales. The Condominium Act states:

- (2) For units intended for residential use, no disclaimer of implied warranties of quality is effective, except that a declarant or dealer may disclaim liability in writing, in type that is bold faced, capitalized, underlined, or otherwise set out from surrounding material so as to be conspicuous, and separately signed by the purchaser, for a specified defect or specified failure to comply with applicable law, if: (a) The declarant or dealer knows or has reason to know that the specific defect or failure exists at the time of disclosure; (b) the disclaimer specifically describes the defect or failure; and (c) the disclaimer includes a statement as to the effect of the defect or failure.
- (3) A declarant or dealer may offer an express written warranty of quality only if the express written warranty does not reduce protections provided to the purchaser by the implied warranty set forth in RCW 64.34.445.

RCW 64.34.450. This provision was enacted in its present form by Laws 2004, ch. 201, § 5, also known as “Senate Bill 5536.”

Prior to Senate Bill 5536, the statute was less clear. In *Marina Cove Condominium Owners Association v. Isabella Estates*, the developer had provided a warranty that contained “performance standards” for an extremely long list of potential defects. *Marina Cove Condominium Owners Association v. Isabella Estates*, 109 Wn. App. 230 (2001). The performance standards stated whether a potential defect would be warranted or not by the developer. At the time, Section 450 stated:

no general disclaimer of implied warranties of quality is effective but a declarant ... may disclaim liability ... for a specified defect ... if the defect ... entered into and became part of the basis of the bargain.

The trial court held that the list was so long it amounted to a general disclaimer of the entire implied warranty. On appeal by the developer, the owners also argued that the requirement that a defect be part of the bargain meant that a defect could only be disclaimed if it was known at the time.

The appellate court ruled that a laundry list did not amount to a general disclaimer even if the defects were not yet known, but that the portions of the document that purported to waive other express or implied warranties were unenforceable. *Id.* at 240. In *Park Avenue*, the court also invalidated the developer’s warranty. *Park Avenue*, 117 Wn. App. at 369.

In response to these cases, the legislature amended Section 450, as set forth above. The Condominium Act now prohibits disclaimers of the implied warranties unless the disclaimer is conspicuous, is signed by the purchaser, relates to a known defect, describes the defect and describes the effect of the defect.

B. Drafting Techniques for Disclaimers

For the attorney drafting home-sale documents, the guidance is clear: make it conspicuous, known, and bargained for. Some developers are afraid that conspicuous warranties will harm their ability to sell homes. Experience has shown this fear to be unfounded. Some very successful California homebuilder clients make buyers sign separate disclaimers on separate pages for every single defect they can think of. That standard of care is not common here. Yet, in the meantime, here are some suggestions for drafting disclaimers.

1. Be Conspicuous

The disclaimer must be made conspicuous. This can be accomplished with font type or size, underlining, bold face, or graphic devices. Consider using separate documents for the disclaimers. The point is to make sure the buyer is aware of the disclaimer.

2. Must Be Known to Buyer

The buyer must sign the disclaimer. Signatures are required for condominiums, and people still buy condominiums every day. There is no reason to avoid signatures on the disclaimers for subdivision homes. The buyer should sign a warranty addendum, the disclaimer paragraphs, and an acknowledgement of the disclaimers. Consider cross-referencing to the disclaimers in your standard or builders addendum, in your public offering statement, and your homeowners’ and association manuals. The cross references should tell the buyer that the warranty is part of the contract and should tell them that when they buy the home they will be waiving their rights to make claims for the implied warranties.

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The Implied Warranty of Habitability in New Home Sales

3. Must be Bargained For

Some homebuilders like to use HBW, 2-10 or other warranty programs due to their popularity with consumers. Those programs tend to work out as text book examples of how not to proceed. Typically, the disclaimers are placed in the midst of a long booklet and are extensive but uninformative. Also, it is typical for the builder to not deliver the warranty booklet until closing (or worse, at move-in), which is long after the bargain was struck and the contract signed. The delivery of the warranty booklet is often overlooked. The builder frequently forgets to have the buyer sign at closing or move-in. The sole purpose of the implied warranty is to protect buyers from defects they might not expect. The sole purpose of the law on disclaimers is to make sure that the buyers are fairly apprised of the waiver of their rights and the acceptance of risks about the house.

Make sure the warranty addendum/booklet is delivered when the contract is signed. It cannot be part of the bargain if it is before the buyer when they execute. If using a program warranty, make sure your sales contract refers to and incorporates the booklet.

Include in the sales documents an explanation of why the disclaimer is required. Include a statement of what the disclaimer means. Explain that they are waiving legal rights to sue you for damages if the house is not a good house. Give examples of what might go wrong, such as foundation problems or code violations. Explain the consequences of the potential defects.

Give the buyer an opportunity to review and rescind. With condominiums, buyers have a seven-day period after signing the contract to review the Public Offering Statement and rescind the contract. Hardly any buyers walk away at the end of that period. Most homebuilders do not offer a similar opportunity, but the downside of doing so is small once a person has decided to buy at your project. If you have a rescission period, include an express provision in the sales contract giving the buyer the right to rescind if the warranty or disclaimer is unsatisfactory. Explain the right to them and have them sign the provision.

It is impossible to disclaim known defects in a condominium when the building doesn't exist. For pre-sales of condominiums, include a provision that explains to the buyer that plans change and defects occur. Give the builder the right to disclaim future defects that become known. Give the buyer the right to rescind if the defect is unacceptable. This hasn't been tested by the courts yet.

C. The Use of Contractual Time Limits for Claims

In *Southcenter View*, the unit purchasers brought implied warranty claims three years after buying the units. *Southcenter View Condominium Owners Assn. v. Condominium Builders, Inc.*, 47 Wn. App. 767 (1986). The court dismissed the warranty claims against the builder/seller because they were brought after

the expiration of a one-year contractual warranty period. The purchase and sale agreement contained a paragraph providing a one-year warranty against defects and further barring any warranty claims after one year. The agreement stated, in relevant part:

Purchaser acknowledges that no action may be commenced or maintained by Purchaser as to any claim, known or unknown, based upon negligence or warranty, express or implied, against Seller more than one year after ...[closing].

Id. at 769. Similar provisions were included in a separate warranty document and in the condominium declaration. *Id.* at 769-70. The seller also required the buyers to initial every page of the purchase and sale agreement, and to acknowledge receipt of the warranty and condominium documents. *Id.*

The court characterized the case as involving a time limit on suits and distinguished the case from others involving a waiver or exclusion of warranties. *Id.* at 771. The court did not provide any explanation of why such cases should be treated differently. But it did recognize that a time limitation could be invalidated if unconscionable under the UCC. It did not provide clear guidance on how those factors would apply to this contract, but it did show that it was not concerned about the buyer's opportunity to understand the clause or its ability to know about the clause.

In *Griffith v. Centex Real Estate Corporation*, the court reached a similar result. In that case it dismissed a class action by home purchasers alleging breach of express warranty concerning the quality of exterior paint. *Griffith v. Centex Real Estate Corporation*, 93 Wn. App. 202 (1998). The developer had included a one-year limited warranty and a waiver of all claims except as covered in the limited warranty. *Id.* at 206-07.

Prior to the enactment of Senate Bill 5536 in 2004, it had been common practice for condominium developers to limit exposure to Condominium Act implied warranties by imposing a contractual limit on the time for bringing a claim. The Condominium Act now states:

A judicial proceeding for breach of any obligations arising under RCW 64.34.443, 64.34.445 and 64.34.452 must be commenced within four years after the cause of action accrues Such periods may not be reduced by either oral or written agreement, or through the use of contractual claims or notice procedures that require the filing or service of any claim or notice prior to the expiration of the period specified in this section.

RCW 64.34.452(1). In regard to a condominium sale, a developer may not contractually shorten the time for bringing an implied warranty claim.

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The Implied Warranty of Habitability in New Home Sales

D. The Use of Arbitration Clauses

1. Developers May Require Arbitration of Implied Warranty Claims

Nothing in the common law prohibits a subdivision builder from requiring an owner to arbitrate claims, including implied warranty claims. Developers of condominium homes may only require arbitration of implied (and express) warranty claims if they comply with the requirements of House Bill 1848, which was enacted in 2005. Prior to HB 1848, developers of condominiums could not require arbitration of warranty disputes. *Marina Cove*, 109 Wn. App. at 234-36. The arbitration provisions have been codified in 64 RCW Chapter 55.

2. Unconscionability Issues

The courts will not enforce arbitration clauses if the effect of enforcement would be unconscionable. In *Palm Harbor*, the purchaser, Mr. Mendez, bought a \$12,000 mobile home on a sales contract. *Mendez v. Palm Harbor Homes, Inc.*, 111 Wn. App. 446 (2002). The contract contained a waiver of jury trial and a clause subjecting all disputes to binding and final arbitration before a panel of three arbitrators. He also signed a separate agreement requiring arbitration before a three-judge AAA panel. *Id.* at 451.

Mr. Mendez sued for defects in the home. Palm Harbor sought to compel arbitration. The Court of Appeals refused to enforce the arbitration clause on grounds it was unconscionable because it was prohibitively expensive. The superior court filing fee was \$115. The AAA filing fee was \$2,000. His primary claim was for \$1,500. Mr. Mendez did not finish high school, made less than \$20,000 per year, and supported a family of five. In light of the facts, the court refused to enforce the agreement.

Attorneys drafting arbitration provisions should consider provisions to guard against such results, such as minimum arbitration amounts or mandatory venue of certain claims in small claims court.

X. Conclusion

The implied warranties for subdivision homes and condominiums arise from the same body of common law. The statutory condominium warranties offer greater protections to home buyers than the common law warranties offer to subdivision home buyers. The cases interpreting both sets of warranties contain broad statements. They lack clear and precise definitions of terms. As more law is developed in both areas, the opportunities for crossover will grow. Lawyers and legislators will ask why the type of home purchased should affect the nature of the warranty. Indeed, condominium developers already ask that question. The political battles over Senate Bill 5536 and House Bill 1848 were intense. There are likely to be further attempts to modify the implied warranties by owners and developers.

In an attempt to move the debate away from the implied warranties of quality, Senate Bill 5536 created 64 RCW Chapter 35, "Qualified Warranties" in the hope that the insurance market would create defect insurance policies for condominium owners. If a declarant provides a qualified warranty under the act, the implied warranties of the Condominium Act do not apply. If the program works, it might offer a model for subdivision homes as well.

- 1 Part 1 of this two-part article covered the common law implied warranty of habitability for subdivision homes. Part 2 covers statutory and implied warranties for condominium homes, issues regarding enforcement and damages, and strategies for managing warranty liability.
- 2 The official comments were prepared by the Condominium Statutory Revision Task Force, the committee of specialists and interested parties that originally drafted the statute, but are not a part of the statute itself.
- 3 See e.g., *Donovan v. Pruitt*, 36 Wn. App. 324 (1983).
- 4 Thus, as noted above, privity is not required and, as noted below, the three-year statute of limitations applies.
- 5 If a non-possessory interest is conveyed, the claim accrues on delivery of the instrument of conveyance. RCW 64.34.452(2)(a).
- 6 RCW 4.16.300 states, in relevant part:
RCW 4.16.300 through 4.16.320 shall apply to all claims or causes of action of any kind against any person, arising from such person having constructed, altered or repaired any improvement upon real property, or having performed or furnished any design, planning, surveying, architectural or construction or engineering services, or supervision or observation of construction, or administration of construction contracts for any construction, alteration or repair of any improvement upon real property.
- 7 "A vendor of land who conceals or fails to disclose to his vendee any condition ... which involves unreasonable risk to persons on the land, is subject to liability to the vendee and others upon the land with the consent of the vendee... for physical harm caused by the condition after the vendee has taken possession if" Restatement (Second) of Torts, § 353 (1965).
- 8 Laws of 1986, Ch. 305, § 703.
- 9 See RCW 62A.2-316(3)(a) (stating that all implied warranties are excluded by terms like "as is" and makes plain there is no implied warranty).
- 10 RCW 64.34.450 allows disclaimer of implied warranties in nonresidential settings with words like "as is" and allows disclaimer of specific defects if conspicuous, separately signed, and if particular about the defects and their impact.
- 11 *Burbo v. Harley C. Douglass, Inc.*, Div. 3, No. 22720-1-III, Brief of Respondent, p. 12.
- 12 *Burbo's* counsel argued to the court that the disclaimer could not be "bargained for" since the seller would not sell without the disclaimer. *Burbo v. Harley C. Douglass, Inc.*, Div. 3, No. 22720-1-III, Brief of Appellant, p. 32.

Article Ideas?

Please contact Ryan Rein if you are interested in writing an article for the newsletter or if you have ideas for article topics. Ryan's phone number is 206-389-1610 and his email is rrein@riddellwilliams.com.

Recent Developments

Probate and Trust

by Brinette C. Bobb – Perkins Coie LLP

***Estate of Bowers v. Museum of Flight,* 132 Wn. App. 334 (2006)**

Summary:

Although RCW 11.20.070 retains the common-law presumption that a lost or destroyed will is revoked, such presumption may be rebutted through the doctrine of dependent relative revocation. Under the doctrine of dependent relative revocation, the presumption that a lost will is revoked is rebutted where the evidence shows that the testator did not intend to die intestate and that the revocation of the lost will was conditioned on the validity of a similar will that the testator never executed.

Facts:

The decedent executed a 1991 Will in which she left a valuable airplane and airplane memorabilia collection to the Museum of Flight and left the remainder of her estate in trust to her daughter. In 2004 the decedent became aware that her daughter had taken various items from her safety deposit box, including the decedent's original 1991 Will. The decedent retained an attorney to revoke the general power of attorney she had given her daughter and to obtain an order directing that her daughter return the items she had taken. At that same time, the decedent asked her attorney to prepare a new will (the "2004 Will"), and the attorney did so. Although the decedent wanted to eliminate the trust for her daughter in her new 2004 Will, leaving the remainder of her estate to her cousins and bequeathing only \$500 to her daughter, she did not want to change the bequest to the Museum of Flight. The decedent died before she was able to execute the 2004 Will, and upon the decedent's death, the 1991 Will could not be located.

The daughter filed a petition requesting that the court appoint a personal representative of the decedent's estate. The petition stated that, although the daughter knew the decedent executed a valid last will, no will belonging to the decedent had been found. A couple of months later, the Museum of Flight filed a petition requesting the court admit a copy of the 1991 Will to probate as provided in the probate statute and under the lost or destroyed will statute, RCW 11.20.070. The superior court held that the 1991 Will was a "lost or destroyed Will and was lost or destroyed under circumstances not amounting to a revocation," and granted the Museum's petition to admit a copy of the 1991 Will to probate. The decedent's daughter appealed the order admitting the 1991 Will to probate.

Discussion:

The dispute in this case is whether the Museum met the requirements of RCW 11.20.070(1). RCW 11.20.070(1) provides that "[i]f a will has been lost or destroyed *under circumstances such that the loss or destruction does not have the effect of revoking the will*, the court may take proof of the execution and validity of the will and establish it, notice to all persons interested having been first given. The proof must be reduced to writing and signed by any witnesses who have testified as to the execution and validity, and must be filed with the clerk of the court." The burden of proof for admitting a lost will under RCW 11.20.070 is "clear, cogent, and convincing evidence."

The court agreed with the daughter-appellant in holding that RCW 11.20.070 retains the common-law presumption that a lost or destroyed will is revoked, and the statute, therefore, requires the proponent of a lost or destroyed will to prove it was not revoked. The Museum, however, argued that the doctrine of dependent relative revocation supports the decision to admit the 1991 Will to probate under RCW 11.20.070(1) because clear, cogent, and convincing evidence supports the conclusion that the decedent did not intend to revoke the 1991 Will and die intestate. For the doctrine of dependent relative revocation to apply, a party must show an "immediate intent to make a new testamentary disposition and [a] conditional [revocation] of the original will." Under the doctrine of dependent relative revocation, the courts presume that the testator would have preferred the revoked will over "the intestacy brought about by the unforeseen thwarting of the attempted later alternative disposition, and there can be no real intent to revoke when the act of destruction or cancellation is induced and motivated by a mental misconception of the effect of the act on account of ignorance, or mistake, or some other error."

Here, the court concluded that there was clearly supported evidence that (1) the decedent did not state that she intended to destroy her 1991 Will, (2) the decedent's attempted change to her 1991 Will did not include a change of the specific bequest to the Museum, and (3) the decedent never intended nor wanted her daughter to receive the airplane and airplane memorabilia collections. The court held that such evidence is "clear, cogent and convincing evidence establishing that the decedent did not intend to die intestate and that her intent to revoke the 1991 Will was conditioned on the validity of the 2004 Will." Thus, the court affirmed the order admitting the lost 1991 Will to probate under RCW 11.20.070.

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