
# A Board of Directors' Guide to Resolving Common Element Construction Defects in a Michigan Condominium

BY KEVIN M. HIRZEL, ESQ.

Michigan condominium associations are responsible for the maintenance and repair of the general common elements. While many condominium associations budget for repairs and maintenance of the common elements over an extended period of time, most associations are unprepared to address common element construction defects caused by a developer's inadequate design, use of defective or substandard materials, insufficient site testing or inferior workmanship. The failure of a board of directors to appropriately investigate and respond to construction defects immediately after the transition control date can be financially devastating to a condominium association.

During the initial construction of a condominium, a developer is primarily concerned with building and selling units as quickly as possible in order to maximize its profits. Often times a developer will take shortcuts with the construction in order to save time or money, which often results in construction defects. In addition, due to the recent economic downturn, many developers have further problems with tighter budgets, less liquidity, reduced access to commercial markets, reduced workforces, and related problems that also may impact the quality of the construction work. This article addresses the appropriate steps a post-transition control board of directors should take with respect to discovering and resolving construction defects attributable to the developer and construction defects caused by contractors in older condominium associations.

## What is a construction defect and how is it discovered?

A common element construction defect is defined as a deficiency in the 1) design 2) materials and/or 3) workmanship in the common elements of a condominium. The defect typically poses a safety hazard, shortens the life expectancy of the common element and/or makes the common element partially or fully unusable. Construction defects, whether due to a deficiency in design, materials or labor, are classified as either patent defects or latent defects.

A *patent defect* is readily apparent and discoverable based upon a reasonable inspection of the common elements. Examples of patent defects include visible holes in a building, missing gutters or downspouts, missing handrails or missing chimney caps. Patent defects are typically discovered by board members, co-owners or property managers through a casual observation of the common elements.

In contrast, a *latent defect* is concealed and not readily observable. Latent defects will only appear after the passage of time and they are not something that would typically be discovered during the initial municipal inspection. Examples of common latent defects are as follows: 1) Collapsing retaining walls resulting from improper installation; 2) Cracking in the foundation or drywall caused by concealed foundation issues; 3) Electrical wiring that is not properly installed within common element walls; 4) Flooding caused

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by improper installation of the underground storm water drainage system; 5) Heaving or cracking of concrete porches, driveways or sidewalks due to poor drainage; 6) Leaks, mold and other water issues caused by improperly installed roofing, siding, flashing and/or windows; 7) Noise related to insufficient insulation and poor sound protection; 8) Pipe bursts that result from a failure to insulate common element pipes; 9) Premature road failure resulting from failing to test and/or account for soil conditions, improper use of base course materials or drainage issues and 10) Missing or improperly installed trusses, which compromise the structural integrity of the roofing and/or building. Given that latent defects are not discovered by a casual observer, a latent defect is typically only discovered after major problems occur or the condominium association commissions a detailed inspection of the common elements by a licensed engineer or other professional construction expert.

### What is a reserve study and does my condominium need it?

A properly run condominium association will commission a reserve study immediately after the developer turns over control of the association to the co-owners. A reserve study is a budget planning tool that focuses on the current status of the condominium association's reserve funds for anticipated major common element expenditures in the future. While a reserve study can take multiple forms and vary in detail, the board of directors should hire a professional engineer to thoroughly inspect the common elements. After the inspection is performed, the engineer will prepare a report that identifies any defects that were discovered, the cause of the defect, a proposed fix and an estimated cost to repair. Additionally, for any common elements that are not defective, the reserve study will also identify the proposed life expectancy of the major common elements and the proposed costs of future repair and/or replacement. This information is invaluable to the preparation of the association's budgets and long term stability. A condominium association should have a reserve study performed every three to five years to ensure that major problems do not arise. In addition, given that the common elements will eventually need to be repaired and/or replaced, frequent reserve studies also ensure that the association's contractors have not caused construction defects.

### Who is liable for common element defects in a new condominium project?

In Michigan, responsibility for construction defects in a new condominium is attributable to the developer(s), the contractor(s) hired by the developer(s) and/or the association's board of directors. Before holding a developer responsible for construction defects, a condominium association must identify the identity of the "developer" which often proves a difficult task. The Michigan Condominium Act defines a developer of a condominium as "a person engaged in the business engaged in the business of developing a condominium as provided in this act." MCL 559.106(2). While real estate brokers and residential builders, in certain circumstances, are excluded from the definition of a "developer" under the Michigan Condominium Act, it is clear that the definition of a developer is extremely broad

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and may often encompass more than one person and/or corporate entity. Accordingly, while the master deed, bylaws, disclosure statement and purchase agreement likely identify a single "developer", it is important to look beyond these documents to determine the identify of every person or corporate entity that could fit within the definition of a "developer" under MCL 559.106(2). Accordingly, any person or corporate entity that participated in the construction, design, financing, marketing and/or planning the condominium could arguably be defined as a "developer".

Additionally, the identity of a "developer" is further clouded by the fact that the entity identified as the "developer" in the master deed, bylaws and/or disclosure statement is often a shell company. Sophisticated developers will often advertise under a trade name and establish separate corporate entities for each condominium project in an attempt to avoid liability. After the sales are completed, the proceeds of the sales are then transferred to a different entity, leaving an unfunded, 'out-of-business' entity as the "developer". As such, in many cases, theories of joint venture, partnership or piercing the corporate veil are used to establish liability against several entities that may constitute the "developer."

There are various theories of liability that can be utilized to establish liability against a developer after the "developer" is identified. Michigan law imposes a duty on a developer to construct the common elements in a good and workmanlike manner. Moreover, a developer impliedly warrants that the common elements of the condominium are habitable, i.e. that they can be used for their intended purpose, in addition to any express warranties that are provided. Accordingly, theories of breach of contract, breach of covenant, breach of warranty and/or negligence can be utilized to hold a developer responsible for construction defects. Additionally, developers often make representations regarding the quality and fitness in the disclosure statement required by MCL 559.184a, the master deed, bylaws or other sales materials. Accordingly, various fraud based claims may be available to an association, including but not limited to fraud, innocent misrepresentation, negligent misrepresentation, silent fraud or a violation of the Michigan Consumer Protection Act. In certain circumstances, an association may also be able to recover attorney's fees for establishing a violation of the Michigan Consumer Protection Act and/or a violation of the condominium association's governing documents. Finally, liability for construction defects can be established based on a theory of breach of fiduciary duty if the developer and/or its agents served on the association's board of directors and failed to take action to correct construction defects.

While a developer of a condominium is responsible for construction defects caused by its agents, it may be appropriate to attempt to hold the architect, civil engineer, contractors or suppliers responsible for construction defects. Given that an agent of the developer does not have a direct contract with the condominium association, the association would need to establish that it was a third-party beneficiary of the contract between the developer and its agent to confer liability under a breach of contract theory. Alternatively, if the association is able to establish that the developer's agent owed a duty to the association, separate from any contractual duty, it may be possible to establish a negligence claim as well.

Finally, the board of directors of a condominium association often fails to realize that they may have personal liability for failing to investigate and/or remedy construction defects. MCL 450.2541 requires that each director act "in good faith and with the degree of diligence, care, and skill that an ordinarily prudent person would exercise under similar circumstances in a like position." MCL 450.2541 specifically requires that directors discharge their duties by acting in good faith when they rely upon the advice of their attorney and other professionals. Accordingly, directors that 'stick their heads in the sand' when faced with construction defects may be liable for failing to take appropriate action against the developer and/or its agents to remedy the same.

## Who is liable for defects resulting from repair and replacement of the common elements?

Seasoned community associations have construction defect issues that arise from projects to repair and replace the common elements after they have outlived their useful life. With respect to projects for repair and replacement of the common elements, the condominium association, through the board of directors, typically enters into a written contract with the contractor that will perform the repair or replacement. Accordingly, the above described theories of breach of contract, breach of covenant and breach of warranty could be utilized to hold a contractor responsible for construction defects. In order to establish a negligence claim against a contractor, however, the association would need to establish a duty that is owed to the association that is separate and distinct from the contractor's contractual obligations. Typically, fraud-based theories of liability are not available in a direct claim against a contractor. Unlike a developer who provides a disclosure statement and sales materials, a contractor does not usually provide anything other than a written contract and warranty. Therefore, fraud claims are less prevalent against contractors.

In the event that a contractor utilizes a subcontract to complete a repair or replacement, the condominium association may also have a claim against the subcontractor. Similar to the situation with a developer, a breach of contract claim based upon a third party ben-

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eficiary theory would need to be established. Alternatively, if the condominium association is able to establish that the subcontractor owed a duty to the association, which was separate and distinct from a contractual obligation, it may be possible to establish a negligence claim against a subcontractor.

Finally, the board of directors of a condominium association has a fiduciary obligation to investigate and resolve construction defects caused by a contractor who inadequately repaired or replaced common elements. Prior to commencing a major construction project, it is crucial that the condominium association has its attorney review the contract for two primary reasons. First, the association's attorney should safeguard the association from most common problems which may arise. Second, having an attorney involved also protects the directors from individual liability pursuant to MCL 450.2541 which authorizes directors to rely upon the opinion of counsel in discharging their fiduciary duties. As such, directors entering into major contracts without the advice of counsel and/or that fail to hold contractors responsible for construction defects may have exposure to liability.

### How should the board of directors resolve common element construction defects?

1. **Inspect the Common Elements.** The board of directors and/or the property manager should perform regular visual inspections of the common elements. Additionally, the board of directors should ensure that a reserve study is performed immediately after the developer turns over control to the co-owners and that a reserve study is performed every three to five years thereafter.
2. **Consult with an Attorney.** After the board of directors becomes aware of a potential construction defect, the board should immediately consult with an attorney to determine the potential claims and ensure that the claims are not time barred by the statute of limitations. MCL 559.276 typically provides an association with three years from the transitional control date or two years from the date that a claim accrues to pursue a construction defect claim arising out of the development or construction of a condominium. A claim for breach of contract against a contractor for a defect that arises from the repair or replacement of a construction defect, typically has a six year statute of limitations. While the statute of limitations could be extended through various theories, such as fraudulent concealment, among others, an association's odds of success are greatly increased by vigilance of the board of directors. In addition, a developer or contractor often defends a construction defect claim by arguing that the defect was caused by natural wear and tear or improper maintenance by the association. Accordingly, the sooner the association takes action, the better the chance of success.
3. **Consult with an Engineer.** After the board of directors consults with an attorney, the board should hire a civil engineer or other qualified professional to prepare a report outlining the construction defects, the cause of the defects, a proposed fix and the estimated cost to fix the problems. The engineering report will assist the board of directors and the condominium association's attorney in evaluating the scope of the problems and determining the best course of action.
4. **Negotiate with the Contractor/Developer.** After the board of directors becomes aware of a potential construction defect, the association should attempt to negotiate a resolution with the responsible parties. The process is typically started by sending a demand letter to the contractor or developer. The demand letter should 1) outline the known construction defects, 2) offer a proposed solution to the defects and 3) summarize the potential costs involved. If settlement negotiations prove unsuccessful, the board of directors should evaluate whether a lawsuit should be filed or whether the association should repair the problem itself.
5. **File a Lawsuit or Repair the Defect.** The board of directors has a fiduciary duty to ensure that the common elements are appropriately maintained and it must take action when learning of construction defects. A condominium association has two options with respect to dealing with a construction defect that a developer or contractor is unwilling to repair: 1) file a lawsuit or 2) fix the defect. The board of directors must decide whether the association is going to levy an additional assessment to fund a lawsuit or levy an additional assessment to repair the construction defect. While imposing an additional assessment is typically not

popular with the co-owners, an unplanned expenditure is often unavoidable when a construction defect is discovered. Typically speaking, the assessment to pursue the lawsuit is cheaper than paying the entire cost of the repair. Accordingly, it is often more prudent for the board to pursue the developer and/or contractor that caused the construction defects instead of shifting that burden to the co-owners. ■

*Kevin Hirzel is a partner at Cummings, McClorey, Davis & Acho, P.L.C. He frequently represents Builders, Community Associations, Condominium Associations, Cooperatives, Co-Owners, Developers, Homeowner Associations, Investors, Property Owners and Property Managers throughout the State of Michigan. Mr. Hirzel can be contacted at (734) 261-2400 or khirzel@cmda-law.com. Please view The Michigan Community Association Law Blog at www.micondolaw.com for additional resources on Michigan Community Association Law.*