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LEGAL ALERT

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NEVADA SUPREME COURT TACKLES CONSTRUCTION DEFECTS IN CONDOMINIUM CONVERSIONS … AND INVALIDATES GENERAL DEFECT WAIVERS FOR GOOD MEASURE

By Leon F. Mead II, Esq.

As we watched the Las Vegas housing marketing reach ever increasing vistas in the early 2000s, developers looking for ways to capture the rising tide started converting existing apartment buildings into condominiums. Why not? Development costs were much less than new construction and sales prices were higher than expected. Prospective homebuyers who found the price increases outstripping their budgets had an alternative option. Soon, those who were looking to rent apartments were disappointed as the available rental units declined, while the conversion price points increased.

Those of us who watch construction litigation, especially construction defect litigation, wondered openly if the wildfire of construction defect litigation in the new construction markets would take hold of the apartment conversions. As the conversions increased, so did the claims. Some purchasers of condo conversions came home to burst pipes or faulty water heaters. Air conditioning units lasted for six months before burning out entirely. Faulty wiring, previous water damage, and other claims began to surface. Construction defect notices were sent and lawsuits were filed. Who

would be responsible for the defects in the original construction? Did the conversion have to be brought up to current building codes?

CHAPTER 40 DOES NOT APPLY TO ORIGINAL CONSTRUCTION DEFECTS WHEN RESIDENCE HAS BEEN PREVIOUSLY OCCUPIED

The first answer came on September 20, 2007. Construction defect claims governed by NRS 40.600 through 40.695 only applies to "original construction which has been unoccupied as a dwelling from the completion of its construction to the point of sale." That means, if an apartment has been rented for a period of time and then is sold, the purchaser only has a construction defect claim on any alterations that were made by the seller to prepare the unit for sale.

In *Westpark Owners' Association v. District Court*, 123 Nev.Ad.Op. 37 (September, 2007), the Nevada Supreme Court reviewed a condominium conversion claim involving 108 apartment units which were converted and sold as condos seven years after they were originally constructed. The developer (and the trial court) had determined that the units were neither "residences" (as defined by NRS 40.630), nor "new" (under NRS 40.615), and therefore the owners did not have any claims under Chapter 40 to assert against the developer. The trial court did not reach issues of whether generalized "waivers and releases" from construction defect claims were valid and did not address whether any alterations that the developer made to the condos in preparation for sale were defective.

On these points, the Nevada Supreme Court reversed the trial court's ruling. First, the Court determined that the trial court was incorrect in declaring the conversions were not "residences" under NRS 40.630. Under a plain reading of the statute, the conversions qualified as "residences" upon sale to the purchasers. Where the trial court was correct was in determining that the converted units were not "new."

In seeking a definition of the term "new residence," the Court struggled with its equal obligations to construe Chapter 40 with the legislation's intent to protect homebuyers by providing a procedure to hold contractors liable for defective original construction, while avoiding an interpretation of the law which would lead to an absurd result. Obviously, a dwelling lived in for several years could not be considered "new" if it was eventually sold. However, allowing a developer to circumvent its responsibility through use of units as "model homes" or leasing them to "strawmen" until a certain time period expired could not be allowed either. Ultimately, to bridge the gap, the Court created a new rule, concluding "*that a residence is 'new' when it is a product of original construction that has been unoccupied as a dwelling from the completion of its construction until the point of sale.*" Because the 108 units had been occupied by renters for seven years after they were constructed, they could not be "new" under the Court's definition. Therefore, Chapter 40 claims were not available for any defects existing as part of the original construction of the units.

The Court did, however, reverse the trial court to allow the homebuyers to sue under Chapter 40 for any defects found to exist in any modification or alteration made during the conversion for sale. Likewise, the Court also allowed the case

to proceed as to other claims the homebuyers might have had outside of the Chapter 40 matrix, such as for breach of any express warranty made during the sale.

WAIVERS OF CHAPTER 40 CLAIMS MUST BE SPECIFIC AS TO AN ACTUAL DEFECT TO BE EFFECTIVE

Interestingly enough, the Court made special efforts to throw a roadblock in front of attempts to have parties waive Chapter 40 constructional defect claims. It is unusual for the Supreme Court to comment on issues not germane to the trial court's decision. Breaking this rule, however, in footnote 37 of the decision, the Court states the following:

> *If the district court determines that the [Homebuyer] has asserted viable claims pursuant to NRS Chapter 40, we conclude that the alleged contractual waivers are clearly invalid. While NRS 40.640(5) allows a contractor and homebuyer to stipulate to a waiver of any potential claims under NRS Chapter 40, the "waived" constructional defect must be disclosed to the buyer in clear language before the purchase of the residence. Here, the waivers did not disclose any constructional defects; they stated only that certain defects "may" exist and listed a number of potential defects. This vague language was not sufficient to waive any claims pursuant to NRS Chapter 40.*

Thus, the Court has made clear that any waiver of Chapter 40 constructional defects is limited to actual known defects.

This is significant. Any attempt to place Chapter 40 waiver language into a sales agreement is probably not going to have any effectiveness without a specific declaration that a particular item is, in fact, defective. This specific declaration is going to be strictly construed to reach only that particular defect and will not be expanded by generalized terms. To buttress this point, the Court also noted in footnote 38 of the decision that general "as is" language already is void to waive implied warranties of quality in residential units under NRS 116.4115. As such, there appears to be little hope that any effective waiver of Chapter 40 claims can be successfully drafted on new construction or altered, modified or repaired construction. Thus, developers should not place any significant reliance on Chapter 40 waivers after the *Westpark* decision.

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AMERICAN INSTITUTE OF ARCHITECTS (AIA) DOCUMENT UPDATE SEMINAR

Join Leon Mead, Jason Ebe and other Snell & Wilmer attorneys as they discuss and interpret the latest AIA documents and help industry professionals fully understand the impact these changes have on their respective business operations. December 4, 2007, 11:30 a.m. – 1:00 p.m., Snell & Wilmer, 3883 Howard Hughes Parkway, Suite 1100, Las Vegas, NV, 89169. Please RSVP to Katy Ramsey, 702.784.5200

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Mr. Mead is a partner with Snell & Wilmer's Las Vegas office. Ranked as one of the top Construction Lawyers in Nevada by Chambers USA, Best Lawyers in America and Super Lawyers, he has represented clients in construction related matters for nearly twenty years. He primarily represents public and private owners, contractors and others in the construction industry in their construction-related legal matters.

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