

## Settling Community Association Warranty Claims

By Shelah Lynn, Ballar Spahr, LLP

The July/August 2010 issue of *BUILDING* magazine included an article about the transition of control from developers to the homeowners in condominiums and community associations. One of the first items on the association's agenda after the transition of control is the review and pursuit of warranty and construction claims. Many condominiums and community associations developed and sold during the height of the real estate industry in our area are now approaching the end of their warranty period or the end of their limitations period for asserting and enforcing warranty and other construction claims. Almost every condominium association and many community associations assert some type of warranty or construction claim during this period of time and most developers work toward achieving amicable resolutions of those claims without the need for arbitration or litigation.

As most association warranty and construction claims are settled in some manner without an adversary proceeding or are ultimately settled as a result of such a proceeding, it is important to consider the type of settlement structure that should be pursued as part of this process. There are many different types of settlements that are used to resolve claims, but most fall within certain categories. The following summarizes the types of settlements typically used to achieve a resolution without litigation or arbitration and some of the benefits and drawbacks of each. While the summary below discusses the various settlement structures that may be used, each requires a detailed legal agreement to carry out the intent of the parties and to protect developers from future obligations once the settlement is achieved.

### Cash Settlements

To the extent feasible, cash settlements are the most desirable. Such a settlement results in a fairly simple agreement, the payment of money or other assets in exchange for a full release as to future claims of any nature and the end of the relationship. The downside to this type of settlement is the cost. Many associations are not focused on receiving cash but rather are focused on correcting particular problems in the community. As a result, they often feel that the developer can implement corrective action more cost effectively through the use of their original contractors and subcontractors and thus, the association will receive greater financial benefit if the developer performs the work. Therefore, the cost of a cash settlement may be higher for the developer than actually performing work. Notwithstanding, the upside is that the matter is permanently resolved and the developer has no further obligation to the community.

### Performance Settlement

This type of settlement agreement is more complex and prolongs the relationship between the developer and the association. Essentially the developer performs certain agreed upon remedial work in exchange for a release of all claims. While this may be more cost effective for the developer, the continued relationship and the complexity can often make this approach less desirable. It is very difficult to achieve a performance settlement agreement without a review and approval process by the association, which can result in additional adversity. Some particular components necessary for this type of settlement are as follows:

- It is necessary to have a fairly detailed objective scope of work to incorporate into the settlement agreement. Sufficient detail will help to avoid dispute over expectations. Subjective standards of performance are undesirable

since they leave too much room for potential dispute as to whether such standards have been achieved.

- It is typically necessary to have a review and approval process by the association once the work is performed. An association will rarely agree to the performance of work as a component of settlement without a review and approval process.
- There should be various notice requirements and time frames applicable to the completion of work, inspection and rejection. Without these requirements, the process could be unending.
- There should be a dispute resolution procedure in the event there are disputes regarding whether the work complies with the specifications and standards outlined in the agreement. This procedure should have short time frames and a definitive resolution without litigation. Often there is a pre-selected arbiter to avoid delays and disputes on the selection process.
- There must be a release that becomes effective upon completion of the work and no timely rejection.
- It is preferable that the developer have no further obligations after the satisfactory completion of work. To the extent that this cannot be achieved through negotiation, any continued obligations or warranty must be specific and narrowly defined.

### Combination Cash Payment/Performance

Often the settlement agreement includes some combination of the two options discussed above. In such case, all of the terms applicable to performance agreements must still be included.

### Structured Settlements

Sometimes the particular facts of the matter may be conducive to other structured settlement arrangements. These types of arrangements may include the conveyance of property in lieu of making a cash payment or other performance. This is fairly common and sometimes includes the conveyance of a unit or units, including a unit to be used as a management office or other service location in the community, conveyance of amenities, and conveyance of parking spaces. For future communities, consideration should be given in document drafting to the potential future use of such assets as a means of settling warranty and construction claims. The designation of such property in the governing documents of the community as common areas or in condominiums as units or common or limited common elements may provide different possible settlement options.

There are many other factors that should be considered when negotiating settlement agreements, however, the above provides an outline of the most common settlement structures used in resolving warranty and construction disputes with condominiums and community associations. Of course, a solid legal agreement implementing the intent and protecting against further exposure is an essential element of the resolution. ■

*Shelah F. Lynn is of counsel in the Real Estate Department and a member of the Construction, Real Estate Development, and Planned Committees and Condominiums Groups. She concentrates her practice in representing developers of common interest projects, including residential, mixed-use and commercial projects. Ms. Lynn also represents developer clients in warranty and construction defect disputes through negotiation, litigation and arbitration. She can be reached at [lynn@ballardspahr.com](mailto:lynn@ballardspahr.com).*