Warranties, Surety Bonds and Correction Periods: How To Get Defects Repaired

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WHAT DO YOU DO WHEN THE WORK FAILS?

The first thing you will do is **look at the** contract to see what your rights are against the contractor or vendor. Generally, this will be in the "Warranty" clause.
WHAT DO YOU DO WHEN THE WORK FAILS?

But this isn't as simple as it seems – there may be more than one warranty clause, and you may have warranties that aren't in the contract.
WHAT IS A “WARRANTY”?

Warranties may be

• **express** (stated or written in the contract),
• **implied** (by the common law) or
• **statutory** (set forth in a state’s statutes).
Express warranties …

Typically, these assurances appear in a section entitled “Warranties” in most standard-form construction contracts. They all tend to look like the AIA language:
3.5 WARRANTY

3.5.1 The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless otherwise required or permitted by the Contract Documents, that the Work will be free from defects not inherent in the quality required or permitted, and that the Work will conform to the requirements of the Contract Documents. Work not conforming to these requirements, including substitutions not properly approved and authorized, may be considered defective. The Contractor’s warranty excludes remedy for damage or defect caused by abuse, modifications not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage. If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment.

AIA A201-2007
But in addition to the “Warranty clause, there can be – and generally are - other “express” warranties scattered throughout the contract.
EXPRESS WARRANTIES

• That the work will be done to the "Highest Standard" of the industry
• That the contractor will provide its "Best Workmanship"
• That the contractor is an "Expert"
Warranties can be:

- printed on *product packaging*,
- in *plans and specifications*,
- or arise out of *conversation* or *correspondence* (including *emails*).
EXPRESS WARRANTIES

Warranties can be, and frequently are, scattered throughout the specifications and printed on the plans. If the specs say that a pump has to produce so many gallons of liquid per minute, its failure to do so is a breach of the contractual warranty.
WARRANTIES “INCORPORATED BY REFERENCE”

Designers frequently incorporate by reference other documents and contract provisions, including trade association standards (SMACNA, UL).

These standards frequently impose additional work on one party or another.
EXPRESS WARRANTIES MAY ALSO BE ORAL

While most express warranties are memorialized in writing, they can also be created orally. Oral warranties are enforced by the courts, but the situation doesn’t arise frequently because there are a lot of hurdles that must be cleared to enforce an oral warranty.
Courts have “implied” warranties to protect parties where there were no express or stated warranties to do so.

The logic is that, in some circumstances, the parties “must have” intended a warranty to apply even though the contract doesn’t expressly say so.
Statutory warranties are created by legislation and become part of some contracts by operation of law. The Uniform Commercial Code creates statutory warranties which apply to the sale of goods.
STATUTORY WARRANTIES ARE IMPOSED BY LEGISLATURES

• **Purchase orders** to material suppliers will usually be governed by the UCC.

• If a contract is characterized as being *predominantly* the purchase of goods more than labor, there is a chance a court will find that the contract is controlled by the UCC.
STATUTORY WARRANTIES ARE IMPOSED BY LEGISLATURES

The **warranty of merchantability** (that the goods will be of at least average quality, conform to the promises made on any labels and are fit for the ordinary purpose for which the goods are used)
STATUTORY WARRANTIES ARE IMPOSED BY LEGISLATURES

The **warranty of fitness for a particular purpose** (that the goods will serve the buyer’s intended use if the seller has reason to know of that intended use)
HOW LONG DOES THE WARRANTY LAST?

Warranties do not necessarily have any set time limitation. Unless agreed otherwise, the product of service should last as long as a “typical” product or service of the same time can be expected to last.
HOW LONG DOES THE WARRANTY LAST?

The answer can be **different for every product** installed in a construction project. It is a jury question.

- Solid brass vs. brass plate door knobs
- Bare concrete floor vs. carpet
- $1,000 compressor vs. $10,000 compressor
- Arena bathroom faucet vs. executive suite faucet
HOW LONG DOES THE WARRANTY LAST?

The **time to sue** is typically from when the breach occurs – so if a product is supposed to last for 5 years, and it fails after 4 years, the time to sue only starts in year 4.

In Missouri, the statute of limitations if 5 year, with a statute of repose of 10 years.
THE STANDARD “ONE-YEAR WARRANTY”

For some mysterious reason that we can’t figure out, most people in the construction industry think that their contracts contain a one-year warranty.

They think that this is “industry standard.”
THE STANDARD “ONE-YEAR WARRANTY”

HA!
This is a myth.

There is no “standard” one-year warranty, particularly in commercial construction.
Many standard form contracts contain a “one-year correction period,” but they are careful to say that this is in addition to any warranty.
The standard “one-year warranty”

§ 3.5 WARRANTY

The Contractor warrants to the Owner and Architect that materials and equipment furnished under the Contract will be of good quality and new unless the Contract Documents require or permit otherwise. The Contractor further warrants that the Work will conform to the requirements of the Contract Documents and will be free from defects, except for those inherent in the quality of the Work the Contract Documents require or permit. Work, materials, or equipment not conforming to these requirements may be considered defective. The Contractor's warranty excludes remedy for damage or defect caused by abuse, alterations to the Work not executed by the Contractor, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage. If required by the Architect, the Contractor shall furnish satisfactory evidence as to the kind and quality of materials and equipment.

AIA General Conditions – Document A201
There is **NO timeframe** mentioned in this warranty.

The only reference to “one year” or “12 months” is in another paragraph, 12.2.2.1, dealing with the “correction period.”
“STANDARD” 12-MONTH CORRECTION PERIOD CLAUSE

The standard “one-year warranty”

§ 12.2.2 AFTER SUBSTANTIAL COMPLETION

§ 12.2.2.1 In addition to the Contractor's obligations under Section 3.5, if, within one year after the date of Substantial Completion of the Work . . ., any of the Work is found to be not in accordance with the requirements of the Contract Documents, the Contractor shall correct it promptly after receipt of written notice from the Owner to do so . . . . During the one-year period for correction of Work, if the Owner fails to notify the Contractor and give the Contractor an opportunity to make the correction, the Owner waives the rights to require correction by the Contractor and to make a claim for breach of warranty. If the Contractor fails to correct nonconforming Work within a reasonable time during that period after receipt of notice from the Owner or Architect, the Owner may correct it in accordance with Section 2.4.
We think that these two clauses represent a compromise by the drafters of the A201 General Conditions. In exchange for inserting an open-ended warranty in 3.5, the drafters put in 12.2.2.1, which basically assumes that anything that breaks in 12 months is the contractor’s responsibility (unless the contractor can prove otherwise).
In exchange for this 12-month obligation, the owner agrees that it *has to* permit the contractor to fix the problem on its own. If the owner doesn’t give the contractor that chance, the owner *waives all warranty rights* with respect to this defect.
“STANDARD” 12-MONTH CORRECTION PERIOD CLAUSE

But 12.2.2.1 is very careful to say that this 12-month repair obligation is “in addition to” the Contractor’s warranty obligations, which are in Section 3.5.
“STANDARD” 12-MONTH CORRECTION PERIOD CLAUSE

And if it weren’t clear enough, the A201 says it again (okay, in words that only a lawyer, and a judge would understand).
§ 12.2.5 Nothing contained in this Section 12.2 shall be construed to establish a period of limitation with respect to other obligations the Contractor has under the Contract Documents. Establishment of the one-year period for correction of Work as described in Section 12.2.2 relates only to the specific obligation of the Contractor to correct the Work, and has no relationship to the time within which the obligation to comply with the Contract Documents may be sought to be enforced, nor to the time within which proceedings may be commenced to establish the Contractor's liability with respect to the Contractor's obligations other than specifically to correct the Work.
THERE CAN BE TRUE ONE YEAR WARRANTIES, HOWEVER.

Due to misunderstanding of the law, it is not unusual to see owners, designers or their lawyers actually inserting one year warranties into construction contracts – when they didn’t have to be so limited.
THERE CAN BE TRUE ONE YEAR WARRANTIES, HOWEVER.

The result of this is to shorten, drastically, what the warranty would otherwise have been.
THERE CAN BE TRUE ONE YEAR WARRANTIES, HOWEVER.

CONTRACTOR’S WARRANTIES –

Contractor warrants the Project will be habitable and constructed in a good and workmanlike manner and free from defects in material and workmanship for a period of one (1) year following the date of Substantial Completion. If defects are discovered by the Owner within one (1) year from the date of final completion, Contractor shall, upon receipt of written notice from the Owner (which shall be given within ten (10) days after such discovery but in no event later than ten (10) days after expiration of such one (1) year period), promptly correct such defects.

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THERE CAN BE TRUE ONE YEAR WARRANTIES, HOWEVER.

The Contractor shall and does hereby guarantee all work for a period of one (1) year from the Date of Substantial Completion of the Work (or from the date of commencement of use on incomplete items as spelled out in the Certificate of Substantial Completion). Nothing in the above intends or implies that this guarantee shall apply where damage occurs due to improper maintenance.

* * *
HOW DOES THE WARRANTY AFFECT SURETY BOND EXPOSURE?

This could be the topic of another whole seminar.

• It depends on how the bond is written.
• It depends on whether there is a statute involved.
• It depends on how a court feels about it.
HOW DOES THE WARRANTY AFFECT SURETY BOND EXPOSURE?

It depends on how the bond is written.

AIA A312 (2010) § 11 (“Any proceeding, legal or equitable, under this Bond . . . shall be instituted within two years after a declaration of Contractor Default or within two years after the Contractor ceased working or within two years after the Surety refuses or fails to perform its obligations under this Bond, whichever occurs first.”)
HOW DOES THE WARRANTY AFFECT SURETY BOND EXPOSURE?

It depends on how the bond is written.

Municipal bond form says that the performance bond obligation is over once the work is “fully performed” and a Maintenance Bond becomes effective.

The Maintenance Bond requires the work to “endure without defect or need of repair or maintenance for a period of two years from final acceptance.”
HOW DOES THE WARRANTY AFFECT SURETY BOND EXPOSURE?

It is entirely possible to end up in a situation where the contractor is on the hook for a warranty, but the surety is not because it capped its liability at a certain length of time. Not good for the owner/obligee!!!
WHAT CAN YOU DO WHEN THE WARRANTY IS BREACHED?

Work not conforming to the warranty may be considered “defective.” What happens next will also depend on what is in (or out of) the contract.
WHAT CAN YOU DO WHEN THE WARRANTY IS BREACHED?

If there is no other limitation in the agreement, typically the owner/promissee is entitled to repair or replace the defective work, so that the owner/promissee gets the full useful life it was promised. It does not necessarily have the obligation to let the contractor fix its own mistakes.
WHAT CAN YOU DO WHEN THE WARRANTY IS BREACHED?

• This can include removal and replacement of work damaged as a result of the failure, and work that has to be torn out in order to get to the defective work.

• Often, the contractor could have found the least expensive and invasive way of solving a problem, if it was allowed to.
WHAT CAN YOU DO WHEN THE WARRANTY IS BREACHED?

• But there is a downside to an owner going ahead and fixing the problem:
  — It means that the owner has to front the money and fight to get it back
  — It might be waiving surety bond rights
  — And if the owner’s work doesn’t solve the problem, it may be worse off, since the contractor isn’t responsible for the Owner’s mistakes.
WHAT CAN YOU DO WHEN THE WARRANTY IS BREACHED?

The contractor/vendor could also be liable for “consequential damages” such as loss of use of the facility or lost profits from a cessation in operations, or “diminution in value” if the damage can’t be repaired (unless there is a waiver of such claims in the contract).
WHAT CAN YOU DO WHEN THE WARRANTY IS BREACHED?

It is ESSENTIAL that you include the surety on ALL correspondence, and get it engaged at the earliest opportunity.

Because of the personal indemnities that the surety probably has, it can influence contractors to do things that you may not be able to.
IS THERE ANYTHING THAT IS NOT COVERED BY A WARRANTY?

Most warranties will typically exclude defects caused by abuse, modifications, improper or insufficient maintenance, improper operation, or normal wear and tear and normal usage.
MANUFACTURERS’ WARRANTIES

Most major manufacturers and vendors of equipment and materials in construction “get it.” They have been around a long time (or are spin-offs from firms that have been around a long time.) They have corporate offices (or parents) with a legal staff. They understand the UCC and they very specifically understand warranties.
MANUFACTURERS’ WARRANTIES

Most manufacturers and vendors will give warranties – but they are always “limited” warranties.

You can be certain that the intent of those written warranties is never to give you more. It is always to limit your rights.
MANUFACTURERS’ WARRANTIES

Typical manufacturer’s limited warranty terms:

• **What remedy** you get: pro-rated refund, replacement parts (you pay shipping), repair
• **Who decides** if there is damage (them!)
• **How long** the warranty will go on
• **What specific promises** are being made (i.e., tires will last 40,000 miles)
MANUFACTURERS’ WARRANTIES

Typical manufacturer’s limited warranty terms:

- **Waiver** of all other rights
- **Where lawsuit** can be brought
- **only the original owner** can make a claim (“good for as long as you own this car”)
- Disclaimer of **all other warranties**
But the manufacturers have to do it right:

• They usually have to use special Disclaimer language to avoid UCC warranties in particular

• The disclaimer may have to be in all capital letters, bigger type

• They may have to say that the buyer’s acceptance of these limitations is essential term of order
MANUFACTURERS’ WARRANTIES

But the manufacturers have to do it right:

Again, this is something that varies A LOT from state to state, and is often in special statutes, or in court decisions.

Manufacturers who sell in many states don’t want to be subject to so many different rules, so they make their terms very strict.
DESIGNERS’ LIMITATIONS ON LIABILITY

A recent phenomenon is clauses in agreements with designers that limit their liability to either the amount of their fees, or the amount of their insurance, with no liability to the designer at all.

Some agreements want the owner to agree that it will only sue if the damages exceed a pre-set amount that the owner should have “expected.”
HOW TO PROTECT THE OWNER?

Don't just go with "boilerplate" language on warranties and correction of work. Make sure that the language is what is best for the client.

• Do not arbitrarily cut off rights after one or two years.
Watch out for inconsistent warranty terms among the various contract documents. Some prepared by design professionals and others prepared by lawyers.

Inconsistent terms may limit or void warranties. Review all contract documents – including those incorporated by reference – for consistency.
HOW TO PROTECT THE OWNER?

Make sure the contractor passes through all manufacturer’s warranties, to the extent they are assignable.
HOW TO PROTECT THE OWNER?

Do your best to protect the owner against very restrictive terms on purchase order terms and conditions from vendors.

- Ask the designer to consider other products
- Write in the specs that restrictive warranties will not be accepted
- Do no agree that all suits are brought in vendor’s home town.
HOW TO PROTECT THE OWNER?

Don't just go with "boilerplate" surety bond language either. Make sure that the bond:

• Does not have a short expiration date
• Gives the owner the right to demand a prompt decision
HOW TO PROTECT THE OWNER – FAIRLY?

Remember that the risk of failure of work will not go away. If it isn’t on you, it is on someone else.

The goal of a good warranty program is to place the risk on the party who is in the best position to avoid or manage the risk, for the right amount of time.
Questions?
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