LEGAL PIPELINE

Builder Beware: Disclaimer of Implied Warranties May Not Be Enforceable

Freedom of contract is not absolute; it has limitations, regardless of the jurisdiction.

By Steven Nudelman

Contracts are an integral part of construction law. They govern the rights, obligations and duties of the parties. But are there limits to what the parties can agree on? Sure, you cannot contract to do something unconscionable or illegal. But are there any other limits?

"A fundamental principle inherent in contract law is freedom of contract — the freedom to determine whether or not to enter into a contractual relationship." In re Greater Southeast Community Hospital Foundation, Inc., 26 B.R. 7, 17 (Bankr. D.D.C. 2001). "[P]arties are free to enter into, and courts are generally willing to enforce, contracts that do not contravene public policy. The parties to a contract are bound by its terms." Riley v. Iron Gate Self Storage, 395 P.3d 1059, 1065 (Wash. Ct. App. 2017) (emphasis added) (citations omitted).

And therein lies the rub: "do not contravene public policy." How does public policy affect freedom of contract for a construction project? That issue was tackled head on in a recent decision of the Supreme Court of Arizona in Zambrano v. M & RC II, LLC, 517 P.3d 1168 (Ariz. 2022).

The facts of the case are relatively straightforward and were undisputed by the parties. Tina Zambrano entered into a preprinted purchase agreement with the defendant to buy a newly constructed home in Surprise, Ariz.

Paragraph fifteen of the agreement states:

"SELLER'S LIMITED WARRANTY.

"(a) At Closing, Seller shall issue a "'Home Builder's Limited Warranty'" to Buyer, a sample of which has been provided to Buyer prior to the execution of this Contract. The Home "'Builder's [sic.] Warranty is the only warranty applicable to the purchase of the Property. …

....

"THE HOME BUILDER'S LIMITED WARRANTY REFERENCED ABOVE IS THE ONLY WARRANTY APPLICABLE TO THE PURCHASE OF THE PROPERTY. ALL OTHER EXPRESS OR IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, HABITABILITY AND WORKMANSHIP ARE HEREBY DISCLAIMED BY SELLER AND ITS AFFILIATES AND WAIVED BY BUYER, ANY IMPLIED WARRANTY THAT MAY EXIST DEPITE [sic] THE ABOVE DISCLAIMER IS HEREBY LIMITED TO A ONE (1) YEAR PERIOD."

Ms. Zambrano initialed the first paragraph and another, which confirmed she had read and understood the agreement. The builder constructed the home and gave Ms. Zambrano a 40-page, preprinted "Builder's Limited Warranty." Notably, within all those pages, the warranty does not cover the workmanship and habitability of the home. Like the purchase agreement, the warranty disclaims all implied warranties.

Four years after agreeing to buy the home, Ms. Zambrano brought a construction defect action against her builder, suing it for breach of the implied warranty of workmanship and habitability. She alleged several design and construction defects, including improper grading and soil movement mitigation, separation of windows from cracking stucco, separation of baseboards from the tile and walls, and nail pops in the ceiling.

Ms. Zambrano could not assert timely claims under her 40-page warranty, nor were such claims covered.

Public Policy vs. Waiver

The builder moved for summary judgment, arguing that Ms. Zambrano had waived the implied warranty under the purchase agreement. The trial court agreed. The court of appeals, however, reversed, finding that "the "public policy supporting the implied warranty clearly outweighs the freedom-of-contract interest in the waiver's enforcement." Zambrano v. M & RC II LLC, 496 P.3d 789, 792 (Ariz. Ct. App. 2021).

Recognizing the high stakes for its homebuilding business, the builder appealed to the Supreme Court of Arizona. The court acknowledged the

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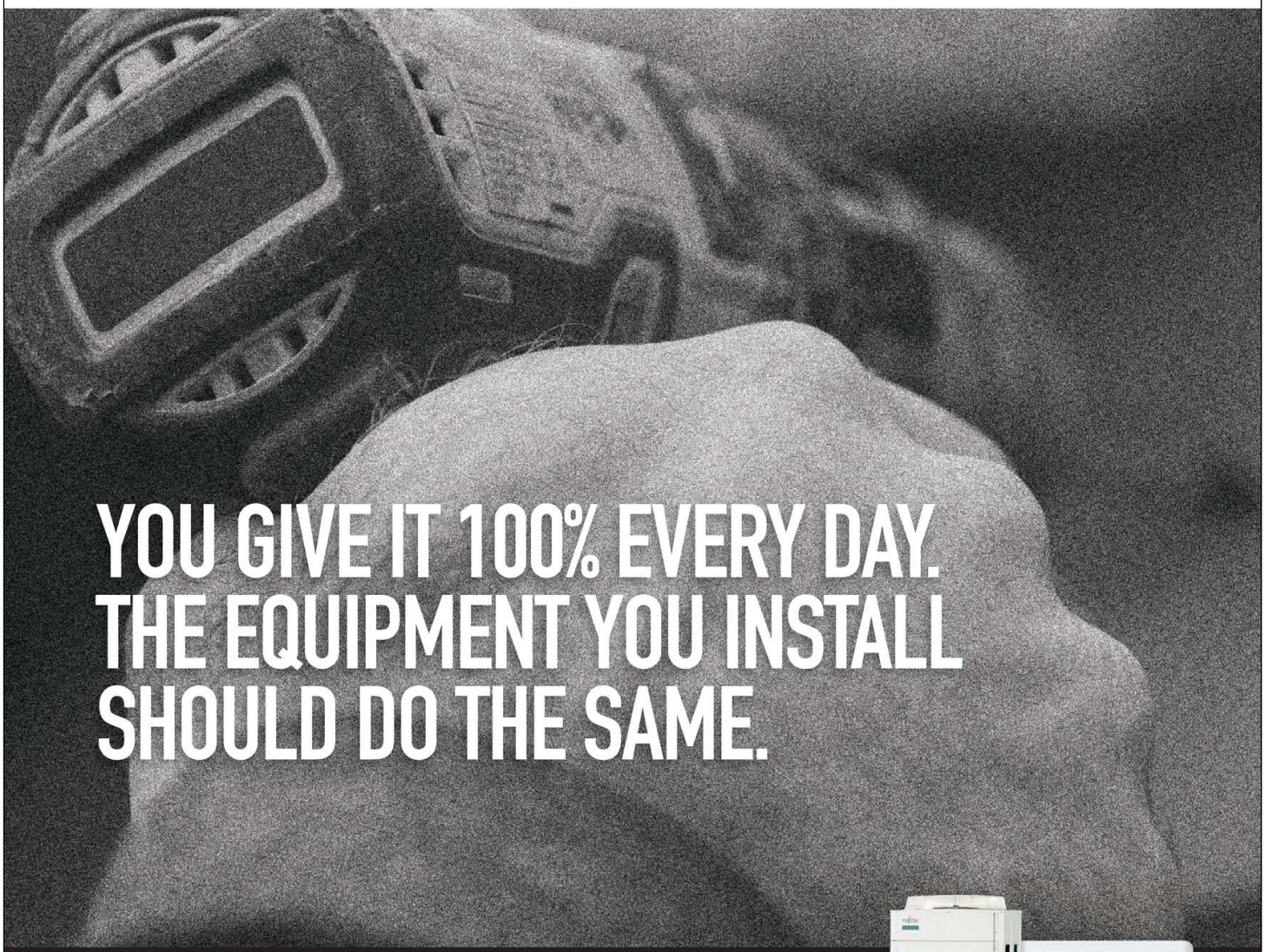

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issue at the outset:

"On the one hand, parties are generally free to contract on whatever terms they choose . . . . unless legislation precludes enforcement of a contract term. Courts will uphold the term unless it "is contrary to an otherwise identifiable public policy that clearly outweighs any interests in the term's enforcement.

"On the other hand, Arizona implies a warranty of workmanship and habitability in every contract entered into between a builder-vendor and a homebuyer. This warranty protects the homebuyer and successive purchasers from financial responsibility for latent defects in the home that the buyer could not have reasonably discovered at the time of purchase and holds the builder accountable for the home's faulty construction."

Zambrano, 517 P.3d at 1171 (citations omitted).

Purpose of Implied Warranty

After an extensive legal analysis, the court (in a 5-2 decision) held that public policy does not allow a builder-vendor and homebuyer to agree to disclaim and waive the implied warranty (regardless of whether it is replaced with an express warranty).

The court explained the broad purposes of the implied warranty:

"The implied warranty serves to protect homebuyers and the public at large in multiple ways. First, warranting that a home was built using minimum standards of good workmanship conforms to a homebuyer's reasonable expectations. Second, the warranty discourages "'the unscrupulous, fly-by-night operator and purveyor of shoddy work,'" who might otherwise blight our communities. Third, it protects not only the original buyer but also subsequent purchasers. Fourth, the warranty shields a purchase that "'is usually the most important and expensive purchase of a lifetime,'" thus minimizing the risk of catastrophic financial losses for all homebuyers who purchase a home within eight years of construction."

Zambrano, 517 P.3d at 1176-77 (citations omitted).

As the court noted, the public policy at issue is twofold: "(1) protecting buyers of newly built homes and successive owners against latent construction defects that were not reasonably discoverable when the home was initially sold and (2) holding builders accountable for their work." Zambrano, 517 P.3d at 1175 (citation omitted).

While recognizing that freedom to contract "has long been considered a 'paramount public policy' under [Arizona] common law that courts do not lightly infringe," the court found that it is not paramount when compared to disclaimer of the implied warranty:

"Enforcing the disclaimer and waiver here would grievously injure homebuyers and the public welfare as doing so would likely spell the end for the implied warranty and eliminate the above-described protections. Builders would almost certainly include a disclaimer and waiver in every purchase agreement with the new homebuyer lacking any realistic ability to negotiate deletion of the term. And, as has already occurred in Arizona and reflected in the public record, the builder would surely record the disclaimer and waiver to provide notice to subsequent homebuyers and prevent them from enforcing the implied warranty, as the law currently permits, even though they had no say in waiving a warranty that arose from the construction itself.

"Effectively eliminating the implied warranty, in turn, would gut a homebuyer's ability to hold a builder responsible for latent defects, increasing the likelihood that homes would be left unrepaired, to the detriment of homebuyers, their neighbors, and the public generally."

Zambrano, 517 P.3d at 1177 (citations omitted).

Takeaways

First, it bears mentioning that this is a case from Arizona and is precedential in only that state. Other states have similar implied warranties, however, and they, too, weigh the public policy impacts before enforcing them.

The "bigger picture" here is the effect on freedom of contract. Parties to commercial contracts sometimes get "carried away," and seek waivers and provisions that are lopsided and favorable to the party with stronger bargaining power. And when one party —— particularly a consumer —-- is presented by a business with a contract that is patently unfair, courts tend to take notice and look to unconscionability and public policy before enforcing such contracts.

Remember, freedom of contract is not absolute; it has limitations, regardless of the jurisdiction. Be cognizant of these limitations and seek legal counsel early on in the contracting process to ensure that your contracts do not run afoul of them. It will cost a lot more for legal fees if you wait until that process is finished and claims start to accrue. ●

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