

## Minnesota Adopts CIC Amendments Addressing Construction Defect Litigation

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Minnesota adopted what many view as “development friendly” amendments to its Common Interest Community (“CIC”) statute, which governs the development and operation of “CICs”—i.e., condominiums, cooperatives, and planned communities (e.g., townhomes).<sup>1</sup>

When first proposed, the amendments were given little chance of passage. However, a last minute compromise between Minnesota’s Democratic governor and the Republican-controlled legislature resulted in their adoption. The compromise benefitted existing CICs. They gained both an exclusion from the unit owner approval and mediation requirements and a delayed effective date for implementing the maintenance plan, schedule and budget.<sup>2</sup> The amendments went into effect on August 1, 2017.<sup>3</sup>

The amendments impose conditions upon and limit a Minnesota CIC association’s power to litigate a claimed defect in the initial design or construction of a CIC project. The type of litigation regulated is broadly defined. “Construction defect claim” covers any civil action or arbitration proceeding based on any legal theory against a “development party” caused by a defect in the initial design or construction of an improvement to real property. The term “development party” is also broadly defined as “an architect, contractor, construction manager, subcontractor, developer, declarant, engineer, or private inspector performing or furnishing the design, supervision, inspection, construction, coordination, or observation of the construction of any improvement to real property that is part of a [CIC], or any other person’s affiliates, officers, directors, shareholders, members, or employees”<sup>4</sup>

As a condition precedent to litigation, the amendments require mandatory mediation.<sup>5</sup> From the date a party makes a written demand for this mediation, the statute of limitations and statute of repose for any action arising out of the alleged construction defect is tolled until the later of five business days after mediation is completed, or 180 days.<sup>6</sup>

As an additional condition precedent to litigation, the amendments require a CIC association to obtain approval from owners of units to which the majority of the total votes in the association are allocated (not a majority of a quorum, which would likely be a far easier threshold to meet).<sup>7</sup> However, votes allocated to units owned by the developer and affiliates of the developer are not

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<sup>1</sup> 2017 Minn. Laws, Ch. 87 (amendments); Minn. Stat. Ch. 515B (Minnesota Common Interest Ownership Act).

<sup>2</sup> 2017 Minn. Laws, Ch. 87, Sec. 7. (Provides that the unit owner approval and mediation requirements apply only to CICs created on or after August 1, 2017; but as of September 13, 2018, the CIC statute, as published by the Revisor’s Office, does not contain this limitation. We believe that the approval and mediation requirements apply to CICs created on or after August 1, 2017.)

<sup>3</sup> *Id.*

<sup>4</sup> Minn. Stat. § 515B.1-103(16a).

<sup>5</sup> *Id.* § 515B.4.116(c).

<sup>6</sup> *Id.* (but not required if parties completed Minn. Stat. § 327A.051 home warranty dispute resolution).

<sup>7</sup> *Id.* § 515B.3-102(d)(2).

included for purposes of obtaining approval.<sup>8</sup> Also excluded are votes allocated to units owned by mortgagees who acquired ownership through a foreclosure sale.<sup>9</sup> Without approval of a majority of all votes, the association lacks the power to institute the litigation.

Obtaining the requisite approval can be a challenging task for the association. At the outset of the approval process, the association must provide written notice to owners, which notice specifies (1) the nature of the claim, (2) the desired relief, and (3) how the association plans to fund the cost of pursuing the action.<sup>10</sup> In addition, there are voting requirements that are specific to obtaining litigation approval. For example, a proxy is only valid if it expressly references the notice required to be provided by the association (as described above), and is executed by the unit owner after receipt of that notice.<sup>11</sup>

The amendments also require the CIC developer to adopt a written preventative maintenance plan, schedule and budget for all common elements and include the plan in the disclosure statement for the project. The plan must be based upon the best available information, listing all building elements to which the plan applies and the generally accepted standards of maintenance on which the plan is based. The developer is required to sign and date the plan and the plan must be fully funded by the initial budget provided by the developer. Unlike reserve funds, budgeted funds for the plan are not restricted and may be comingled with other association funds.

An association may amend or replace the plan and schedule.<sup>12</sup> It is required to provide all unit owners with a copy of the plan, including any amendments or modifications to or replacements of the plan.

The amendments provide a defense to implied warranty claims against a development party if loss or damage is caused by the failure of the association or a unit owner to comply with obligations imposed under the plan, unless the loss or damage was caused by failure to comply with the plan while the developer controlled the board.

The developer friendly amendments were welcomed by the development community in a state that has extensive implied warranties and a forgiving statute of repose.

Minnesota has two sets of implied residential construction warranties. The first set, contained in Minnesota's CIC statute, contains the following implied warranties: (i) a unit and the common elements are suitable for the ordinary uses of real estate of its type; (ii) any improvements subject to use rights by the purchaser, made or contracted for by the declarant, or made by any person in contemplation of the creation of the common interest community, will be free from defective materials and constructed in accordance with applicable law, according to sound engineering and construction standards and in a workmanlike matter; (iii) the residential use of the unit will not violate applicable law at the earlier of the time of conveyance or delivery of possession; and (iv) that the unit will be in at least as good condition at the earlier of the time of the conveyance

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<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

<sup>10</sup> Minn. Stat. § 515B.3-102(d)(1).

<sup>11</sup> *Id.* § 515B.3-102(d)(2).

<sup>12</sup> *Id.* § 515B.3-107(b).

or delivery of possession as it was at the time of contracting, reasonable wear and tear excepted.<sup>13</sup> The statute of limitations applicable to the implied warranties is six years, commencing on the earlier of the time of conveyance to, or possession by, the purchaser. The parties may agree to reduce the statute of limitations from six years to not less than two years.<sup>14</sup>

The second and more comprehensive set of implied warranties applies to residential new construction in Minnesota and contains the following implied warranties: (i) a one year warranty that a dwelling shall be free from defects cause by faulty workmanship and defective materials due to noncompliance with building standards; (ii) a two year warranty that a dwelling shall be free from defects caused by faulty installation of plumbing, electrical, heating and cooling systems due to noncompliance with building standards; and (ii) a ten year warranty that a dwelling shall be free from major construction defects due to noncompliance with building standards.<sup>15</sup> The statute of limitations on a claim for breach of the implied warranties is two years but does not commence to run until discovery of the breach.<sup>16</sup> The statute of repose on claims based upon these implied warranties is 12 years.<sup>17</sup>

It is too early to tell what impact the amendments will have on new CIC projects and the insurance markets. For developers, the initial challenge will be preparing a maintenance plan, schedule and budget based upon standards that are not yet well defined. For associations, the challenges include both navigating through the daunting pre-litigation approval requirements and performing and funding a preventative maintenance plan.

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<sup>13</sup> *Id.* § 515B.4-113.

<sup>14</sup> Minn. Stat. 515B.4-1151(b).

<sup>15</sup> *Id.* § 327A.02, subd. 1

<sup>16</sup> *Id.* § 541.051, subd. 4.

<sup>17</sup> *Id.*