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Sienna Court v. Champion Aluminum: The Illinois Supreme Court Bars Claims For Breach Of The Implied Warranty Of Habitability Against Subcontractors

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Introduction

Exposure to warranty of habitability claims by new home purchasers can be a matter of significant concern to subcontractors, including design and engineering professionals. As discussed below the courts have created significant barriers to these claims, although exceptions allowing them to proceed do exist among the jurisdictions.

Most recently, the Illinois Supreme Court clarified nearly forty years of precedent in holding that purchasers of new residential construction cannot prevail on a claim for breach of the implied warranty of habitability against a subcontractor, absent contractual privity with the subcontractor. This article provides a brief background of the implied warranty of habitability, followed by analysis of the opinion in *Sienna Court Condominium Association v. Champion Aluminum Corporation*, et al., (Ill., Dec. 28, 2018, No. 122022) 2018 WL 681844, and finally a comparative review of the law in several other states.

In the construction context, the implied warranty of habitability protects the first purchaser of new residential construction from latent defects by providing a route to recovery against the "builder-vendor." The seminal Illinois case recognizing the implied warranty – *Petersen v. Hubschman Const. Co., Inc*. (1979) 389 N.E.2d 1154 – defined the doctrine and its policy rationale as follows:

> Because of the vast change that has taken place in the method of constructing and marketing new houses, we feel that it is appropriate to hold that in the sale of a new house by a builder-vendor, there is an implied warranty of habitability which will support an action against the builder-vendor by the vendee for latent defects and which will avoid the unjust results of Caveat emptor and the doctrine of merger. Many new houses are, in a sense, now mass produced. The vendee buys in many instances from a model home or from pre drawn plans. The nature of the construction methods is such that a vendee has little or no opportunity to inspect. The vendee is making a major Investment, in many instances the largest single investment of his life. He is usually not knowledgeable in construction practices and, to a substantial degree, must rely upon the integrity and the skill of the builder-vendor, who is in the business of building and selling houses. The vendee has a right to expect to receive that for which he has bargained and that which the builder-vendor has agreed to construct and convey to him, that is, a house that is reasonably fit for use as a residence. (*Id*. at 1157-58.)

While this general recognition of the implied warranty of habitability was consistent with the law of most states across the nation, Illinois developed an unusual framework for permitting claims against subcontractors, even absent privity of contract.

In 1983, the First District of Appeals decided *Minton v. Richards Group of Chicago*, holding that that the policy rationale of the protection of innocent purchasers justified extending the implied warranty even to subcontractors in the event the purchaser has "no recourse" against the builder or developer. *Minton v. Richards Group of Chicago*, 452 N.E. 2d 835 (1st Dist. 1983). The court found that purchasers depended on the builder-vendor's "ability to hire sub-contractors capable of building a home of sound structure," and

that the builder-vendor was in a better position to know "which subcontractor could perform the work adequately." *Id*. at 854. Thus, at least where the builder-vendor has been "dissolved as an entity and is insolvent," *Minton* permitted the plaintiff to proceed against the subcontractor allegedly responsible for the latent defect under an implied warranty of habitability theory, even absent a contractual relationship. *Id*. at 855.

The *Sienna Court* Opinion

The recent *Sienna Court* decision arose out of a claim by the plaintiff condominium homeowners' association against the developer of the project (TR Sienna Partners, LLC), general contractor, architect and engineering design firms, suppliers, and several subcontractors. The lawsuit alleged numerous latent defects which resulted in water infiltration allegedly rendering the condo units and common area uninhabitable. *Id*. at *1.

Prior to the filing of the lawsuit, both the developer and general contractor declared bankruptcy. Plaintiff was granted relief from the automatic stay to pursue claims against the developer and contractor "to the extent of their available insurance," which was discovered to be several million dollars, in addition to $308,000 in a warranty escrow fund required by a local City ordinance. *Id*.

The suppliers and subcontractors ("defendants") filed a motion to dismiss all counts directed against them, including the claim for breach of implied warranty of habitability. They argued that, under *Minton*, plaintiff was not without recourse against the developer and general contractor due to the available insurance policies and warranty escrow fund. Plaintiff countered that legal insolvency was the determinative factor, not potential recourse; if the developer and contractor were legally insolvent, under *Minton* there was "no recourse" as a matter of law and plaintiff's suit could proceed. *Id.*

The circuit court denied the motion to dismiss, but granted defendants' motion to certify the order denying the motion for discretionary appeal under Illinois Supreme Court Rule 308. As required under the rule, the circuit court identified four separate pertinent questions of law for determination. The questions essentially sought clarification of whether the existence of an insolvent developer's (or contractor's) insurance policies or escrow warranty fund constituted "recourse" under *Minton*, thereby barring a claim for breach of implied warranty of habitability against a party with whom the plaintiff was not in privity of contract. *Id*.

The Supreme Court did not ultimately address the certified questions, disagreeing with the underlying "general assumption" that it is ever appropriate to recognize a claim for breach of an implied warranty of habitability against a subcontractor with which the homeowner was not in privity of contract. *Id*. at *3. The Court modified the questions certified by the circuit court to add the following threshold inquiry: "May the purchaser of a newly constructed home assert a claim for breach of an implied warranty of habitability against a subcontractor who took part in the construction of the home, where the subcontractor had no contractual relationship with the purchaser?" *Id*. at *3.

In answering the question in the negative, the Court rejected plaintiff's argument that "privity should not be a factor" because the cause of action was "tort-like." *Id*. at *4. The Court held that "the loss that can be recovered under the implied warranty of habitability is for disappointed commercial expectation, i.e., pure economic loss." Under Illinois' "Moorman Doctrine," and similar doctrines throughout the country, a plaintiff cannot recover for a pure economic loss through a tort action, aside from certain limited exceptions. *Id*. at *4; citing *Moorman Manufacturing Co. v. National Tank Co*., 91 Ill. 2d 69, 435 N.E.2d 443 (1982).) As a result, the Court held that the implied warranty cause of action must be a "creature of contract" and cannot proceed absent a contractual relationship. *Sienna Court*, *supra* at *7.

Consistent with *Sienna Court*, other jurisdictions across the country have likewise declined to permit homebuyer suits against subcontractors for breach of the implied warranty in the absence of privity. A review of the law in several jurisdictions reveals

varying methods of analysis and interesting exceptions which may assist in prosecuting or defending an implied warranty cause of action.

Approaches Taken by Other Jurisdictions

In *Pugh v. Gen. Terrazzo Supplies, Inc.,* 243 S.W.3d 84, 89–90 (Tex.App.2007), Ronald and Betty Pugh contracted with Westbrook building company to build their home. After discovering extensive water damage and mold due to defective construction, the Pughs sued the allegedly responsible subcontractor, General Terrazzo Supplies, for breach of the implied warranty of good and workmanlike service and habitability, among other causes of action. The Pughs did not have a contract with General Terrazzo.

The Texas Court of Appeals for the First District affirmed summary judgment for General Terrazzo on the ground that Texas does not recognize any implied warranties running from a subcontractor or supplier to a homeowner with whom it has no direct contractual relationship. (*Id*. at 89). The Court referenced numerous precedents, most notably *Raymond v. Rahme*, 78 S.W.3d 552, 563 (Tex.App.-Austin 2002), in which it was held that "because the property owner has recourse against general contractor with whom he contracted, 'there is no compelling public policy reason to impose an implied warranty against a subcontractor.'" (*Id*. at 90, citing *Raymond*, *supra* at 563.) The use of the word "recourse" harkens back to the Illinois' *Minton* opinion, however there is no appellate decision in Texas permitting suit against a subcontractor, absent privity of contract, on the ground there was no recourse against the prime contractor or developer.

Arizona also recognizes the necessity of contractual privity, though with two interesting exceptions. In *Yanni v. Tucker Plumbing, Inc*312 P.3d 1130. (Ariz. Ct. App. 2013), homeowners brought an action against plumbing subcontractor Tucker Plumbing, with whom the owners were not in contract. The court affirmed summary judgment for Tucker, noting that breach of implied warranty of habitability sounds in contract, and a contractual relationship is therefore necessary to proceed on the claim, at least against a subcontractor. (*Id*. at 1133.)

In reaching its decision, *Yanni* examined two important limitations to the general rule. First, notwithstanding the acknowledgement that breach of implied warranty is a contract-based cause of action, Arizona permits a purchaser of residential real property to proceed against a builder for breach of implied warranty of habitability, even absent privity of contract. (*Yanni*, *supra* at 1133, citing *Lofts at Fillmore Condo Ass'n v. Reliance Commercial Construction*, 190 P.3d 733 (Ariz. 2008).) The holding is based on the policy rationale that "[i]nnocent buyers of defectively constructed homes should not be denied redress on the implied warranty simply because of the form of the business deal chosen by the builder and vendor." (*Ibid*.)

Second, subsequent homebuyers, not in contract with the original builder, can also sue the builder for breach of implied warranty of habitability. This exception is based on the policy that latent defects are "just as catastrophic on a subsequent owner as on an original buyer" and "[b]ecause the builder-vendor is in a better position ... to prevent occurrence of major problems, the costs of poor workmanship should be his to bear." (*Yanni*, supra at 1133, citing *Richards v. Powercraft Homes, Inc*., 678 P.2d 427, 430 (Ariz. 1984).

In rejecting Yanni's argument that the exceptions should apply to claims against subcontractors, the Court noted that "there is a distinction between the creation of an implied warranty by virtue of construction of a structure and the contractual relationship required to assert its breach as a cause of action." (*Yanni*, *supra* at 1134.) The Court found that while an implied warranty "flows from the construction of a residence and applies to all of its individual components, the exceptions to the general privity requirement found in *Richards* and *Lofts* have never been extended to a homebuyer's claims against a builder's subcontractors." (*Ibid*.)

Finally, beginning with *Gilbert Financial Corp. v. Steelform Contracting Co*., 82 Cal.App.3d 65, 69, 145 Cal.Rptr. 448 (1978), California recognized a broad exception to the necessity of contractual privity in connection with a breach of implied warranty claim. In *Gilbert* the court permitted a claim by the owner against subcontractors on the ground that the owner was a third party beneficiary of the subcontractor's agreement with the general contractor. (*Id*. at pp. 69-70.) The court observed that the property owner was "the ultimate beneficiary" of the subcontractor's performance on the project because the labor and materials furnished by the subcontractor were specifically intended for use in constructing the owner's building. (*Id*. at p. 70.) *Gilbert* thus stands for the general proposition that a property owner may be an intended beneficiary of a contract between a general contractor and a subcontractor for services performed on the owner's property.

Conclusion

The states seem reluctant to expand the scope of the warranty of habitability in construction defect litigation. As a result, these claims, when asserted against subcontractors, including engineering and design professionals, may often be subject to challenge. Some jurisdictions like California, seem more willing to entertain this cause of action and it remains to be seen whether in the context of an uptick in construction warranty of habitability claims will be more frequently litigated.

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