DENVER
THE MILE HIGH CITY

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TO: Denver City Council

FROM: David W. Broadwell, Assistant City Attorney

RE: Draft of proposed construction defects ordinance

DATE: October 8, 2015

At the direction of Mayor Hancock, we have prepared for internal and external review and comment a draft of a proposed construction defects ordinance for the City and County of Denver. The text of the proposed ordinance is attached to this memorandum. Before filing, we will include detailed recitals to the ordinance more fully explaining the legislative intent of this measure and the public purposes it is intended to serve.

Discussion of the ordinance is scheduled for the Business Development Committee on **Tuesday October 27 at 10:30 a.m.** We certainly encourage all council members to attend the committee meeting to participate in the discussion of this important proposal.

Rationale for the proposed ordinance

Condominium construction in the Denver metropolitan area now comprises less than 4% of all new owner-occupied housing. As a landlocked city with no ability to annex, Denver has no choice but to grow "up" rather than "out" in order to accommodate new residential growth. Furthermore, with the build-out of FasTracks, Denver enjoys unprecedented opportunities to encourage transit-oriented development (TOD), particularly the clustering of housing opportunities near many of the rail stations that either exist or are planned for the city.

While high-rise apartment construction in Denver is booming, very little high-rise condominium construction is occurring. Denver officials believe that the dearth in condominium construction is a direct result of recent trends in construction defect litigation brought by some condominium homeowners associations against homebuilders. Simply put, the costs and risks associated with high-rise condominium projects have made the construction of these projects prohibitive, except at the very highest price point.

Thus, the availability and the affordability of condominiums in Denver has been dramatically impacted, and potential home buyers seeking to invest in a new home in Denver's urban environment (particularly in TOD areas), are left with few choices in the market place.

Legal context

In general, municipalities have a recognized legal interest in promoting diverse and affordable housing within their communities. Likewise, municipalities have a legitimate role in protecting the public health and safety through the enforcement of building codes governing new construction. However, traditionally the subject of construction defect claims has been governed entirely by state law. The legal relationship between buyers and sellers is addressed by a combination of state statutes and common law tort theories, including: the Colorado Construction Defect Action Reform Act (CDARA); the Colorado Common Interest Ownership Act (CIOA), the Colorado Consumer Protection Act, and common law tort and warranty theories such as the "implied warranty of habitability" that apples to the sale of any new dwelling unit in Colorado. Although the state adopted CDARA in 2001 to provide a detailed and comprehensive statutory framework for litigating construction defect claims, in fact homebuilders can be sued under a variety of statutory or common law theories.

The key to the legal viability of any municipal ordinance the subject of construction defects litigation is an approach that *complements*, and does not *conflict* with existing state laws that already govern the legal relationships between homebuilders and homebuyers. We believe the proposed ordinance passes this test.

Three proposed elements for the Denver ordinance

1. ***Limit the manner in which technical building code violations can be used in construction defects litigation***

There is a substantial body of case law in Colorado defining the circumstances under which the violation of a municipal ordinance can give rise to private civil liability. In general, the municipal legislative body can indicate whether a city law is intended to be enforceable exclusively by the city itself, or instead whether violations of the ordinance can also give rise to a private cause of action. Plaintiffs who sue homebuilders and design professionals sometimes use proof of local building code violations as a basis for their damage claims, even if the violation is technical in nature and has not been shown to have caused any tangible harm to anyone. In fact, plaintiffs sometimes essentially claim that homebuilders are subject to "strict liability" for violation of a building code, regardless of whether or not any proven intent or negligence was involved in the violation.

The proposed ordinance would restrict the manner in which Denver building codes may or may not be used to support private civil claims for damages in two distinct ways:

A. The ordinance would include a provision that mimics language in the CDARA—proof of a local building code violation can be used in a private civil action *only* if it is linked to actual property damage or injury or the risk thereof. But the ordinance would go a step further and apply this principle, not just to negligence claims arising under the CDARA, but also claims against homebuilders arising under *any* other statutory or common law theory. The ordinance would expressly disclaim that violation of a city code can ever support a claim for damages under a "strict liability" theory.

B. The ordinance would codify the principle that the City's current building codes represent the standard in Denver for safe and sound construction. Thus, if the improvements in a common interest community are constructed and maintained in compliance with Denver's regulatory codes in effect at the time improvements were constructed, the improvements cannot be said to be "defective" in a civil claim against the parties that designed or built the improvements.

2. *Support covenants that require alternative dispute resolution of construction defect claims*

On May 7, 2015 homebuilders won a very significant victory in the Colorado Court of Appeals in the case of *Vallagio at Inverness Residential Condominium Association, Inc. v. Metropolitan Homes, Inc.* This decision stands for the proposition that the original developer of a condominium project can structure the declaration of covenants in a way that permanently governs the procedures for any future construction defect claims, and prevents HOAs from amending or repealing the covenant without the consent of the original declarant. In this case the covenants required binding arbitration for any construction defect claims, and advised prospective condo purchasers that the developer's ability and willingness to build and market the project was absolutely based upon the homebuyer's acceptance of the binding arbitration requirement for construction defect claims.

The proposed Denver ordinance would institutionalize the *Vallagio* holding by saying that when a new common interest community is created in Denver, and the declaration of covenants clearly advises homebuyers of a requirement for binding arbitration of construction defect claims while stating that this requirement cannot be eliminated without the consent of the original declarant, then city law recognizes such as covenant as being binding and inviolate.

3. ***Require informed consent of a majority of condo owners before construction defect litigation.***

The proposed ordinance would include a requirement for "informed consent" by condo owners as a prerequisite before an HOA board could bring a construction defect claim, consisting of two elements: (1) Full notification to the owners about the consequences of bringing such a claim; and (2) a majority vote requirement for the owners of all the affected condos (not including any condo units that still may be owned by the original developer.) Other municipalities have included informed consent provisions as one component of their multi-faceted construction defects ordinances. A version of informed consent was also included in SB 15-177, which was adopted on a bi-partisan vote of 24-11 in the Colorado Senate this year (before being killed in the House).

A municipal ordinance focusing on the issue of informed consent has the advantage of balancing both developer interests and consumer interests because all condo owners in a particular project are affected (sometimes negatively) by construction defect litigation brought by their HOA board.

Chapter 10
Buildings and Building Regulations

Article XII: CONSTRUCTION DEFECT CLAIMS IN COMMON INTEREST COMMUNITIES

Sec. 10-201. Definitions.

As used in this article, the following terms shall have the following meaning:

(1) "Association" shall be defined as provided in the Colorado Common Interest Ownership Act, Article 33.5 of Title 38, C.R.S., as amended.

(2) "Common interest community" shall be defined as provided in the Colorado Common Interest Ownership Act, Article 33.5 of Title 38, C.R.S., as amended.

(3) "Construction defect claim" means a civil action or an arbitration proceeding for damages, indemnity, or contribution brought against a development party to assert a claim, counterclaim, cross-claim, or third-party claim for damages or loss to, or the loss of the use of, real or personal property or personal injury caused by a defect in the design or construction of an improvement to real property that is part of a common interest community.

(4) "Declarant" shall be defined as provided in the Colorado Common Interest Ownership Act, Article 33.5 of Title 38, C.R.S., as amended.

(5) "Declaration" shall be defined as provided in the Colorado Common Interest Ownership Act, Article 33.5 of Title 38, C.R.S., as amended.

(6) "Development party" means an architect, contractor, subcontractor, developer, declarant or affiliates of a declarant, builder, builder vendor, engineer, or inspector performing or furnishing the design, supervision, inspection, construction, or observation of the construction of any improvement to real property that is part of the common interest community or any other party responsible for any part of the design or construction of any portion of the common interest community, or any of such parties' affiliates, or the officers, directors, shareholders, members, managers, employers or servant of any of them.

(7) "Executive Board" shall be defined as provided in the Colorado Common Interest Ownership Act, Article 33.5 of Title 38, C.R.S., as amended.

(8) "Governing documents" means the declaration, articles of incorporation, bylaws, rules and regulations, policies and procedures of a common interest community.

(9) "Unit" shall be defined as provided in the Colorado Common Interest Ownership Act, Article 33.5 of Title 38, C.R.S., as amended.

(10) "Unit owner" shall be defined as provided in the Colorado Common Interest Ownership Act, Article 33.5 of Title 38, C.R.S., as amended.

Sec. 10-202. Relationship of city building codes to construction defect claims.

a. *In general.* A violation of any city building code as adopted in Article II of this Chapter 10,[1] or a failure to substantially comply with any such code shall not, in and of itself, create a private cause of action.[2] A violation of any city building code as adopted in Article II of this Chapter 10, or a failure to substantially comply with any such code may not be used to support or prove any construction defect claim, regardless of the statutory or common law theory under which the claim is asserted,[3] unless the violation or failure to substantially comply results in one or more of the following:

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[1] Article II adopts by reference the International Building Code, the International Energy Efficiency Code, the International Fire Code, the International Fuel Gas Code, the International Mechanical Code, the International Residential Code, the International Plumbing Code and the National Electric Code (all subject to various local amendments).

[2] "Whenever a claimant alleges that a statute, ordinance, or regulation implicitly creates a private right of action, the critical question is whether the legislature intended such a result. For this reason, we will not infer a private right of action based on a statutory violation unless a clear legislative intent to create such a private cause of action." *Gerrity Oil and Gas v. Magness,* 946 P.2d 913, 923 (Colo. 1997).

[3] The Colorado Construction Defect Action Reform Act, as originally adopted in 2001, purports to regulate the manner in which violations of local building codes may or may not be used to prove a construction defect claim, but the statute ***only*** refers to the manner in which code violations may be used in "***negligence***" actions asserted under CDARA itself. § 13-20-804, C.R.S. The four enumerated circumstances under which a code violation may be used in this proposed ordinance are identical to the language in CDARA. However, the proposed ordinance is intended to more broadly address the manner in which Denver's building codes may be used in ***any*** type of construction defect claim, *e.g.* claims for alleged breach of the common law warranty of habitability and claims arising under the Colorado Consumer Protection Act.

1. Actual damage to real or personal property;

2. Actual loss of the use of real or personal property;

3. Bodily injury or wrongful death; or

4. A risk of bodily injury or death to, or a threat to the life, health, or safety of, the occupants of residential real property.

b. *No strict liability for building code violations.* Under no circumstances shall a violation of any city building code as adopted in Article II of this Chapter 10, or a failure to substantially comply with any such code, support or prove a construction defect claim based upon a theory of strict liability,[4] or under the common law doctrine of negligence *per se*.[5]

c. *Code compliant improvements shall not be considered defective.* The building codes adopted in Article II of this Chapter 10 are intended to establish a minimum standard for safe and sound construction in Denver. Therefore, any particular element, feature, component or other detail of any improvement to real property that is specifically regulated under the city's codes and is constructed or installed and then maintained in substantial compliance with such codes shall not be

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[4] ***Strict liability*** is a form of legal liability that does not depend on actual negligence or intent to harm, but that is based on the breach of an absolute duty to make something safe. "The contractual responsibilities of a new home builder are implicit in the concept [of] 'implied warranty of habitability' and include the buyer's right to *both* a home that is built in a workmanlike manner *and* one that is suitable for habitation. Such an implied warranty has been likened to ***strict liability*** for construction defects, and proof of a defect due to improper construction, design, or preparations is sufficient to establish liability in the builder-vendor." *Hildebrand v. New Vistas Homes II, L.L.C.*, 252 P.3d 1159, 1169 (Colo. App. 2010). (Internal citations omitted.)

[5] "The underlying principle of the common law doctrine of ***negligence per se*** is that legislative enactments such as statutes and ordinances can prescribe the standard of conduct of a reasonable person such that a violation of the legislative enactment constitutes negligence. Thus, the doctrine serves to conclusively establish the defendant's breach of a legally cognizable duty owed to the plaintiff. A party may recover under a claim of ***negligence per se*** if it is established that the defendant violated the statutory standard and the violation was the proximate cause of the injuries sustained. However, the plaintiff must also show that he is a member of the class the statute was intended to protect, and that the injuries he suffered were of the kind the statute was enacted to prevent." *Lombard v. Colorado Outdoor Education Center, Inc.*, 187 P.3d 565, 573 (Colo. 2008). (internal citations omitted.) Colorado courts have been inconsistent on the question of whether or not the violation of a local building code supports a claim of ***negligence per se***. Compare: *Everson v. Solsbery*, 641 P.2d 314 (Colo. App. 1982) and *Aetna Casualty and Surety Co. v. Crissy Fowler Lumber Co.*, 687 P.2d 514 (Colo. App. 1984).

considered defective for purposes of proving any construction defect claim.

Sec. 10-203. Informed consent for construction defect claims associated with common interest communities.[6]

(a) *Additional information*[7] *required in notice to unit owners.* Before the executive board of a common interest community institutes any legal action involving a construction defect claim, the executive board shall include in the notice to unit owners required by §38.33.3-303.5, C.R.S. the following additional information to more fully advise the unit owners of the nature of the action and the relief sought, in substantially the following form:

(1) If the association does not file a claim by _____ (DATE), the claim cannot be filed at all under the applicable statute of limitations, statute of repose, or both.

(2) If the association prevails, the executive board expects that the association may recover from the defendant(s) an amount between $_____ and $_____.

(3) The executive board intends to enter into a contingency fee arrangement with the attorneys representing the association, under which, of the amount the association recovers from the defendant(s), the attorneys will be paid a contingency fee equal to _____ percent of the (net) (gross) recovery. The executive board estimates that, in addition to the attorney fees, the association will incur costs totaling approximately $ _____ for consultants, expert witnesses, depositions, filing fees, and other expenses of litigation.

(4) If the association makes a claim and does not win, the executive board expects that the association will have to pay for its own attorney fees, consultant fees, expert witness fees, and other costs

[6] This section is largely modeled after the informed consent provisions contained in the engrossed version of SB 15-177, which was approved by the Colorado Senate on a bipartisan vote (24 yes, 11 no) on April 14, 2015; but then assigned to and killed by the House State Affairs Committee on April 27, 2015.

[7] The existing state statute currently requires the notice to include only the following information in the notice to unit owners before the association "institutes an action asserting defects in the construction of five or more units": "(I) The nature of the action and the relief sought; and (II) The expenses and fees that the executive board anticipates will be incurred in prosecuting the action."

(the amount listed in paragraph 3, above)plus defendant's consultant fees, expert witness fess, and court costs.

(5) If the association does not recover from the defendant(s), it may have to pay to repair or replace the claimed defective construction work. In addition, the Association may have to pay the defendant's attorney fees.

(6) Until the claimed defective construction work is repaired or replaced, or until the construction defect claim is concluded, the market value of the affected units will be adversely affected.

(7) Until the claimed defective construction work is repaired or replaced, or until the claim is concluded, owners of the affected units will have difficulty refinancing and prospective buyers of the affected units will have difficulty obtaining financing. In addition, certain federal underwriting standards or regulations prevent refinancing or obtaining a new loan in projects where a construction defect is claimed. In addition, certain lenders as a matter of policy will not refinance or provide a new loan in projects where a construction defect is claimed.

(b) *Timing for delivery of notice to unit owners.* The notice to unit owners required by §38.33.3-303.5, C.R.S., including the additional information set forth in subsection (a) of this section, must be sent at least sixty days before service of the notice of a construction defect claim under the Colorado Construction Defect Action Reform Act, section 13-20-803.5, C.R.S.

(c) *Majority consent of unit owners required.* A construction defect claim is not authorized unless the executive board obtains the signed, written consent from owners, other than the declarant, of units to which at least a majority of the total votes, excluding votes allocated to units owned by the declarant, in the association are allocated, which written consent acknowledges that the owner has received the notice required under §38.33.3-303.5, C.R.S., including the additional information set forth in subsection (a) of this section, and approves of the executive board's proposed action.

(d) *Preservation of privileged information.* Nothing in this section shall be construed to:

(1) Require the disclosure in the notice or disclosure to a unit owner of attorney-client communications or other privileged communication.

(2) Permit the notice to serve as a basis for any person to assert the waiver of any applicable privilege or right of confidentiality resulting from, or to claim immunity in connection with, the disclosure of information in the notice.

(3) Limit or impair the authority of the executive board to contract for legal services, or limit or impair the ability to enforce such a contract for legal services.

Sec. 10-204. Enforcement of covenants requiring alternative dispute resolution for construction defect claims.[8]

Whenever a declaration in a common interest community requires any form of alternative dispute resolution for construction defect claims asserted by the association, by the executive board, or by any unit owners, and the declaration expressly prohibits any future amendment to the declaration that would modify or eliminate the requirement for alternative dispute resolution without the consent of the declarant, then any attempt to modify or eliminate the requirement for alternative dispute resolution by the association, by the executive board or by the unit owners absent the consent of the declarant shall be deemed ineffective, an abrogation of a contractual obligation, and void as against public policy. This section shall apply if and only if:

(1) The declaration and the purchase agreements executed with unit owners contains a provision substantially in the following form:

"The terms and provisions of Section ___ of the Declaration requiring alternative dispute resolution for construction defect claims inure to the benefit of Declarant, are enforceable by Declarant, and shall not ever be amended without the written consent of Declarant and without regard to whether Declarant owns any portion of the Real Estate at the time of such amendment. BY

[8] The provisions of this section are consistent with the holdings of the Colorado Court of Appeals in the cases of *Triple Crown at Observatory VIII Assn. v. Village Homes of Colorado, Inc.*, 328 P.3d 275 (Colo. App. 2013) and *Vallagio at Inverness Residential Condominium Association, Inc. v. Metropolitan Homes, Inc.*, 2015 WL 2342128 (Colo. App., May 7, 2015). The intent of this section is essentially to adopt as standing public policy in Denver the holdings in those cases.

TAKING TITLE TO A UNIT, EACH OWNER ACKNOWLEDGES AND AGREES THAT THE TERMS OF THE DECLARATION REQUIRING ALTERNATIVE DISPUTE RESOLUTION OF CONSTRUCTION DEFECT CLAIMS ARE A SIGNIFICANT INDUCEMENT TO THE DECLARANT'S WILLINGNESS TO DEVELOP AND SELL THE UNITS AND THAT IN THE ABSENCE OF THE ALTERNATIVE DISPUTE RESOLUTION PROVISIONS CONTAINED IN THE DECLARATION, DECLARANT WOULD HAVE BEEN UNABLE AND UNWILLING TO DEVELOP AND SELL THE UNITS FOR THE PRICES PAID BY THE ORIGINAL PURCHASERS."

and,

(2) The provisions of the declaration requiring alternative dispute resolution for construction defect claims inures to the benefit of other development parties in addition to the declarant; and

(3) The provisions of the declaration requiring alternative dispute resolution for construction defect claims are consistent with the requirements of the Colorado Uniform Arbitration Act, Part 2 of Article 22 of Title 13, C.R.S., including but not limited to the requirement that any mediatory or arbitrator selected to preside over a construction defect claim must be a neutral third party as required by §13-22-211 (2), C.R.S., and that the mediator or arbitrator shall make the disclosures required by § 13-22-212, C.R.S.[9]

Sec. 10-205. Effective Date.

This Article XII shall be effective January 1, 2016, and shall apply to any common interest community created in the city on and after that date.

[9] The Uniform Arbitration Act contains various disclosure requirements to ensure that an arbitrator or mediator is in fact impartial, has no relationships with any of the parties, and does not have a personal or financial interest in the outcome of the proceedings.