Construction Defect

Real property transactions in the United States have been governed by the principle of *caveat emptor* since at least 1817, when the Marshall Court incorporated this principle into its decision in *Laidlaw v. Organ*.

Caveat emptor means that it is incumbent upon the purchaser to research and inspect any defects within the property for sale and to make his offer commensurate with his knowledge of defects. Under this principle, the seller retains no liability for any defects after the date of purchase unless the seller has deliberately misrepresented the property or has committed other fraudulent action.

Beginning in the 1960s, however, a series of court decisions began to confer onto sellers a liability for latent defects after the time of sale. This evolving body of "construction defect law" was formalized most clearly in California, where, by the 1990s, litigating arguably defective construction had become a highly prevalent and lucrative occupation. The increasing rate of litigation has significantly impacted California's construction market, particularly for attached housing units – the most frequent target of litigators.[1]

California trial lawyers, facing dwindling opportunities for litigation in that state, began looking east to Nevada, hoping to create a new market for litigation by shepherding construction defect legislation through the state capitol.[2] In 1995, Nevada lawmakers acceded to their overtures, voting unanimously in favor of construction defect legislation that had been rewritten by lobbyists from the Nevada Trial Lawyers Association.[3]

Key Points

Construction-defect laws mean higher home prices. Nevada's construction-defect laws originally placed an asymmetrical liability for unknown defects on the seller of the home vis-à-vis the purchaser. It did this by – in a significant departure from all other sectors of Nevada civil law – guaranteeing attorneys unlimited "prelitigation" fees, whether or not the case ever went to court. Thus, while builders typically purchased insurance to safeguard against liabilities, many insurers refused to issue coverage in states with construction defect laws or did so only at exorbitantly high rates.[4] The result was that fewer affordable-housing units were built, with higher prices for those that were.

A significant share of Nevada construction-defect litigation may have been fraudulent. Because Chapter 40 of the Nevada Revised Statutes incentivized long-running "prelitigation" maneuvering, it fostered the corruption of Nevada's legal process. Builders and their insurers became prey for endless, highly lucrative tag-teaming between the plaintiff bar and their defense bar counterparts — before judges whose election campaigns were funded with contributions from both legal camps. Not coincidentally, the FBI has charged lawyers and other insiders with corrupt schemes to stack homeowners associations with board members who would agree to their representation in construction-defect lawsuits.[5] In many instances, these suits were filed on behalf of entire neighborhoods although many residents never knew their home was involved in a lawsuit that could cloud its title.

Reform legislation in 2015 enacted sweeping reforms. Many were reversed in 2019. Assembly Bill 125 narrowed the definition of a construction defect to items that present "an unreasonable risk of injury to a person or property" or that are "not completed in a good or workmanlike manner and proximately causes physical damage to the residence." AB 125 further removed the guarantee of legal fees for attorneys. In response to a series of exposed frauds and conspiracies, AB 125 barred homeowners' associations from initiating a construction-defect lawsuit, although this ability was partially restored in 2019. AB 125 also reduced the statute of limitations for filing claims from 10 years to six years after construction. This change was reversed in 2019. Additional changes in 2019 weakened the notice requirements to contractors and relieved plaintiffs from first exhausting claims under a homeowner warranty.[6]

Recommendations

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[1] Association of Bay Area Governments, "Service Matters: Issue No. 60," July/August 2002.

[2] Andrea Adelson, "Building is Booming and California Lawyers Are Massing on State Line," New York Times, 4 December 1996.

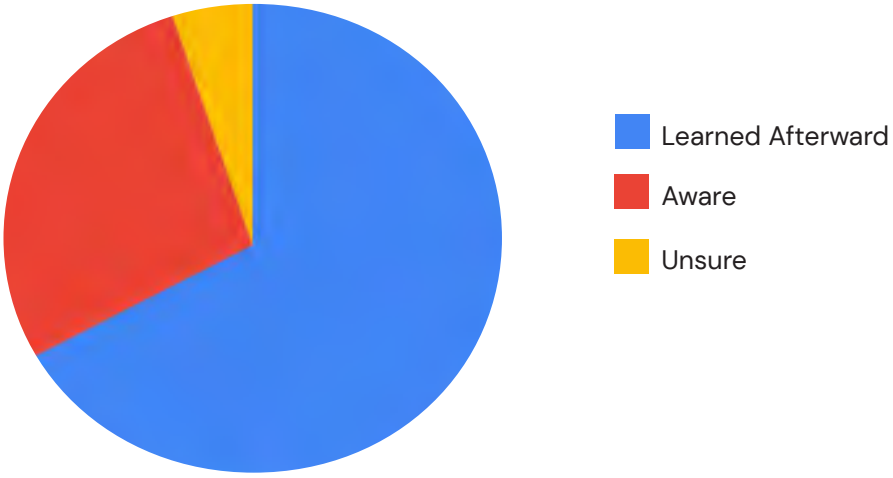
[3] Nevada Legislature, 68th Session, Senate Bill 395; also, Nevada Legislature, 68th Session, Minutes of the Senate Committee on Judiciary, 10 May 1995.

[4] California Legislature, California Research Bureau, "Construction Defect Litigation and the Condominium Market," CRB Note, Vol. 6, No. 7, 1999.

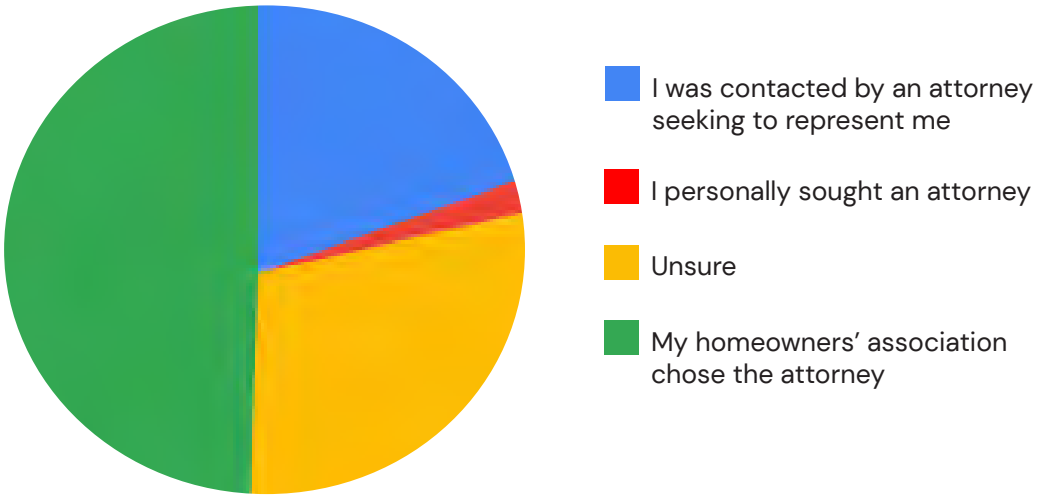
Prevent further erosion of 2015 reforms. AB 125 enacted the reforms previously outlined in this volume. Lawmakers should maintain them.

From January to February 2015, LUCE Research conducted a survey of Nevada homeowners whose homes had been involved in a construction-defect lawsuit. The survey indicates that a majority of these homeowners had gotten involved in these lawsuits without their knowledge and that their homeowners associations had initiated the lawsuit.

Survey Question: Were you aware of the construction-defect lawsuit involving your home before lawsuit was filed or did you learn about it aftweward?



Survey Question: Which of the following best describes how you came to be represented by a construction defect attorney?



Source: LUCE Research, Survey Conducted for Nevada Homebuilders Association, February 2015.

[5] Jeff German, "GOP Consultant Helped Rig HOA Elections in Plot," Las Vegas Review-Journal, 1 September 2011.
[6] Nevada Legislature, 78th Session, Assembly Bill 125; Nevada Legislature, 80th Session, Assembly Bill 421.