'HOW' SETTLES CONSUMER DISPUTES

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In 1974, the housing industry began to police itself by offering the new home buyer a waranty/insurance plan. This plan recognized the growing strength of the consumer movement and the movement's increasing demand for federal controls of the industry. Under the leadership of President George Martin, the National Association of Home Builders (NAHB) developed the Home Owners Warranty (HOW) program, the nations's first ten-year new home buyer protection plan.

As vice president of NAHB in 1972, Martin went to England to deliver a talk on housing trends in the United States. While there he discovered that builders were offering a ten-year warranty/insurance plan on ninety-nine percent of the new homes built in Great Britain. Martin also discovered that the National House Builders Registry Council, England's version of NAHB, administered the ten-year-old plan. When Martin returned home, he set the wheels in motion for the formation of a similar program in this country. Two years later, the United States had a warranty program of its own. NAHB formed the HOW program as a wholly owned subsidiary in 1973, and in August 1974, HOW enrolled its first home.

The HOW program is voluntary, based on the establishment of local HOW councils licensed by the national headquarters. Each council is

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responsible for screening each builder-applicant for his technical competence, financial stability, and integrity in dealing with his customers. Additionally, HOW councils must administer the program, including its dispute-settlement mechanism.

The progam has satisfied a real need and consequently has grown at an amazingly fast rate. After just over four years of operation, HOW covers more than 550,000 new homes through nearly 14,000 registered builders. The program is now available in forty-six states through 126 local HOW councils.

The HOW coverage is divided into warranty and insurance coverage during the ten-year period.

Warranty

First Year. The HOW builder warrants the home to be free from defects in workmanship and materials in compliance with the program's approved standards.

Second Year. The builder continues to warrant against major structural defects and against malfunctioning of the wiring, piping and ductwork in the electrical, plumbing and heating and cooling systems.

Insurance

First Two Years. The program's insurance carrier, INA Underwriters Insurance Company, an affiliate of INA, backs the builder's warranty if for any reason the builder fails to meet his obligations. In other words, the HOW warranty is an *insured* warranty.

Third through Tenth Years. The INA directly insures the home against major structural defects.

The HOW warranty/insurance plan comes with the home and stays with it for ten years regardless of how often ownership changes. The plan covers single-family homes and townhouses, as well as both high- and low-rise condominiums.

A new home is a complex product consisting of thousands of parts. As such, any defect in the home covered under the warranty may lead to a disagreement between buyer and builder. In anticipation of such problems, the HOW program includes a built-in dispute settlement system to help builders and their customers resolve disputes.

HOW's DISPUTE SETTLEMENT PROCESS

HOW uses a two-step dispute settlement program. The first step calls

for a voluntary conciliation. If an agreement is not reached, a more formal arbitration procedure is available to the homeowner.

During conciliation an impartial third party, usually an industry expert, reviews the alleged defects and helps the parties reach an agreement. The conciliator's role is that of a problem-solver, not embroiled in the emotional aspects of the conflict. He reviews the warranty coverage with the parties and assists them in understanding their respective obligations. Without power to order the parties to perform in any specific way, he must rely on persuasion and the parties' need to resolve their problems to reach an agreement.[1] Nearly eighty percent of all disputes submitted to conciliation in the HOW program in 1978 were resolved at that stage.[2]

Arbitration is a more formal decision-making mechanism traditionally used in labor and commercial disputes. HOW has incorporated a form of arbitration into its dispute-settlement mechanism to handle problems which cannot be resolved by the agreement of the parties. The arbitration hearing is administered by the American Arbitration Association (AAA). An arbitrator is selected by the association, and the disputing parties are given an opportunity to present their cases. The hearing is usually held at the warranted home, and the award is issued in writing through the association within a few weeks of the hearing date. HOW takes no role in the administration or the decision-making aspect of the arbitration mechanism once it has been referred to the AAA.[3]

CHARACTERISTICS OF HOW DISPUTES

It is important to understand a few general characteristics of the disputing parties. Buying a new home is the single largest consumer purchase most families will ever make. The transaction is far more complex than most other purchases and generally is a highly emotional experience.

The homebuilder, whether he builds ten homes per year or ten per month, faces difficult problems ranging from rising costs and material

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1. Home Owners Warranty Corporation, Conciliation: Its Process, Its Techniques 7 (1978) (Wash., D.C.).

2. Home Owners Warranty Corporation, Consolidated Conciliation and Arbitration Case Report 1-18 (Dec. 1, 1978) (Wash., D.C.) [hereinafter cited as Arbitration Case Report].

3. American Arbitraiton Assoc., 2 Expedited Home Construction Arbitration Rules (1978) (N.Y.) *See also* Home Owners Warranty Corp. Operations Manual, 57 Operations Bul. 1-3 (1979).

and labor shortages to poor weather. The daily pressures of operating a construction business can affect a builder's handling of a consumer problem. Although conflicts arising after the purchase of a new home are not inordinate as measured by the volume of HOW program enrollments and the number of filed demands for dispute settlement, they are compounded by the emotional involvement of the two parties.[4] The builder may consider himself a skilled craftsman, while simultaneously, the homeowner may expect a flawless home. In this highly charged atmosphere where values and egos conflict, a relatively minor problem can lead to an explosive situation.

The new home purchase is extremely different from other consumer purchases involving an appliance or an article of clothing. A new home is unique. There is no exact duplicate of any house built. While many so-called "spec" homes are quite similar, the very fact that they are constructed on different lots makes them slightly different in ways not always initially apparent to the purchaser. For this reason, buyers who look at a model and later find that the home they buy is a bit different may be dissatisfied for reasons having nothing to do with workmanship or suitability.[5]

One of the ways the new homeowner can identify defects is to go on a "walk-through" with his builder prior to closing and fill out the itemized "punch list." The builder usually agrees to correct the problems discussed within a specified time and sends service personnel out to make repairs. The homeowner, not realizing that he too has certain responsibilities, often calls on the builder to take care of what is really a maintenance matter, not a defect. To clear up this problem, HOW provides warranty and approved standards which outline the duties of each party.[6]

PROBLEM SOLVING, NEGOTIATION, DISPUTE SETTLEMENT AND LITIGATION

When a typical homeowner complaint is brought to the attention of a

4. Home Owners Warranty Corporation, Builder's & House Status Report 1-8 (Nov. 30, 1978) (Wash., D.C.). For a picture of disputes relative to enrollments when compared cumulatively, see Arbitration Case Reports, *supra* note 2, at 1-15.

5. Film, Home Owners Warranty Corporation, Haunting of Seven Dragon Avenue (1978) (Rudine-Wittman Production, Dallas).

6. Home Owners Warranty Corporation, Limited Warranty: Home Warranty Agreements 4 (June 1978) (Wash., D.C., HOW #104). *See also* Home Owners Warranty Corporation, Approved Standards 1-16 (March 1977) (Wash., D.C., HOW #15).

builder, his response may range from general apathy to intense concern. The nature of the builder's response may affect the homeowner's decision as to which forum he selects to pursue his problem.[7] The HOW program gives the homeowner a forum. The HOW council notifies the builder when a homeowner reports a complaint, asking him to take care of the problem and also requesting the homeowner to report any further difficulties in getting service.[8]

Should the problem go unresolved, the HOW council appoints a conciliator to go to the house and review the problem with both parties.[9] As a member of the HOW program, the builder is obligated to participate in conciliation and perform repairs agreed upon in good faith. Failure to do so may result in his termination from the program. [10] If, however, the parties are unable to reach an agreement, the HOW council will forward the case to the AAA.[11] At this point, for the first time, the parties forfeit control over how the problem will ultimately be resolved. The program is placed in the hands of an outsider who will decide the final resolution.

During this process the emphasis shifts from problem-solving (Will you fix the defect?) to negotiation (I'll fix the defect if you can wait for a crew to be free) to conciliation (Let's review both parties' positions) to arbitration (Does the warranty/contract cover this problem?). The focus of the issues becomes further removed from the *real problem* with each step of the process. Should the dispute escalate to the point where both

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7. Home Owners Warranty Corporation, Builder's & House Status Report 1-8 (Nov. 30, 1978) (Wash., D.C.); Arbitration Case Report, *supra* note 2, at 1-15. Also, the statistics are partially explained by the researach of the HOW staff which monitors homeowner explanations for filing for arbitration, conciliation and threatening and filing lawsuits against builders.

8. Home Owners' Warranty Corporation, Local Council Role in Complaint Handling During the Initial Warranty Period, *in* Operations Manual 2 (Wash., D.C. 1977) (Operations Bul. #54).

9. *Id.* at 1-2.

10. Home Owners Warranty Corporation, Agreement of Builder and Local Warranty Council 4, *in* #8 Documents Catalog Article VI(1)(a).

11. American Arbitration Association, 2 *Expedited Home Construction Arbitration Rules* (1978) (N.Y.). One rationale for the establishment of such rules is set forth by Soia Mentschikoff. *See* Mentschikoff, *Commercial Arbitration,* 61 COLUM. L. REV. 846 (1961), *reprinted in* M. BERNSTEIN, PRIVATE DISPUTE SETTLEMENT: CASES AND MATERIALS ON ARBITRATION 8-14 (1968). It is noteworthy that the generic explanation of this sort of arbitration system is long established and that restrictions imposed by the Magnuson-Moss Act affect not just the HOW program but have implications for commercial arbitration in general as suggested in another section of the paper.

parties have consulted attorneys, the issue before the courts might be the validity of the warranty agreement or the enforceability of the agreement to arbitrate. The homeowner might demand the retention of escrowed funds (an issue which might never have been raised except as a leverage device over the builder which the homeowner now believes is necessary to use).

The HOW program seeks to prevent builder/buyer disputes from escalating beyond the point where resolution can be expeditiously affected. When coverage is the issue, the local council can advise the builder as to what documents define his obligation so that he can make an intelligent assessment of his responsibilities. If the homeowner is not satisfied with builder response, he has recourse through conciliation wherein an expert can fully explain coverage and attempt to examine other issues which may really be at the source of the parties' difficulty. Where coverage or construction standards are subject to varied interpretations, perhaps then an arbitrator's judgment is the best *guidance* for the parties. If, however, there is a complex dispute of liability wherein the major issues extend beyond questions of warranty interpretation, and the real problem involves legal issues not contemplated under the limited warranty, perhaps the courts may be the proper forum for resolution once HOW procedures have been exhausted. It is important for both parties to make every effort to resolve those questions that come under the HOW warranty during the dispute settlement procedures prior to seeking final determination of other issues which may be beyond the scope of the program.[12]

A measure of the effectiveness of a dispute settlement system is its ability to dispose of most cases at the first step of the process. A properly functioning system should give the parties a chance to reach an agreement before formally beginning the procedure. It should then provide an opportunity for solving the problem at the administrative level and should provide for effective neutral intervention with quick and efficient procedures. The system should also include some option for final and binding dispute resolution such as arbitration. This type of provision encourages the parties to resolve the dispute on their own terms rather than on the arbitrator's, whose decisions may well raise as many questions as they resolve.

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12. Peters, *How the Magnuson-Moss Warranty Act Affects the Builder/Seller of New Housing*, 5 REAL EST. L.J. 338, 356 (1977).

FTC and Conciliation

The HOW program designed this unique two-step dispute settlement procedure before new Federal Trade Commission (FTC) rules and regulations[13] went into effect on new product warranties. Under provisions of the Magnuson-Moss Warranty-Federal Trade Commission Improvement Act,[14] the FTC regulates warranties on consumer products including many items that go into the construction of a new home. As of May 1, 1977, the HOW warranty complied with the FTC Rules and Regulations.

In designing its dispute settlement mechanism, HOW sought the advice of several of the most authoritative individuals and organizations in the dispute settlement field, including the AAA and the Federal Mediation and Conciliation Service. Since this work was done prior to the development of the FTC rules, the question arises whether these rules disregard much of the experience and insight which went into the creation of the HOW dispute settlement program in establishing a *non-binding, quasi-decision-making mechanism* and specific criteria for its operation.

As noted, the HOW program's first stage in dispute settlement is conciliation in which a neutral "third-party," a conciliator, acts as an "expediter" or "facilitator" of the negotiation process. While he may be an expert in the home construction business, he is more than a technical consultant. Often, he is able to open the lines of communication between buyer and builder by encouraging the parties to discuss their real concerns and avoid the emotionalism that often interferes with the problem-solving process.

The nature of the process is such that it should not be used unless a real problem exists in the primary relationship between the principals. It is not a substitute for problem-solving, discussion, negotiation and compromise; rather, it is a special tool to be selectively employed. For this reason, prior to the promulgation of the FTC rules, HOW required that a homeowner first make an effort to report any problem or complaint directly to the builder (warrantor) of the home. A twenty-five dollar deposit was required to deter frivolous claims to the local HOW council which were filed without an honest effort by both parties to resolve any problems which may not have been disputed questions.[15] Moreover, the

13. 16 C.F.R. § 703 (1978) (effective May 1, 1977).

14. 15 U.S.C. §§ 2301-2312 (1976).

15. Home Owners Warranty Corporation, Home Warranty Agreement 3 (1974) (HOW-11, Conciliation and Arbitration).

deposit would encourage a homeowner to review the terms of his coverage which is limited both in terms of time and scope. The deposit is similar to that of a court filing fee; it is *not* a means of funding the mechanism. Deposits were refunded to the homeowner upon a finding that the complaint had substantial merit and all deposits filed were returned to the homeowners under this procedure.

After May 1, 1977, when the FTC Rules and Regulations became effective for the homebuilding industry, the refundable deposit and the notification of builder requirements were eliminated as required by the FTC.[16]

This change has had a substantial impact on the HOW caseload. Many "conciliations" are really no more than customer service calls instead of real dispute resolution meetings. Many cases involve problems where there is no dispute over nature, cause, remedy or responsibility. Nevertheless, once reported to HOW, such problems must be treated as disputes rather than merely problems.[17] Thus, a bathtub leak which could be repaired with a bit of caulking by a service employee, now becomes a warranty claim and must be processed in keeping with FTC rules.

To fully understand the impact of the Magnuson-Moss Act on the conciliation mechanism, one must understand that the "conciliation" process described earlier is severely restricted under the FTC rules. Only by special exemption is HOW able to continue to operate any process of non-decision-making dispute settlement. The FTC rules require that all disputes referred to the mechanism be resolved within forty days or that the mechanism reach a decision as to the proper disposition of the claim at that time.[18]

Under a temporary and limited exemption, HOW is allowed to operate its conciliation process up to twenty days before a complaint must be submitted to the "informal dispute settlement mechanism," such as arbitration.[19] Therefore, the most effective dispute settlement tool available to homebuyers and builders is now limited to its effectiveness as a result of the FTC rules which have failed to take into full account the

16. Home Owners Warranty Corporation, Limited Warranty, Home Warranty Agreement 6 (1977, rev. June, 1978) (HOW-104).

17. 16 C.F.R. § 703.5(j) (1978) Informal Dispute Settlement Mechanisms. (HOW-104).

18. *Id.*

19. Letter from Robert J. Cox, Acting Secretary of FTC to Richard J. Canavan, Home Owners Warranty Corporation (April 28, 1978).

experience of dispute settlement agencies such as the AAA.[20] Instead, they have:

(1) Eliminated deposits[21]
(2) Eliminated the requirement that the homeowner seek redress direct from the builder.[22]
(3) Limited the operating time for the disposition of complex cases to forty days including time for administration by the mechanism (AAA) as well as local council.[23]

Dispute settlement systems in the builder-buyer relationship are the result of a long and difficult search for the best means of obtaining consumer justice when resolving new home construction disputes. The role of the FTC in bringing about the impetus for the adoption of such systems in various areas of consumer-producer conflict no doubt will be expanded in the future. Whether this is a desirable outcome depends upon the perspective of the observer, but it is certain that in the housing field the effectiveness and duration of any mechanism regulated by the Commission will depend on the motivation and ability of the private and public sector to cooperate for the "public interest," in the most broadly defined meaning of that phrase.

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20. Gerald Aksen, General Counsel AAA, testifying before the FTC provided extensive background and procedural information dealing with dispute settlement systems and practice.

21. 16 C.F.R. § 703.3(a) (1978).

22. *Id.* § 703.5(e) (2).

23. *Id.* § 703.5(d).