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PROTECTION FOR THE PURCHASER AGAINST DEFECTS IN USED HOUSING: THE EMERGING HOME INSPECTION PROFESSION

By RICHARD J. NIXON*

I. INTRODUCTION

Buying a house is often the largest purchase that an individual makes. Nevertheless, house buyers frequently discover defects only after their purchase. Unfortunately, most are unable to avoid bearing the cost and nuisance of correcting these defects themselves.

The first part of this paper will outline the difficulties confronting used house buyers attempting to discover physical defects prior to purchase. The second part will summarize the unsatisfactory state of the law in this context and the drawbacks surrounding litigation-based remedies. The strengths and weaknesses of various proposals that have been suggested to relieve disappointed used house buyers, will be identified in part three. The emerging Canadian home inspection profession will be profiled in part four. And the final part will identify the problems confronting this new profession and evaluate the merits of various regulatory schemes designed to address them.

The problem of physical defects in new houses will not be addressed in this paper for several reasons. First, the problem has already been the subject of considerable discussion by various organizations.¹ Moreover, *The Building Code Act*² ensures that minimum standards for new house construction are met and *The Ontario New Homes Warranties Plan Act*³ provides new home purchasers with a measure of statutory protection generally unavailable to purchasers of used homes. Finally, the problem is of relatively less concern because individuals are more likely to purchase used houses than new houses.⁴

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* Mr. Nixon is a member of the Ontario bar. The author would like to acknowledge the helpful advice of Professor Barry Reiter in the course of preparing this article.

¹See Ont., *Report of the Ontario Law Reform Commission the Trade Sale of New Homes* (Toronto: Dept. of A.G., 1968) [Hereinafter *Report of the Ontario Law Reform Commission*]; cf. The Housing and Urban Development Association, Central Mortgage and Housing, and Department of Consumer and Corporate Affairs, *Interim Report on Consumer Protection For New Home Buyers*, Sept. 1, 1972; cf. English Law Commission, *Third Annual Report 1967-1968*, July 22, 1968, item VII.

² R.S.O. 1980, c. 26.

³ R.S.O. 1980, c. 350.

⁴ For example, there was a total of 23,466 houses sold through the Multiple Listing Service of the Toronto Real Estate Board in 1979. Of these, 506 were new houses. See *House Price Trends and Residential Construction Costs in The Toronto Real Estate Board Market Area And In Canada* published by the Toronto Real Estate Board, 1980 at 19 and 30.

II. THE DIFFICULTIES FACED BY PROSPECTIVE USED HOUSE PURCHASERS

Absent a vendor's fraud, express representations, promises or warranties, most used house purchasers realize that they are assuming the risk of physical defects that they could have discovered prior to their purchase. However, few purchasers ask vendors for warranties or promises. Most fail to think about obtaining them while others do not appreciate the legal protection that they could provide. Moreover, since most purchasers do not consult a lawyer prior to signing an agreement of purchase and sale, few are advised to try to extract warranties from the vendor.

Faced with this situation, prospective purchasers might be expected to examine thoroughly the used house which they are considering purchasing since most would concede that a comprehensive inspection could conceivably uncover thousands of dollars of hidden repairs and maintenance expenses. Few, however, make more than a cursory examination.⁵ Many seem prepared to rely on the satisfactory appearance or young age of a house, realizing that they lack the time, knowledge, skills, experience and equipment to detect more than obvious defects. Others may feel awkward and uncomfortable inspecting a house in the presence of the vendor. Some buyers may be too distracted by other concerns related to their purchase such as mortgage financing, moving or renovating. Others may focus on the aesthetic aspects of the house and ignore the less interesting components such as its heating, plumbing and electrical systems. Still others may rely on their real estate agent's opinion of the house, failing to recognize that he may be unqualified to make a proper evaluation, or has a conflict of interest. In summary, the result is that many used house purchasers discover physical defects only after their purchase.

III. THE EXTENT OF A PURCHASER'S PROTECTION AT COMMON LAW AGAINST PHYSICAL DEFECTS IN USED HOUSING

Upon discovering a physical defect in a used house after purchase, a buyer finds himself in an unenviable position. He cannot rely on a statutory warranty and insurance scheme.⁶ Instead, he must fall back on his rights at common law which are unclear and unsatisfactory.

Disappointed house buyers must overcome the hurdle of *caveat emptor*, which literally means "let the buyer beware".⁷ Strictly applied, this maxim

⁵ It has been estimated that most used house buyers spend an average of 25 minutes going through a house before making an offer. See Roseman, "No warranty for workmanship on old homes," *The Globe & Mail* (Toronto), March 15, 1976 at 5 col. 1; cf. Guinan, "Let's take the gamble out of buying a house," *Quest Magazine*, Nov. 1975.

⁶ In contrast, the purchaser of a new house in Ontario may be able to rely on *The Ontario New Home Warranties Plan Act*, *supra* note 3.

⁷ *Black's Law Dictionary* (5th ed. St. Paul: West Publishing, 1979) at 202. The roots of this Latin maxim stretch back to the turn of the seventeenth century. See *Report of the Ontario Law Reform Commission*, *supra* note 1, at 6; cf. Hamilton, *The Ancient Maxim Caveat Emptor* (1931), 40 *Yale L.J.* 1133.

means that absent an express warranty, fraud or mistake, the buyer assumes all the risks of physical defects in the house.⁸ It is said that no warranties will be implied and that vendors are not under any duty to disclose to purchasers the presence of physical defects.⁹

The *caveat emptor* principle is most significant in the context of patent defects.¹⁰ These are defects that could be discovered by inspection and ordinary vigilance on the part of a purchaser.¹¹ In contrast, latent defects are such as would not be revealed by any inquiry which a purchaser is in a position to make before entering into a contract.¹² It has been stated that unless a purchaser complaining of a latent defect proves fraud or breach of warranty, he has no remedy.¹³ Because of the difficulty of classifying patent and latent defects, the usefulness of the distinction must be questioned.¹⁴ A purchaser can never be certain that a court will not dismiss his claim by categorizing the defect as patent.

Yet numerous courts, while paying lip service to the *caveat emptor* principle, have allowed purchasers to recover damages for physical defects discovered after purchase. For example, the principle can often be overcome if express promises, warranties and representations have been made by the vendor, except in cases where the defect was patent.¹⁵ To obtain relief, home buyers

⁸ *Report of the Ontario Law Reform Commission, supra* note 1, at 5.

⁹ Reiter and Risk, *Real Estate Law* (Toronto: Emond-Montgomery, 1979) at 264. It is interesting to contrast the vigour of the *caveat emptor* principle as it relates to realty, with its demise in the context of personality after the passage in 1893 of *An Act for codifying the Law relating to the Sale of Goods*, 56 & 57 Vict. c. 71 in England and its subsequent adoption in Canada as *An Act for codifying the Law relating to the Sale of Goods*, S.O. 1920, c. 40; now *The Sale of Goods Act*, R.S.O. 1980, c. 462. For a discussion of this point, see *Report of the Ontario Law Reform Commission, supra* note 1, at 7. It is also interesting to examine the strength of the *caveat emptor* principle in respect of new houses. For an American perspective, see Bearman, *Caveat Emptor In Sales of Realty—Recent Assaults Upon The Rule* (1960-61), 14 *Vanderbilt L. Rev.* 541.

¹⁰ *Id.*

¹¹ *McCallum v. Dean*, [1956] O.W.N. 873 (C.A.); cf. *Halsbury's Laws of England* (3d ed.), Vol. 34 at 211, ¶ 353; cf. Reiter and Risk, *supra* note 9, at 264.

¹² *Halsbury's Laws of England, supra* note 11.

¹³ *Scott-Polson v. Hope* (1958), 14 D.L.R. (2d) 333, 25 W.W.R. 427 (B.C.S.C.).

¹⁴ By what standard is a defect to be judged patent or latent? The Ontario Law Reform Commission noted (see *supra* note 1, at 10) that an inspection by an ordinary purchaser is unlikely to reveal more than the most patent of defects, and that there may be important defects which a casual inspection, even by a trained person, might not reasonably be expected to reveal.

¹⁵ For example, in *In Re Puckett And Smith's Contract*, [1902] 2 Ch. 258, 71 L.J. Ch. 666, 87 L.T. 189, the vendors innocently described a property as suitable for development and knew that the purchasers were relying on this description. Unfortunately, a culvert ran across the land which the court held the purchaser could not have discovered through reasonable inquiry and inspection. The court decided that the misdescription was material and substantial and permitted the purchasers to rescind their agreement. Similarly, in *Carlish v. Salt*, [1906] 1 Ch. 335, 75 L.J. Ch. 175, 94 L.T. 58, the vendors did not disclose that they had been given notice that they would have to pay a share of the cost of repairing a party wall. The court held that the purchaser's deposit should be returned. The court found that the notice was of a material defect

face several difficulties. They must rebut the argument that the vendor's express warranty merged with the passing of the deed and therefore did not survive closing.¹⁶ In addition, if the express promise, warranty or representation has not been reduced to writing, it may be difficult to prove in light of the parol evidence rule¹⁷ and the *Statute of Frauds*.¹⁸ Many courts have also held that absent a written contract, statements made by the vendor at the time of sale are "mere puffery", devoid of legal consequence.¹⁹ As well, some purchasers may be unable to prove that they relied on the representations of the vendor.²⁰ Finally, purchasers must overcome standard clauses in their agreements of purchase and sale which provide that the written agreement constitutes the entire agreement between the parties and that there is no representation, warranty, collateral agreement or condition other than as expressed therein.²¹ In short, a vendor can potentially argue several defenses any one of which, if successful, can bar a purchaser from recovery.

exclusively within the vendor's knowledge and which the purchaser could not have been expected to discover for himself with ordinary care. In contrast, in *Jackson v. Pearldale Ltd.* (1962), 47 M.P.R. 257 (N.S.S.C.) a purchaser's action for the return of money paid for an option on certain property was dismissed despite the fact that he was unaware that a culvert ran across the property on which he intended to construct a bowling alley. There, however, the court found the culvert to have been patent. Moreover, the purchaser had not informed the vendor of his intended use of the property. Finally, in *Hauck v. Dixon* (1976), 10 O.R. (2d) 605, 64 D.L.R. (3d) 201 (H. Ct.) a vendor agreed to sell a property to the plaintiff that contained three rented apartment units. Both the vendor and the purchaser thought that the building could be used as a triplex. However, after the transaction closed, the plaintiff discovered that the applicable zoning permitted only a duplex. The judge held that the purchaser's suit for damages failed because the vendor believed the building could be used as a triplex. Cf. *Flight v. Booth* (1834), 1 Bing. N.C. 370; *Lash v. Miller*, [1956] O.W.N. 758, 5 D.L.R. (2d) 469 (H. Ct.); *In re Belcham And Gawley's Contract*, [1930] 1 Ch. 56, 99 L.J. Ch. 37, 142 L.T. 182; Laskin, "Defects Of Title And Quality: Caveat Emptor And The Vendor's Duty of Disclosure," [1960] *Law Society of Upper Canada Special Lectures* (Toronto: De Boo, 1960) 389 at 404.

¹⁶*Redican v. Nesbitt*, [1924] S.C.R. 135, [1924] 1 W.W.R. 305, [1924] 1 D.L.R. 536; *Lawrence v. Cassel*, [1930] 2 K.B. 83, 99 L.J.K.B. 525 (C.A.); *Croft v. Prendergast*, [1949] O.R. 282, [1949] O.W.N. 248 (C.A.); *Richview Construction Co. v. Raspa* (1975), 11 O.R. (2d) 377, 66 D.L.R. (3d) 193 (C.A.); *Knight Sugar Co. v. Alberta Railway & Irrigation Co.*, [1938] 1 W.W.R. 234, [1938] 1 D.L.R. 321, [1938] 1 All E.R. 266 (P.C.); *Inter-Canadian Consulting Co. v. Martin May General Contractor Ltd.* (1979), 9 R.P.R. 161 (H. Ct.).

Fortunately, this potential bar to recovery has been severely weakened by the Supreme Court of Canada decision in *Fraser-Reid v. Droumtsekas*, [1980] 1 S.C.R. 720 at 738, 103 D.L.R. (3d) 385 at 392, 9 R.P.R. 121 at 143 where it was held that there is no presumption of merger.

¹⁷Jaeger, ed., 4 *Williston On Contracts* (3rd ed. Mount Kisco, N.Y.: Baker, Voohris and Co., 1961) ¶ 631.

¹⁸*The Statute of Frauds*, R.S.O. 1980, c. 481.

¹⁹Laskin, *supra* note 15, at 404.

²⁰In order for a purchaser to succeed, he must prove that he relied on the representations. See *Hedley Byrne & Co. v. Heller & Partners, Ltd.*, [1964] A.C. 465, [1963] 2 All E.R. 575, [1963] 3 W.L.R. 101 (H.L.); *Esso Petroleum Co. v. Mardon*, [1976] Q.B. 801, [1976] 2 All E.R. 5, [1976] 2 W.L.R. 583 (C.A.).

²¹Reiter and Risk, *supra* note 9, at 8 (clause 21); cf. *Alesio v. Jovica*, [1974] 2 W.W.R. 126, 42 D.L.R. (3d) 242 (Alta. C.A.).

The courts have been unwilling to imply warranties in the context of the sale of used houses.²² In fact, the Supreme Court of Canada has recently rejected the notion that warranties could be implied to protect purchasers of newly-completed houses.²³ *A fortiori*, the court would not be willing to imply warranties in the case of used houses.²⁴

Other courts have circumvented the *caveat emptor* principle by holding the vendor guilty of fraud.²⁵ Fraud necessitates a finding that the vendor intentionally perverted the truth for the purpose of inducing the purchaser to buy his house.²⁶ The courts, however, have been reluctant to hold a vendor guilty of fraud where he is unaware of the physical defect or has made no active effort to transform an otherwise patent defect into a latent defect.²⁷

The difficulty in interpreting these cases is exacerbated by the courts' failure to articulate the reasons underlying their decisions although several factors influencing their findings can be detected. To the extent that the physical defect could not have been discovered by a reasonable inspection, the courts seem more sympathetic to the plight of the purchaser.²⁸ The question of whether the vendor actually knew of the defect also appears to be fairly important.²⁹ If the vendor intentionally or negligently misrepresented

²² For an interesting discussion of this topic see Haskell, *The Case For An Implied Warranty Of Quality In Sales Of Real Property* (1965), 53 Georgetown L.J. 633.

For example, in *Scott-Polson*, *supra* note 13, at 335 (D.L.R.), 430 (W.W.R.) the Supreme Court of British Columbia stated that "the law appears to be clear that there is no implied warranty that a residential property is fit for human habitation.

²³ *Fraser-Reid v. Droumsekas*, *supra* note 16, at 723 (S.C.R.), 386 (D.L.R.), 129 (R.P.R.).

²⁴ For an interesting paper proposing a cause of action for breach of an implied warranty of quality in the sale of used houses, see Haskell, *supra* note 22.

²⁵ *Obde v. Schlemeyer* (1960), 56 Wash. (2d) 449, 353 P. (2d) 672, (S.Ct. Wash.).

²⁶ *Black's Law Dictionary*, *supra* note 7, at 594-95.

For example, in *Gronau v. Schlamp Investments Ltd.* (1975), 52 D.L.R. (3d) 631, [1975] W.W.R. 47 (Q.B. Man.) a vendor decided to patch a serious structural crack rather than to repair it permanently. Shortly afterwards, he listed the structure for sale. The Court held that the active concealment by the vendor of a defect which would otherwise have been patent was fraudulent. The court also found that the concealment of the crack amounted to a material misrepresentation and that the purchaser was entitled to rescission.

Similarly, in *Obde v. Schlemeyer*, *supra* note 25, the court decided that where the vendors knew of widespread termite infestation and proceeded to conceal the condition from the purchasers, the vendors were guilty of fraudulent concealment. *Cf. Allen v. McCutcheon* (1979), 10 B.C.L.R. 149, 9 R.P.R. 191 (B.C.S.C.).

²⁷ For example, in *Hughes v. Stusser* (1966), 68 Wash. (2d) 707, 415 P. 2d 89 (S.Ct. Wash.) a purchaser's claim for rescission and damages was dismissed when the court held that the vendor was unaware of the latent defect.

Similarly, in *Swinton v. Whitinsville Savings Bank* (1942), 311 Mass. 677, 42 N.E. (3d) 808 (S.Ct. Mass.) the court held that fraudulent concealment, in the sense of a vendor's failure to reveal a non-apparent defect to a purchaser, could not form the basis of a successful claim for damages. *Cf. supra* note 13.

²⁸ Reiter and Risk, *supra* note 9, at 264.

²⁹ *Supra* note 15.

the property, the courts are more inclined to compensate the purchaser.³⁰ That the vendor concealed an otherwise patent defect, as opposed to mere non-disclosure of a latent defect, also seems to weigh heavily on the courts' conscience.³¹ They also appear to be influenced by the extent of the vendor's unjust enrichment if allowed to exact the full purchase price when the purchaser is being asked to accept less than he expected.³² Furthermore, if the vendor knew of the purchaser's expectations and of his reliance on the representations, the courts seem more willing to grant relief.³³ Finally, the extent of the purchaser's disappointment may persuade the court to grant relief for mistake, recognizing that the purchaser bought something substantially different from what he had bargained for.³⁴

The courts have stopped short of holding that vendors owe a duty to disclose physical defects of which they are aware. Yet the vendor is the person most likely to know of any physical defects in a house because he has been responsible for its repairs and maintenance and often has been its most recent occupant. It would seem more efficient to require the vendor to disclose defects rather than to force a purchaser to seek them out for himself. Absent a duty to disclose, a vendor appears to have little incentive to reveal defects to a purchaser.³⁵ Even with such a duty, it would be difficult to prove what the vendor actually knew or should have been aware of.

A disappointed purchaser can try to obtain relief from parties other than the vendor. Local governments may be held liable for damage that could have been prevented but for the negligent omissions of their building inspectors.³⁶ Real estate agents may also be held liable for innocent, negligent or fraudulent misrepresentations that the purchaser has relied upon to his detriment.³⁷

Apart from the confusing and unsatisfactory state of the common law, disappointed purchasers are bedevilled with litigation-related problems.

³⁰ *Id.*

³¹ The logic underlying this distinction is difficult to appreciate. In both cases, the vendor will be unjustly enriched. One possible explanation is that if a vendor takes active steps to conceal a patent defect, this is conclusive evidence of his awareness of the defect.

³² This is particularly true in instances where the vendor himself received an adjustment in the price he paid upon learning of the physical defect at the time he purchased. For an example of this set of facts, see *supra* note 25.

³³ *Supra* note 15.

³⁴ Reiter and Risk, *supra* note 9, at 280.

³⁵ Trebilcock, "An Economic Approach to the Doctrine of Unconscionability," in Reiter and Swan, eds., *Studies in Contract Law* (Toronto: Butterworths, 1980) 379 at 408 *et seq.*

³⁶ *Dutton v. Bognor Regis Urban District Council*, [1972] 2 W.L.R. 299, [1972] 1 All E.R. 462 (C.A.); *Anns v. London Borough of Merton*, [1977] 2 All E.R. 492, [1977] 2 W.L.R. 1024 (H.L.).

³⁷ *Komarniski v. Marien*, [1979] 4 W.W.R. 267, 100 D.L.R. (3d) 81, 8 R.P.R. 229 (Sask. Q.B.); *Charter-York Ltd. v. Hurst* (1978), 2 R.P.R. 272 (Ont. H. Ct.); *Enns v. Panju*, [1978] 5 W.W.R. 244, 5 R.P.R. 248 (B.C.S.C.); *Bango v. Holt* (1971), 21 D.L.R. (3d) 66 (B.C.S.C.).

Many purchasers may be unaware of their legal rights.³⁸ Few are likely to carry their dispute to court because litigation is time-consuming and expensive³⁹ and the chances of ultimate success are by no means assured. Vendors may be impossible to locate or may have left the jurisdiction. Moreover, the courts' decisions may be inconsistent and, as a result, unpredictable because of their limited resources and lack of expertise.⁴⁰ Finally, the courts may deny a purchaser's claim for rescission and instead award damages once a transaction has closed and the vendor and purchaser have moved.⁴¹

In summary, a used house buyer has no clear right to relief for physical defects discovered after purchase, given the confusing and unsatisfactory state of the common law. His predicament is exacerbated by the institutional problems inherent in pursuing relief through litigation. In this light, it should not be surprising that many disappointed purchasers do not exercise their legal rights. They either learn to live with the physical defect or they pay the cost of rectifying it themselves.

IV. A REVIEW OF VARIOUS PROPOSALS FOR THE PROTECTION OF USED HOUSE PURCHASERS

The frequency with which used house purchasers discover defects after purchase is difficult to estimate. The reported cases and the academic writing canvassing the subject suggest that the problem is of considerable magnitude.⁴² In light of the vague and unsettled state of the law and the pitfalls associated with litigation-based remedies, various schemes designed to protect used house buyers have been proposed. These proposals include:

1. Enacting legislation requiring vendors of used houses to offer warranties;
2. Encouraging used house purchasers to buy private insurance to cover the risk of physical defects discovered after purchase;
3. Imposing a duty on vendors to disclose physical defects to purchasers;
4. Requiring mandatory government certification of used houses prior to sale; and
5. Encouraging used house buyers to retain the services of private home inspection firms.

The strengths and weaknesses of these proposals and reactions to them are discussed and summarized below.

³⁸ Belobaba, "The Resolution of Common Law Contract Doctrinal Problems Through Legislative and Administrative Intervention," in Reiter and Swan, *supra* note 35, 423 at 443.

³⁹ *Id.*

⁴⁰ *Id.* at 446.

⁴¹ Alternatively, a disappointed purchaser may reluctantly conclude that rescission no longer represents a practical remedy for him either, after taking possession of and moving into his new house.

⁴² See discussion under Part II, *supra*.

A. *Used House Warranties*

Several proposals have called for used house warranty programmes.⁴³ Many have been patterned after and have been designed to operate in conjunction with warranty schemes covering new houses.⁴⁴ Under such proposals, legislation would be passed forcing vendors to offer warranties on various systems in, and components of, the used house. Typically, warranties on the heating, plumbing and electrical systems of the house as well as its roof and structure, would be deemed by legislation to be extended by the vendor to the purchaser. If a breach of the warranty occurred, the purchaser would be entitled to sue the vendor. Various consumer spokespersons have expressed their support for these proposals.⁴⁵

Most used house warranty proposals have faltered when confronted by the following questions. Should vendors be exposed to such large potential liability? Over what period of time should the warranty remain in force? Should a vendor be forced to make repairs to a house which he knows will not meet the warranty standard before being permitted to sell it? On which components of a used house should a warranty be required? Would the government assume the cost of the warranty if the vendor could not be located, was bankrupt, or was dead? Should vendors be held liable for physical defects of which they were unaware at the time of sale?

A used house warranty programme may suffer from more fundamental weaknesses. Such proposals often require complicated legislation.⁴⁶ In addition, yet another expensive government bureaucracy might be created to supervise the scheme and to adjudicate disputes.⁴⁷ Purchasers would still face the institutional problems associated with litigation-based remedies.⁴⁸ Finally, governments, real estate agents and the public often do not want such schemes.⁴⁹ Because of these weaknesses no legislation requiring vendors to offer warranties presently exists anywhere in Canada.

B. *Private Insurance*

Private optional insurance schemes covering the risk of physical defects discovered after purchase have been proposed as a method of providing addi-

⁴³ Rafe, Mair, Minister, Consumer and Corporate Affairs, Gov't of B.C., in a speech delivered at the 1977 annual conference of the British Columbia Real Estate Association, as reported in the *Canadian Real Estate Reporter*, July 1977 at 1, *cf.* statement of Sidney Handelman, Minister, Consumer and Commercial Relations, Gov't of Ontario as reported by Roseman, *supra* note 5 at 5, col. 2; *cf.* comments of Blair Jackson, Canadian Real Estate Association, as reported by Stead "Warranty plan for buyers of older houses is rejected," *The Globe & Mail* (Toronto) January 24, 1979 at 5, cols. 2-3.

⁴⁴ For example, the Housing and Urban Development Association of Canada's ("HUDAC") New Home Warranty Program; *cf. supra* note 3.

⁴⁵ For example, Roseman, *supra* note 5, at 5, cols. 1-4.

⁴⁶ Stead, *supra* note 43.

⁴⁷ *Id.* at col. 3.

⁴⁸ See text accompanying notes 38-40, *supra*.

⁴⁹ Stead, *supra* note 43, at 5, col. 2.

tional protection to used house buyers.⁵⁰ In essence, these schemes simply proceed one step further than warranties by transferring such risk from the vendor of the used house to an insurance company. A warranty buttressed by insurance gives the warranty itself more security and credibility.

In theory, either the vendor or purchaser of a used house could purchase the insurance. One plan, entitled "Major Repair Insurance", envisages the vendor arranging for the insurance before he lists his house for sale.⁵¹ Prior to writing a policy, the insurance company requires the vendor and the listing real estate agent to sign a statement describing the apparent condition of the house and its appliances.⁵² Structural defects, breakdowns in the heating, plumbing and electrical systems, malfunctioning household appliances and other major unforeseen repair and replacement costs are covered during the first twelve months after the purchase date.⁵³ Houses having a value of up to \$750,000 can be insured, but coverage is limited to 50% of the sale price or \$50,000, whichever is less.⁵⁴ Policy premiums cost one tenth of one percent of the selling price, with a \$150 minimum fee on a one or two family house.⁵⁵ Payments under the plan are subject to a \$100 deductible clause.⁵⁶

At first glance, one might expect that such insurance would be a valuable selling tool for the vendor. To date, however, there has not been widespread demand for it. Possibly, vendors are generally unaware of its existence.⁵⁷ Alternatively, vendors may not believe that purchasers know about or desire this form of protection.⁵⁸ Some purchasers may be willing to assume the risks without insurance, relying instead on a careful inspection of the used house and its appliances. Other purchasers may feel that the insurance is

⁵⁰ For a summary of such schemes see Brisco, "Warranty Programs For Resale Homes Seeking Success in Canadian Market," *Can. Real Estate J.*, Spring, 1980 at 10.

⁵¹ This plan is offered by the Victoria Insurance Company of Canada and the Scottish & York Insurance Co. Limited, through Reed Shaw Stenhouse Limited and Ducketts Limited, insurance brokers and agents. Cf. Weiss, "Repair insurance 'could boost resale market,'" *The Financial Post* (Toronto) Dec. 8, 1979 at 36, cols. 1-2; Goldstein, "Insurance scheme protects purchasers of resale homes," *The Toronto Star*, Dec. 3, 1979 at B8, cols. 1-4.

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ If the insurance was in fact a valuable selling tool, a vendor's real estate agent would likely inform him of its existence. The plan has been widely advertised within the real estate community.

⁵⁸ If this were true, vendors would have little incentive to buy the insurance. They would only secure it upon a purchaser's request. See comments of Blair Jackson, Executive Vice-President of the Canadian Real Estate Association as reported by Goldstein, *supra* note 51, at B8, cols. 3-4. A consumer market survey conducted by a Toronto Real Estate Board subcommittee "demonstrated questionable demand" for such schemes. As well, a subcommittee of the legislation committee of the Ontario Real Estate Association reported that consumer demand for resale home warranties was limited. See Brisco, *supra* note 50.

inadequate and insufficient in light of its twelve month term and its coverage ceiling of \$50,000. Still others may feel that the \$100 deductible clause reduces the expected benefits that the insurance could offer.⁵⁹ Finally, used house buyers may wish to be covered for risks excluded by the insurance.⁶⁰

Recognizing that the vendor does not know what type of protection the eventual purchaser will desire, other proposals leave it to the purchaser to arrange privately for his own house warranty. For example, in the United States, the National Association of Realtors launched a National Home Protection Program in sixteen states and twenty-eight metropolitan areas in 1975.⁶¹ Under this programme, the used house was inspected prior to its sale by a qualified engineer and a checklist of its major components was compiled. An insurance company then would underwrite a policy guaranteeing to repair anything that failed to meet certain standards. The policies typically contained various exclusions and often a \$100 deductible clause. The cost of the warranty premium ranged from \$130 to \$300 and was usually paid by the purchaser.

One such combined warranty and insurance scheme is offered by an American firm.⁶² It conducts a detailed inspection of the house to be purchased and submits a report to the buyer. It then offers the buyer an opportunity to purchase additional protection in the form of a warranty. The firm's warranty, backed by a \$1,000,000 policy with a private insurance company, covers all mechanical and structural systems, except as noted in its report. The firm agrees to repair or replace any item covered by the warranty that fails during the first twelve months after conveyancing or occupancy, whichever comes first. Cumulative liability to the firm under the warranty cannot exceed \$25,000 and there is a \$100 deductible clause. The cost of the warranty premium is around \$100 for most residential houses.

To date, only one such scheme has been introduced in Canada and it has enjoyed only marginal acceptance by the public.⁶³ Used house buyers do not seem to recognize a need for this type of insurance or warranty protec-

⁵⁹ Eric Charman, President of the Canadian Real Estate Association as reported by Goldstein, *supra* note 51, at B8, cols. 1, 4.

⁶⁰ The policy does not cover repairing minor structural cracks, eradicating termite infestation and replacing equipment which fails as a result of excessive demands being placed upon it.

⁶¹ Brisco, *supra* note 50; *cf.* Roseman, *supra* note 5.

⁶² The warranty is entitled the "Gold Seal Home Warranty" and is offered by The Engineered Inspection System, Inc.

⁶³ This resale home warranty program, entitled "Warranty II" was introduced in February, 1979 by Ephor Ltd. of Kitchener, Ontario. The warranty is backed by the Hartford Insurance Company and the Economical Insurance Company. The program was initially designed to cost one percent of the market value of the home and required an inspection. It provided coverage of basic electrical, plumbing and heating systems with no deductible for one year. No coverage on structural defects or appliances was provided. After only marginal acceptance by the public, the fee was reduced to \$300, the inspection eliminated, and a \$50 deductible clause inserted. Response has still not been overwhelming. See Brisco, *supra* note 50.

tion. Such schemes are unlikely to enjoy an enthusiastic reception among used house buyers in the future.⁶⁴

C. *Imposing a Duty on Vendors to Disclose Physical Defects*

Other initiatives have focused on encouraging or forcing vendors of used houses to disclose physical defects to prospective purchasers. The rationale underlying these proposals is that vendors are more familiar than purchasers with physical defects in the houses being sold.⁶⁵ Therefore, it would be more efficient to encourage vendors to disclose this information to purchasers than to insist that purchasers invest the time and effort to discover the defects themselves.⁶⁶ Proponents of such disclosure schemes also believe that it is unconscionable to allow vendors to take advantage of unsuspecting purchasers by failing to make disclosure, thereby defeating a purchaser's reasonable expectations and unjustly enriching the vendor.⁶⁷

One such scheme was introduced in the form of a private member's bill in the Ontario Legislature in December 1979. Bill 207, *An Act to Provide Protection for the Buyers of Homes*,⁶⁸ would require vendors and realtors involved with the sale of previously owned houses to provide buyers with a signed statement of facts. The facts to be divulged would include the type and quality of the water supply, any record of flooding, and the nature of the sewage disposal facilities.⁶⁹ The Bill also provides that all agreements to purchase would be conditional upon this signed statement being given to the purchaser.⁷⁰ This Bill, however, has not received serious attention from the government.⁷¹

In British Columbia, a voluntary residential housing disclosure pilot project was undertaken jointly by the British Columbia Real Estate Association and the Ministry of Consumer and Corporate Affairs in June, 1978.⁷² The programme applied only to used houses. Vendors were asked to fill out a Residential Disclosure Statement, which was not part of the formal offer to purchase. This Statement asked vendors to disclose information about aspects of the house not easily determinable by a purchaser on an initial inspection such as drainage, insulation and availability of water. The pro-

⁶⁴ The economics of providing resale home warranties within the shallow Canadian market may also be marginal. See Brisco, *supra* note 50, at 12.

⁶⁵ See text accompanying note 35, *supra*; cf. Haskell, *supra* note 22, at 653.

⁶⁶ Since vendors already have this information, the cost of acquiring it is nil. On the other hand, a prospective purchaser would have to hire someone to obtain the same information. This cost of acquisition would be multiplied by the number of prospective purchasers interested in the house. At present, vendors have little incentive to disclose the existence of physical defects to used home buyers prior to purchase.

⁶⁷ *Supra* note 35.

⁶⁸ (31st Leg. 3d Sess.) Tabled by Colin Isaacs, M.P.P., Ont. N.D.P.

⁶⁹ *Id.* cl. 2.

⁷⁰ *Id.* cl. 6.

⁷¹ The bill died on the order table.

⁷² Ministry of Consumer and Corporate Affairs, Province of British Columbia, *News Release*, June 12, 1978.

gramme was to be operated on a trial basis for a one year period,⁷³ but was discontinued as a formal programme in the spring of 1979 because real estate agents and vendors did not provide the Statements to purchasers and the latter seldom asked for them.⁷⁴

An even more stringent scheme was proposed by United States Senator Philip A. Hart. In 1973, he organized a drive to enact a Bill which came to be known as the *Truth in Housing Act*.⁷⁵ It required that any person who sold, or acted as an agent in the sale of, or furnished mortgage credit for the purchase of a house would be responsible for written disclosure to the purchaser of any substantial defects that existed as of the date of the disclosure.⁷⁶ The disclosure was intended to cover the house's structure, plumbing system, heating system, electrical system and such other matters as the Federal Trade Commission would require.⁷⁷ It was also to include the estimated cost of eliminating defects and the estimated useful life of each of the parts of the house noted above.⁷⁸ The cost of any inspection relating to the disclosure was to be paid by the purchaser.⁷⁹ In the event that its provisions were breached, the Bill provided for civil and criminal liability.⁸⁰ Senate hearings on the proposed Bill were held, but shortly thereafter, Senator Hart died. No other Senator supported the Bill enthusiastically and it was never enacted.

Several reasons can be advanced to explain why these disclosure schemes have been unsuccessful. On the one hand, vendors may be reluctant to sign written disclosure statements for fear of being held liable for any misleading or untrue statements or omissions—whether innocently, negligently or intentionally made.⁸¹ The experience in British Columbia suggests that vendors and real estate agents believed that disclosing problems to a prospective purchaser could jeopardize the eventual sale of a house. This would seem particularly true in a buyers' market if all vendors were not required to make disclosure. Similarly, there would be little incentive for making disclosure in a sellers' market because purchasers would not be inclined to insist on disclosure before buying.

On the other hand, prospective purchasers in British Columbia seldom asked that the vendor make voluntary disclosure. They may have been unaware of the programme. Alternatively, buyers may have been unprepared to rely on the statements believing that the vendor would not be impartial.

⁷³ *Id.*

⁷⁴ Letter from Chris Lovelace, Acting Director, Policy Legislation and Program Planning, Ministry of Consumer and Corporate Affairs, Province of British Columbia (Feb. 6, 1980). *Cf. supra* note 50, at 11.

⁷⁵ S. 2028, In The Senate Of The United States, 93d Cong. 1st Sess. (1973).

⁷⁶ *Id.*

⁷⁷ *Id.*

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*

⁸¹ According to at least one spokesperson, a vendor may be incompetent to identify and describe the seriousness of defects. See comments of Jackson, *supra* note 58.

Purchasers may also have thought that they could uncover all the physical defects themselves.

Apart from the lack of widespread acceptance, these disclosure schemes appear to have more fundamental weaknesses. Purchasers must still face the problems inherent in litigation-based remedies when seeking relief for inaccurate or incomplete disclosure.⁸² Moreover, if the vendor must disclose only the defects of which he is aware, one must question whether the purchaser would be adequately protected. Finally, potential liability for inaccurate or incomplete disclosure would be assumed by individual one-time vendors with limited ability to insure.

D. *Government Certification of Used Houses Prior to Sale*

Some commentators have proposed a scheme to protect used house buyers similar to that which governs the sale of used cars in Ontario.⁸³ All vendors would be required to have their houses examined by licensed inspectors.⁸⁴ Only those houses meeting certain standards would receive a "Certificate of Fitness".⁸⁵ A Certificate would have to be obtained before title to a vendor's house could be transferred to the purchaser.⁸⁶ The onus would rest with the vendor to bring his house up to standard by making the appropriate repairs and correcting any defects.

While this scheme would provide some protection to the used house buyer, several factors make it less desirable than it would at first appear. First, it could involve the formation of yet another large and expensive government bureaucracy. Second, in contrast to the used car certification scheme, where the most important objective is protecting owners and third parties against personal injury, a used house certification scheme would be primarily designed to protect used house buyers' economic interests. Third, there is no evidence to suggest that used house buyers and the public perceive a need for this form of government protection. Fourth, while a used house might meet the government's minimum certification standards, these might be considered inadequate by many purchasers. Fifth, since vendors rather than purchasers would arrange for inspections, there may be a danger that information concerning defects would be suppressed.⁸⁷ Because a vendor may be unable to sell or may receive a lower price for his used house if defects are uncovered, there is no incentive for him to have the most meticulous inspection possible carried out. Finally, such a scheme would still not address the difficulties

⁸² See text accompanying notes 38-40, *supra*.

⁸³ Reiter and Risk, *supra* note 9, at 291. The certification scheme governing the sale of used cars is contained in s. 73 of *The Highway Traffic Act*, R.S.O. 1980, c. 198.

⁸⁴ Reiter and Risk, *supra* note 9, at 291.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ In contrast, a purchaser has a much stronger incentive to ensure that all defects are uncovered by the inspection. Common sense suggests a more comprehensive inspection may result if it is the purchaser's responsibility to arrange for the inspection, rather than the vendor's responsibility.

faced by used house purchasers who discover physical defects after purchase.⁸⁸

E. *Private Home Inspection Firms*

The unattractiveness of the above four schemes combined with their failure to secure widespread public acceptance has led to the development of a Canadian home inspection profession.⁸⁹ It represents a direct response to the need of used house buyers to try to avoid the cost of defects discovered after purchase. Inspection firms specialize in providing prospective purchasers with an independent, unbiased and professional examination of every visible facet of a house to identify existing and potential problems. The staff of these firms has the training and experience to uncover many physical defects which would generally escape the attention of the average used house buyer. The inspectors can determine the seriousness of defects, how easily and in what way they should be repaired, and how quickly the repairs should be effected. They summarize their findings in a report which is submitted to the purchaser shortly after the inspection.

There are numerous advantages stemming from a house buyer's decision to retain an inspection firm. For example, when purchasers ask vendors for permission to conduct an inspection, either before an agreement of purchase and sale is signed or as a condition of the agreement of purchase and sale, some may refuse. This refusal puts prospective purchasers on notice that their vendors may have something to hide. In addition, if a purchaser requests an inspection before signing an agreement, he has several options upon receipt of his report. He may decide not to buy the house in light of the physical defects uncovered or he may use the report as a basis for negotiating a lower price with the vendor. He can also decide to purchase the house and use the report later as an agenda for effecting repairs and maintenance.

Even if a used house buyer has signed an unconditional agreement, there are still several advantages to retaining the services of such firms. These advantages relate to the practical and legal implications of early discovery of physical defects. The purchaser may choose to rescind his agreement upon learning of a physical defect. By doing so, the purchaser risks being sued by the vendor for damages. However, the vendor has an obligation to mitigate his damages, and therefore must try to resell his house. This may or may not be difficult depending on market conditions. A purchaser may choose to assume the risk of paying the vendor's damages rather than to bear the certain cost of repairing the physical defect. Alternatively, where an inspection reveals that a vendor's statements have been untrue, the purchaser may attempt to negotiate a lower price to reflect the problems uncovered. Here, the purchaser is in effect seeking an allowance for damages in advance. By analogy, this amounts to specific performance of the agreement with an abatement in the price. As well, because of the early stage at which the in-

⁸⁸ See text accompanying notes 36-41, *supra*.

⁸⁹ Roseman, "Service helps those buying older houses," *The Globe & Mail* (Toronto), April 19, 1979 at T1, cols. 1-5.

spection takes place, the legal issue of whether or not the vendor's representations, promises and warranties merge with or survive closing is avoided entirely.⁹⁰

An ancillary advantage relating to early discovery of defects through inspections is that disputes between the purchaser and vendor are more likely to be settled privately. Rescission remains a practical remedy. Neither the vendor nor the purchaser is likely to have seriously prejudiced his position because the inspection usually precedes closing and change of possession by several weeks.⁹¹ Should the purchaser refuse to complete the transaction, the vendor will probably resell his house to another buyer rather than bring an action for specific performance against the original purchaser. In summary, the purchaser's and vendor's options and remedies at this stage are speedy and inexpensive.

Purchasers may also obtain insurance protection against a certain range of risks by having an inspection. This protection is not comprehensive since inspection firms do not guarantee that various components of a house will operate for a fixed period of time. However, if a purchaser can prove that the inspection firm breached its contract by failing to discover a patent defect, he has another potential defendant from whom he can claim damages. Moreover, if a purchaser can show that the inspection firm performed its services negligently and that he relied on it to his detriment, he will have an alternative claim in tort.

In summary, further study of the home inspection profession is warranted since it appears to offer many benefits to used house purchasers desiring to protect themselves against the risk of discovering physical defects after purchase. However, the profession remains relatively unknown since it is relatively new and has not received serious academic attention to date. Therefore, in the remainder of this paper, a profile of the profession will be presented which will include a summary of the profession's history, growth, services and fees. Next, the existing and potential problems confronting the profession will be identified and discussed. Finally, an analysis will be made of why and how this emerging profession ought to be regulated.

V. A PROFILE OF THE HOME INSPECTION PROFESSION IN CANADA⁹²

A. *History*

The home inspection profession traces its roots back to England where it has been common practice since the turn of the twentieth century for pur-

⁹⁰ See earlier discussion under Part III *supra*; *cf. supra* note 16.

⁹¹ Contrast this situation with that outlined under Part III *supra*; *cf. supra* note 41.

⁹² Many sections of the following profile are based on information obtained during personal interviews with representatives of four home inspection firms in Metropolitan Toronto during January, 1980. These four firms provide their services on a full-time and exclusive basis and are among the largest providing home inspections in the area. It was agreed that their names would remain completely confidential. Other sections of the profile are based on the general knowledge of the author who has been a principal of one of the above firms for over four years.

chasers to hire a surveyor to inspect a house prior to purchase. It was not until 1954 that the concept of home inspections established itself in the United States.⁹³ By 1972, at least one Canadian firm was offering such services.⁹⁴ Table I indicates that since that time, inspection firms have been established in many major Canadian cities.

TABLE I
SURVEY OF INSPECTION FIRMS ACROSS CANADA

City	Number of Home Inspection Firms	Date
Calgary	0	June, 1979
Edmonton	0	March, 1980
Halifax	0	April, 1979
Hamilton-Wentworth	1	December, 1979
Montreal	3	July, 1979
Ottawa-Hull	5	January, 1980
Quebec	0	October, 1979
Regina	1	May, 1979
Thunder Bay	2	June, 1979
Toronto	11	May, 1979
Vancouver	5	July, 1979
Victoria	1	December, 1979
Winnipeg	2	June, 1979

Source: Yellow Pages Directories, under the heading Building Inspection Services

B. *Growth of the Inspection Profession in Metropolitan Toronto*

In 1975, there was one inspection firm in Metropolitan Toronto.⁹⁵ Since then, more than ten firms have begun to offer inspection services in the area.⁹⁶ Only five of these firms offer their services on a full-time and exclusive basis and they are generally considered to be the largest. Each of the four firms interviewed began offering its services as a sole proprietorship or partnership of individuals.⁹⁷ Three are now, or are in the process of becoming, incorporated. During 1979, the four firms boasted combined revenues of approximately \$125,000 and performed over 750 inspections. To put this latter number into perspective, 23,466 houses were sold through the Mul-

⁹³ Arthur Taucher, Home Inspection Consultants Inc., New York, New York.

⁹⁴ Ron O'Shaughnessy, Home Inspection Consultants of Quebec, Montreal, Quebec. This company was a franchise of Home Inspection Consultants, Inc., *id.*

⁹⁵ Vercan Building Inspection Services. This company does not appear to provide home inspection services any longer.

⁹⁶ Yellow Pages Directory, The City of Toronto, May 1979.

⁹⁷ *Supra* note 92.

Multiple Listing Service (MLS) of the Toronto Real Estate Board during 1979.⁹⁸ Since it is estimated that MLS represents ninety percent of all houses sold in Metropolitan Toronto, around three percent were inspected by these four firms.⁹⁹

C. *The Nature and Scope of a Typical Inspection*

The inspector first examines the heating, electrical, plumbing and hot water systems to determine their condition, life expectancy and adequacy. Then he inspects the foundations, walls and ceilings to discover whether the house has suffered any structural damage. All of the living areas are subsequently checked, followed by an evaluation of the attic's insulation and ventilation. The final part of his inspection focuses on the exterior of the house. A typical inspection requires between two and three hours to complete. Throughout the process, the inspector uses various tools and measuring devices and records his findings on checklists. The inspection is limited to those aspects of the house which can be visually examined without altering, tampering with or damaging the vendor's property.¹⁰⁰

The scope of an inspection varies among the firms. For example, some firms' inspectors go up on the roof of the house while others remain on the ground and rely on binoculars. Some firms' inspectors remove the covers from and test all electrical outlets while others make only random checks. Finally, not all firms will inspect swimming pools, driveways, detached garages, drinking wells or septic tanks.

D. *Reports of Inspections*

Firms have adopted different styles of reporting their inspection findings. Two have selected a checklist format on which the inspector indicates the condition of each component of the house. Following the checklist, there is a section reserved for general notes and remarks. In contrast, the two other firms prepare a ten-to-fifteen page typewritten report describing in layman's language the condition and adequacy of the house.

The firms' reports also differ in other ways. For example, some firms are willing to provide their clients with written estimates of the cost of repairs and maintenance. Two firms are also prepared to perform verbal inspections. In these instances, the client accompanies the inspector, asks questions and makes his own notes.

E. *Fees for Home Inspection Services*

Table II outlines how the four firms determine their fees.

⁹⁸ A total of 27,960 properties were sold through the Multiple Listing Service of the Toronto Real Estate Board during 1979. Of these, 23,466 were houses; *cf. supra* note 4, at 19.

⁹⁹ Robert Mitchell, General Manager, Home Inspection Consultants of Ontario Limited, Suite 203, 3416 Dundas Street West, Toronto, Ontario.

¹⁰⁰ At the time most inspections take place, the house remains the property of the vendor. However, even if the house was the property of a client, these firms are hesitant to alter the property physically without the express written consent of the client.

TABLE II
THE DETERMINATION OF INSPECTION FEES

	Fee for a House Listed at \$100,000
<i>Firm No. 1</i> Minimum of \$150 for all houses listed at \$60,000 or less. An additional \$1 per \$1,000 over \$60,000 listing value.	\$190
<i>Firm No. 2</i> Minimum of \$125 for all houses listed at \$100,000 or less. An additional \$1 per \$1,000 over \$100,000 listing value.	125
<i>Firm No. 3</i> Minimum of \$150 for all houses listed at \$150,000 or less. An additional \$1 per \$1,000 over \$150,000 listing value.	150
<i>Firm No. 4</i> Minimum of \$100 plus an additional \$1 per \$1,000 of listing value.	200

Source: Interviews with representatives from four Metropolitan Toronto inspection firms.

Table II illustrates that fees vary widely. None of these firms' fees is calculated on the basis of the number of hours it spends on the inspection or on the size of the house. The average fee for an inspection, when all four firms are combined, was \$166 in 1979.

F. *The Backgrounds and Qualifications of the Inspectors*

The backgrounds and qualifications of the inspectors varies widely. Four had gained considerable experience in residential construction and renovation prior to performing inspections. Another inspector previously held an executive position in a project management firm while another had earned a Diploma in Civil Engineering Techniques from a community college. Two others, one of whom is a Professional Engineer, had performed inspections on industrial sites for an insurance company.¹⁰¹ Apart from full-time inspectors, two of the firms retain other individuals with similar backgrounds on a part-time basis to assist on more difficult or unusual inspections, or during periods when the firms are busy.

One individual had performed approximately 500 inspections by the end of 1979. Two others had performed approximately 190 and 100 respectively while the remaining inspectors had performed considerably fewer. With no existing inspection school, on-the-site experience is the only means by which inspectors can become competent and qualified.

G. *Warranties, Guarantees, Insurance and Disclaimers*

The firms perceive that their only role is to express a professional opinion on the condition of a house as of the date of inspection. None offers

¹⁰¹ It is interesting to note that many of the inspectors have university degrees in unrelated fields such as teaching, computer science, mathematics, business and urban planning.

a guarantee or warranty covering the components it inspects although two carry errors and omissions and general liability insurance policies.¹⁰² All firms attempt to disclaim liability for hidden and latent defects. Three include a general disclaimer as part of their report while the fourth contains a notice to this effect on a contract signed by the client before the inspection. The experience of these four firms is that clients consider these disclaimers to be reasonable.

H. *Conflicts of Interest*

To ensure that their reports remain independent and unbiased, most inspection firms are scrupulous in not recommending, and avoiding any affiliation with, other professionals such as real estate agents, building contractors, architects or lawyers which might be perceived as giving rise to conflicts of interest. However, one firm has entered into a long term contract with a real estate company to perform inspections on every house that the latter lists. As well, a partner in one firm is a general contractor, but refuses to undertake any work for the firm's inspection clients.

I. *Characteristics of Houses Inspected*

To determine the types of houses that are most frequently inspected, Table III sets out some of their more salient characteristics.

As Table III indicates [see following page], almost all houses inspected are used rather than new. Of the used houses, the majority appear to have been constructed between twenty and fifty years ago. Approximately half have a value or asking price of between \$60,000 and \$100,000. For comparative purposes the average price of a house sold through the Toronto Real Estate Board during 1979 was \$70,830.¹⁰³ Their general condition could usually be described as fair to good. In summary, the houses inspected do not appear to have any general characteristics that distinguish them from those which are sold without inspections.

J. *The Role of Inspections in the Used House Purchase*

A prospective purchaser typically requests an inspection after visiting a house with his real estate agent. It is usually the prospective purchaser's responsibility to obtain permission from the vendor to have an inspection conducted. However, the timing of the actual inspection is often left with the inspection firm to arrange with the vendor or his agent. Inspection firms usually require twenty-four hours notice and restrict their activities to daylight hours. Most encourage their clients to accompany them on the inspection as this provides the client with a second and often more sobering opportunity to examine the house thoroughly.

Table IV [see following page] depicts the relationship between the timing of inspections and the signing of agreements of purchase and sale.

¹⁰² Errors and omissions insurance policies are intended to protect the firms in the event they are held to have performed their services negligently. General liability insurance policies are intended to cover damages caused by the firms to houses they have inspected.

¹⁰³ *Supra* note 4, at 69.

TABLE III
CHARACTERISTICS OF HOUSES INSPECTED

	Firm No.			
	1	2	3	4
1. <i>Question:</i> What percentage of your firm's inspections are conducted on:				
(a) new houses?	10	5	15	25
(b) used houses?	90	95	85	75
2. <i>Question:</i> Of the used houses your firm inspects, what percentage are:				
(a) under 5 years old?	5	10	5	20
(b) between 5 and 20 years old?	20	30	20	30
(c) between 20 and 50 years old?	65	30	60	30
(d) over 50 years old?	10	30	15	20
3. <i>Question:</i> What percentage of the houses that your firm inspects have a value or asking price of:				
(a) under \$40,000?	1	0	1	5
(b) between \$40,000 and \$60,000?	10	30	5	10
(c) between \$60,000 and \$100,000?	65	45	55	35
(d) between \$100,000 and \$200,000?	23	5	29	35
(e) over \$200,000	1	20	10	15
4. <i>Question:</i> What percentage of the houses that your firm inspects are in:				
(a) excellent condition?	5	10	10	10
(b) good condition?	45	75	30	30
(c) fair condition?	40	15	35	40
(d) poor condition?	10	0	25	20

Source: Interviews with representatives from four Metropolitan Toronto inspection firms.

TABLE IV
RELATIONSHIP BETWEEN INSPECTIONS AND
AGREEMENTS OF PURCHASE AND SALE

<i>Question:</i> What percentage of your firm's clients request an inspection:	Firm No.			
	1	2	3	4
(a) prior to signing an agreement of purchase and sale?	20	10	20	40
(b) after signing an agreement of purchase and sale conditional upon a satisfactory home inspection?	70	40	60	40
(c) other?	10	50	20	20

Source: Interviews with representatives from four Metropolitan Toronto inspection firms.

This Table reveals that inspections are often conducted before agreements of purchase and sale are signed. But more frequently, inspections occur after agreements have been signed, conditional upon a satisfactory home inspection.

K. *Types of Defects Uncovered During Inspections*

The types of problems uncovered during inspections are innumerable. The most common include leaky basements, termite infested structural members and beams, structural cracks and subsidence, inadequate electrical services, frayed wiring, corroded galvanized steel plumbing, insufficient insulation, inadequate ventilation and exterior wood rot.

L. *The Effect of Inspections on Prospective Purchasers' Decisions*

Table V attempts to trace the impact that inspections have on prospective purchasers' decisions.

TABLE V
THE EFFECT OF INSPECTIONS ON
PROSPECTIVE PURCHASERS' DECISIONS TO BUY

<i>Question:</i> Of the houses your firm inspects where either the inspection is occurring prior to an agreement being signed, or where an agreement is conditional upon a satisfactory inspection, what percentage of your clients eventually go through with their purchase?	Firm No.			
	1	2	3	4
	75	90	75	70

Source: Interviews with representatives from four Metropolitan Toronto inspection firms.

This Table shows that a large majority of the purchasers who have an inspection performed eventually follow through with their purchases. Looking at the question from another standpoint, Table VI attempts to determine the effect that inspections have where clients do not ultimately purchase the house. The answer is unclear.

TABLE VI
THE EFFECT OF INSPECTIONS ON
PROSPECTIVE PURCHASERS' DECISIONS NOT TO BUY

<i>Question:</i> Of those clients who do not follow through with their purchase where an inspection occurred prior to an agreement being signed, or where an agreement was conditional upon a satisfactory inspection, what percentage made this decision primarily on the basis of the inspection?	Firm No.			
	1	2	3	4
	20	0	50	80

Source: Interviews with representatives from four Metropolitan Toronto inspection firms.

M. *Consumer Awareness of the Existence of Home Inspection Firms*

The firms interviewed agreed that a major problem facing the profession is how to inform the general public of the profession's existence. They believed that only a small percentage of the house buying public is aware that inspection services are available. While the profession has enjoyed rapid growth, most firms report that unless the volume of their business increases, they will not continue to operate on a long term basis. As a consequence, promotion has been and remains a high priority.

It is difficult to promote inspection services directly to house buyers because they are a constantly fluctuating and amorphous group representing only a very small percentage of the general public at any particular time. Moreover, most inspection firms report that direct advertising is generally ineffective and prohibitively expensive in relation to their limited financial resources. As a consequence, the emphasis of inspection firms has been on soliciting free articles in the real estate or consumer sections of newspapers.

Encouraging the use of inspection services could be accomplished in several ways. For example, the government or a group of inspection firms could launch a public education programme to inform potential house buyers of the risks of physical defects in used houses and the availability of inspection services. Alternatively, all agreements of purchase and sale could be revised to include a clause stating that the agreement is conditional upon a satisfactory inspection. Efforts could also focus on various intermediaries involved in the house buying process. For example, lawyers could be asked to advise prospective purchasers of the benefits of inspections. Real estate agents could be made aware of the selling features of an inspection. Finally, lenders could be persuaded to make the availability of mortgage funds conditional upon the obtaining of a satisfactory inspection.

Compounding the consumer awareness problem is the general reluctance of most real estate brokers to accept and encourage the role of inspections as an integral part of the house buying process. Real estate brokers are uniquely situated in that they almost always meet house buyers before they make an offer. As a consequence, they are in a position to encourage or discourage the use of inspections. According to the firms interviewed, most real estate agents discourage prospective purchasers from retaining inspection services because they believe that an inspection may dissuade an otherwise enthusiastic house buyer from following through on his purchase, thereby jeopardizing the agent's commission. Such concerns may have been one of the reasons underlying the Toronto Real Estate Board's decision during 1979 not to accept advertising from inspection firms in its newspaper.

Nevertheless, some real estate agents do encourage inspections by informing their clients of the availability of the service and by requesting inspections on their clients' behalf. They recognize their own lack of expertise in evaluating a house and wish to avoid making any misrepresentations to the purchaser. As well, they recognize that an inspection can serve as an effective selling tool especially in the case of a cautious purchaser.

N. *The Reaction of Clients After the Inspection*

One firm has made a practice of sending a post-inspection questionnaire to clients. The almost unanimous reaction to their service has been favourable. Past clients occasionally complain that a problem or defect was missed during the course of their inspection. Their complaints are usually minor. Typical examples are a hole in a screen door, the absence of an electrical outlet for a dryer or a small isolated leak in a roof. However, none of the firms reported being threatened with litigation by a disappointed client.

O. *Sources of Business for Inspection Firms*

Inspection firms often secure business through the recommendations of previous clients. As well, the firms promote their services directly to the house buying public through print advertising, free newspaper articles, the Yellow Pages and Home Show booths. Other promotion methods are aimed primarily at lawyers and real estate agents and are designed to persuade them to inform their clients of the advantages of a home inspection.

P. *Drawbacks and Limitations of Inspections*

Inspection fees are sometimes perceived as a drawback by prospective purchasers. Many are unsure whether the service is worth what they are paying, particularly when buying a newer or more expensive house. For purchasers stretching their budgets, an inspection may be perceived as a luxury they cannot afford.

Table VII sets out the reactions of vendors to inspections.

TABLE VII
REACTION OF VENDORS TO INSPECTIONS

Question: When vendors learn that your firm is about to inspect their houses, what percentage are perceived by you as:

	Firm No.			
	1	2	3	4
(a) Frightened?	20	40	25	15
(b) Uneasy?	30	70	75	70
(c) Curious?	50	65	40	30
(d) Skeptical?	25	35	30	10
(e) Nervous?	75	70	70	60

Source: Interviews with representatives from four Metropolitan Toronto inspection firms.

Most vendors have never heard of the home inspection profession and are apprehensive about having an inspector "snooping" around their house. Some decide not to permit an inspection while others have abruptly asked inspectors to leave without completing their examinations. As well, real estate agents often discourage prospective purchasers from having an inspection for fear that it may jeopardize the sale.¹⁰⁴

¹⁰⁴ *Supra* note 92.

Another drawback of inspections is that they often result in delay and uncertainty where inspections are carried out prior to signing an agreement of purchase and sale or are conducted for the purpose of satisfying conditions in such an agreement. Moreover, until completion of the inspection, considerable uncertainty enshrouds the entire transaction.

VI. REGULATION OF THE HOME INSPECTION PROFESSION

A. *Theoretical Reasons Justifying Regulation*

The theoretical justifications for regulating a particular activity are well documented.¹⁰⁵ For example, regulation is often perceived as necessary to control the exercise of monopoly power or to ensure that the general public receives the economic rents flowing from scarce resources.¹⁰⁶ It is also justified as a means of preventing externalities or spillovers from occurring and as a way of ensuring that consumers have sufficient information to evaluate competing products.¹⁰⁷ Other rationales for regulation include the prevention of excessive competition, the rationalization of certain industries, the prevention of enormous but infrequent losses being suffered by consumers, the correction of unequal bargaining power among parties, the allocation of scarce resources and the protection of unsophisticated lay persons.¹⁰⁸ The unsuitability of the common law in the resolution of contemporary consumer contract problems has also led to demands for legislative intervention.¹⁰⁹ The question whether any of these justifications for regulation applies in the case of the home inspection profession will be examined below.

B. *Circumstances Creating the Need for Regulation*

As discussed earlier, the home inspection profession offers individual benefits to prospective purchasers.¹¹⁰ To preserve these benefits however, the profession must recognize the problems it faces. The most serious of these is that unqualified individuals may begin to offer inspection services to the general public. If this occurs, prospective purchasers could suffer substantial economic losses and personal injuries. The remainder of this section canvasses the circumstances in which the potential for abuse arises.

¹⁰⁵ Breyer, *Analyzing Regulatory Failure: Mismatches, Less Restrictive Alternatives, and Reform* (1979), 92 Harv. L. Rev. 549 at 553. For an account of free market defects, see Bator, *The Anatomy of Market Failure* (1958), 72 Q.J. Econ. 351. For a summary of the conditions necessary for the optimal operation of competitive markets, see Trebilcock, Tuohy and Wolfson, *Professional Regulation—A Staff Study of Accounting, Architecture, Engineering and Law in Ontario* (Toronto: Min. of A.G., 1979) at 45-60. For a summary of the efficiency rationales for regulation, see Trebilcock, Waverman and Pritchard, "Markets for Regulation" in *Government Regulation—Issues and Alternatives 1978* (Toronto: Ontario Economic Council, 1978) 11 at 16.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ *Supra* note 38.

¹¹⁰ See discussion under Part IV E, *supra*.

1. The Inability of Prospective Purchasers to Identify Competent Inspection Firms

Most prospective purchasers are unable to distinguish competent from incompetent inspection firms. Few ask meaningful questions in order to determine a firm's qualifications and experience. Those that do seldom have the background to intelligently weigh the answers they obtain. Unfortunately, there is no common standard upon which they can rely because the services that each of the firms offers differ considerably. As well, inspection firms have not been in existence long enough to establish reputations upon which prospective purchasers can rely.¹¹¹

Prospective purchasers have no opportunity to learn through repeated experiences whether an inspection firm is competent. Unlike their regular use of other services, purchasers seldom require an inspection on more than one or two houses prior to making their purchase decision. Moreover, most prospective purchasers are not sufficiently knowledgeable to realize whether they have received competent service. In short, inspection firms are seldom confronted with meeting the expectations of regular, well-informed and sophisticated clients.

Finally, prospective purchasers cannot rely upon an umbrella organization to protect their interests. To date, no organization has been formed to represent house buyers.¹¹² They cannot rely on real estate agents for advice in selecting an inspection firm since many agents may not recommend the service for fear of jeopardizing a sale.¹¹³

2. The Absence of a Standard-Setting and Disciplinary Organization

To date, a standard-setting and disciplinary organization has not been formed by inspection firms. No licences, certificates or minimum standards of competence or integrity are required before an individual or firm may perform inspections. Unlike other professions, there are no prescribed education or experience prerequisites. Furthermore, no set of minimum performance standards has been accepted by inspection firms. Opinions vary widely concerning what aspects of a house should be inspected and how detailed an inspection ought to be. Differences among firms also exist as to fees, the nature and scope of reports, and willingness to provide written estimates of the cost of repairs. Moreover, the profession has no method of sanctioning its members. As a consequence, an inspection firm does not risk being disciplined by the profession for rendering incompetent or negligent services.

¹¹¹ Spence, *Entry, Conduct and Regulation in Professional Markets, Working Paper #2* (Toronto: Min. of A.G., 1978) at 1.

¹¹² This is no doubt related to the fact that potential house buyers are a constantly fluctuating and amorphous group. Their interests seldom coincide for a sufficiently long period of time to provide them with the incentive to band together. If they did, house buyers could put pressure on the government to regulate the home inspection profession. It is interesting to contrast this situation with that of Canadian homeowners who, in the spring of 1980, put significant pressure on the federal government to reduce mortgage interest rates by means of a well-organized campaign.

¹¹³ *Supra* note 92.

Finally, the members of the profession do not adhere to any commonly accepted code of ethics. For example, an inspection firm is not prevented from having a contracting subsidiary effect repairs and maintenance identified as necessary during an inspection despite the existence of a conflict of interest.

The absence of an organization to set entry and performance standards on the one hand, and to discipline incompetent or unethical practices on the other, holds the potential for further problems. Firms without sufficient knowledge and experience may begin to offer inspection services. In providing inferior inspections, these firms could charge lower fees than those charged by firms of greater competence and integrity. If this occurs, competent firms may be forced out of business and the profession itself may earn a poor reputation.

Without a standard-setting and disciplinary organization, a prospective purchaser has no assurance that a firm is qualified to perform inspections. A purchaser is likely to receive radically different inspections depending upon the firm that he retains. Moreover, there is no professional organization to which he can complain if he believes he has not been served properly.

The absence of an organization has also prevented the profession from addressing some of the common problems and challenges that its members face. For example, such an organization could obtain liability insurance tailored to meet the needs of its members. It could also advance the views of its members on various issues to the general public, to other professional organizations and to various levels of government.

C. *A Summary of the Case for Regulation*

In view of the expense of the typical house purchase and the losses that could potentially result from an inadequate inspection, the absence of regulation seems startling. Unfortunately, unfettered market forces cannot be expected to remove incompetent firms from the market because prospective purchasers are relatively unsophisticated. It is therefore necessary to examine the costs and benefits of various regulatory alternatives and to compare them to the costs and benefits of the *status quo*.

D. *Costs and Benefits of Various Forms of Regulation*

There are several possible approaches to addressing the issue of how the home inspection profession ought to be regulated. Perhaps the simplest focuses on the regulation of its outputs and inputs.¹¹⁴ In regulating outputs, one focuses on the results of inspection services in terms of their quality, quantity and price. There are two general forms of output regulation. The first is a civil liability suit for professional negligence. It is the best known and the least interventionist response to problems of professional misconduct and negligence.¹¹⁵ The second form of output regulation involves the estab-

¹¹⁴ See, e.g., Trebilcock, Tuohy and Wolfson, *supra* note 105, at 65-66.

¹¹⁵ Under this approach if a house buyer could prove that an inspection firm performed its services negligently he would seek relief by asserting his common law rights through litigation.

lishment of detailed conduct and performance standards. These standards entail monitoring, reviewing and enforcement provisions.¹¹⁶

In contrast, the regulation of inputs concentrates on the individuals providing inspection services in order to ensure in advance that they fulfill certain criteria of competence, training and integrity. There are two general types of input regulation. The first envisages the certification of inspection firms that meet certain criteria.¹¹⁷ Under this scheme, uncertified firms could still provide inspection services. The second approach to input regulation is licensing. It goes a step beyond certification in that only those firms licensed to provide inspection services would be legally entitled to do so. A review of the advantages and the disadvantages of each of these four regulatory schemes will be undertaken below.

1. A Civil Liability Regulatory Regime

The effectiveness of a civil liability scheme as a regulatory regime has been studied from many perspectives.¹¹⁸ It is worthwhile to identify and review its advantages and disadvantages.¹¹⁹ First, such a scheme does not involve a dramatic intervention into the market place. Second, it focuses on the loss suffered by the client due to the inspection firm's negligence, which is ultimately of most interest to the client. Third, by exposing inspection firms to civil liability for negligence, external constraints are imposed on the profession. This contrasts with other schemes of professional regulation where individuals are primarily subject to self-regulatory constraints. Fourth, if a negligent inspection firm must assume the economic losses caused by its negligence, it will have an incentive to improve the quality of its services.¹²⁰ Fifth, by basing civil liability on negligence, a flexible standard for inspection performance is created. Sixth, third parties, such as visitors of inspection clients, may indirectly seek relief if they have suffered damages caused by a negligently performed inspection. Third parties, however, may face several

¹¹⁶ The responsibility for setting and enforcing these standards could lie with government or be delegated to a professional organization of inspectors.

¹¹⁷ For example, those entities that satisfied certain requirements would be entitled to refer to themselves as "Certified Home Inspectors".

¹¹⁸ Belobaba, *Civil Liability as a Professional Competence Incentive, Working Paper #9* (Toronto: Min. of A.G., 1978); Prichard, "Professional Civil Liability and Continuing Competence," in Klar, ed: *Studies in Canadian Tort Law* (Toronto: Butterworths, 1977) at 377; Kretzmer, *The Malpractice Suit—Is It Needed?* (1973), 11 Osgoode Hall L.J. 55; Calebresi, *The Problem of Malpractice: Trying to Round Out the Circle* (1977), 27 U.T.L.J. 131; Reder, *An Economic Analysis of Medical Malpractice* (1976), 5 J. of Leg. Stud. 267; Prins, *Accident and Malpractice Liability of Professional Corporation Shareholders* (1977), 10 U. Mich. J. L. Reform 364; Epstein, *Medical Malpractice: The Case for Contract*, [1976] A.B.F. Res. J. 87; Spence, *Consumer Misperceptions, Product Failure and Producer Liability*, 44 Rev. Econ. Stud. 561.

¹¹⁹ Much of the following analysis of the advantages and disadvantages of various regulatory frameworks is taken directly from Trebilcock, Tuohy and Wolfson, *supra* note 105, at 67-82.

¹²⁰ However, the effectiveness of civil liability as a market form of deterrence is still widely debated. See Belobaba, *supra* note 118, at 3-13.

procedural and substantive hurdles, such as privity of contract and reasonable foreseeability of damages in tort.

While the advantages of regulation through a civil liability system are significant, its disadvantages must also be weighed carefully. First, a civil liability regime relies exclusively on the victim to initiate an action.¹²¹ Its effectiveness, therefore, depends upon the sophistication of the inspection client. If he is unable to obtain and understand the information necessary to recognize that he is a victim or unable to attribute his injury to the inspection firm, the scheme's effectiveness is weakened considerably.¹²² Second, an inspection client may find the cost of obtaining the information necessary to support a claim prohibitive.¹²³ Third, an aggrieved client may have difficulty persuading another expert from the inspection profession to assist him in his action against the negligent firm. Firms within the profession may close ranks in a conspiracy of silence when faced with a threat from the outside.¹²⁴ Fourth, the civil liability system depends on inexperienced courts to judge the competence of inspection firms. The probability of error in their determinations may be quite high. Fifth, legal costs alone may discourage meritorious suits. Sixth, a civil liability system may not deter negligent firms. This will occur if victims fail to litigate through either ignorance or expense,¹²⁵ or if insurance carried by a firm allows it to avoid bearing the full cost of its negligence.¹²⁶ Finally, the response of the inspection profession as a whole to the incidence of negligence amongst its members will influence the civil liability system's effectiveness in achieving its deterrent objective.¹²⁷ If the incidence is high, the profession may react by holding compulsory loss control seminars and continuing education programmes for its members,¹²⁸ or by imposing disciplinary sanctions.¹²⁹

2. A Standard-Setting and Enforcement Regulatory Regime

A more market-interventionist approach to regulation of inspection firms would involve the establishment and enforcement of conduct and perform-

¹²¹ Prichard, *supra* note 118, at 385.

¹²² See discussion in Part VI at B.1, *supra*.

¹²³ The prospect of making his own investigation or hiring a second or third expert to obtain the required information may often appear unattractive.

¹²⁴ Grange, *The Silent Doctor v. The Duty to Speak* (1973), 11 Osgoode Hall L.J. 81; Dedmon, *Problems Shared In Common by Doctors and Lawyers* (1976), 49(5) Wisc. Bar Bull. 49.

¹²⁵ Belobaba, *supra* note 38.

¹²⁶ Prins, *supra* note 118, at 373-75.

¹²⁷ Belobaba, *supra* note 118, at 11-12.

¹²⁸ Reiter, *Discipline As A Means Of Assuring Continuing Competence in the Professions, Working Paper #11* (Toronto: Min. of A.G., 1978) Part H: Proposals for Reform; cf. Huozagh and Molloy, *Legal Malpractice: A Calculus for Reform* (1977), 37 Montana L.Rev. 279 at 324.

¹²⁹ Swan, *Continuing Education and Continuing Competence, Working Paper #15* (Toronto: Min. of A.G., 1979).

ance standards by a self-regulatory body.¹³⁰ Investigation of a firm's compliance with these standards could be triggered in a variety of ways.¹³¹ Sanctions for non-compliance could also vary considerably.¹³²

Regulation through standard-setting and enforcement has several advantages. First, the setting and enforcement of standards focuses on the services of inspection firms, which are ultimately what clients are most interested in. Second, the regulatory body can apply its expertise and resources to the challenge of developing, reviewing and enforcing appropriate standards. Third, if the standards are developed by the inspection profession rather than by the courts, firms may perceive them as being more credible and may try to comply with them more diligently. This may result in a reduction in the cost of enforcement. Fourth, the mere setting of standards may have the effect of raising the general level of conduct and performance within the profession.¹³³ Fifth, in contrast to a disappointed client contemplating a negligence suit, the regulatory body should have sufficient information and expertise to make an assessment of an inspection firm's performance. Therefore, both in terms of enforcement and adjudication, this system may generate fewer errors than a civil liability regime.¹³⁴ Finally, to the regulatory body could be delegated the power to bar inspection firms from offering their services if they continually failed to comply with the standards. This sanction might be viewed as more ominous than the threat of damages in a civil action and in turn stimulate firms to upgrade their services.¹³⁵

Notwithstanding the foregoing advantages, the standard-setting and enforcement method of regulation suffers from some serious weaknesses. First, a large investment by the inspection profession would be required to meet the challenge of setting meaningful standards.¹³⁶ Second, monitoring and reviewing the conduct and performance of firms could prove quite expensive and time consuming. As in civil actions, the determination of complex factual and technical issues would be required in each case. Third, administrative review and enforcement of standards may introduce certain rigidities to, and discourage or completely suffocate innovation in, the activities, conduct and services of inspection firms.¹³⁷ Fourth, there is a risk that standards may be set at such an unreasonable level that inspection costs be-

¹³⁰ *Id.* at 3-16.

¹³¹ For example, investigations could be triggered by a dissatisfied client's complaint or through regular peer review of a firm's activities and practices. For elaboration on this point, see Swan, *supra* note 129, at 32-43; Reiter, *supra* note 128, at 22-31.

¹³² Sanctions could vary from a reprimand, to a suspension of the inspection firm from the professional organization, to a requirement of successful completion by the employees of the inspection firm of specified continuing education courses. See Reiter, *supra* note 128, at 43-46 and Swan, *supra* note 129, at 65-91.

¹³³ Swan, *supra* note 129, at 11.

¹³⁴ Trebilcock, Tuohy and Wolfson, *supra* note 105, at 71.

¹³⁵ Swan, *supra* note 129, at 12.

¹³⁶ *Id.* at 16.

¹³⁷ *Id.* at 99; cf. Spence, *supra* note 111, at 2 *et seq.*

come unnecessarily high.¹³⁸ Fifth, aggrieved clients may be unaware of the regulatory body's existence with the result that only a few may complain. This situation may be exacerbated by the regulatory body's procedural requirements for registering complaints.¹³⁹ Sixth, disappointed clients may have less financial incentive to complain to a regulatory agency charged with enforcing standards than to attempt to recover damages through civil litigation.¹⁴⁰ Seventh, a regulatory body responsible for disciplining an inspection firm may have a circumscribed choice of relatively crude sanctions from which to choose. To the extent that the cost of the sanctions imposed does not match the social costs of its incompetent or negligent acts, a firm may not optimize its behaviour.¹⁴¹ Finally, there is a danger that a body's regulatory activities may reflect the profession's norms, values and attitudes rather than those of the house buying public.

3. A Certification Regulatory Regime

Regulating the delivery of products and services under a civil liability or a standard-setting and enforcement regime is frequently perceived as inadequate because of the weaknesses discussed above. The medical, legal and accounting professions are examples where this type of regulation is considered inadequate. The broad regulatory alternative is to supervise entry to the market. There are two general ways to achieve this: certification¹⁴² and licensing.¹⁴³

There are many advantages inherent in a certification scheme. First, it

¹³⁸ Swan, *supra* note 129, at 8; Prichard, *supra* note 118, at 383; Belobaba, *supra* note 118, at 61.

¹³⁹ Reiter, *supra* note 128, at 39.

¹⁴⁰ Nevertheless, a client may complain to a regulatory body in the hope that its intervention will induce a favourable response by the inspection firm to the client's complaint. See Reiter, *supra* note 128, at 28.

¹⁴¹ A crude discipline process is unlikely to confront firms with either the cost of sanctions or the cost of incompetent or negligent acts with any degree of accuracy. In practical terms, the result will be that the disciplinary process may encourage superfluous services or fail to discourage inadequate services. See Trebilcock, Tuohy and Wolfson, *supra* note 105, at 72; *cf.* Reiter, *supra* note 128, at 29.

¹⁴² A certification regime envisages the designation of a label to individuals or firms by some government authority or by some private organization of home inspection firms. In order to qualify for this label, the individual or firm would have to satisfy certain criteria. In the context of the inspection profession, such criteria might include successful completion of training programmes, the performance of a certain number of inspections, or obtaining some professional degree. Certification represents a clear signal to the public that the certified individuals or firms have satisfied all the requirements that the authority views as relevant to the performance of inspections in a competent and professional manner. Until individuals or firms satisfied the certification criteria, they would be prevented from using the certification label.

¹⁴³ The fundamental distinction between certification and licensing regimes is that under the former, uncertified individuals and firms would remain entitled to provide inspection services to the public. In contrast, unlicensed individuals and firms would be barred from offering inspection services under a licensing regime. See Freidman, "Occupational Licensures" in *Capitalism and Freedom* (Chicago: U. of Chi. Press, 1962); *cf.* Dusault, *L'Evolution du Professionalisme au Québec* (1977), 20 *Can. Pub. Admin.* 275.

could help prospective purchasers to determine the relative competence of inspection firms. Second, in contrast to licensing, a certification scheme is more flexible in that it would not preclude new firms from offering inspection services. Third, two or more organizations might be empowered to certify firms that satisfied their respective criteria. This might result in competition between organizations to ensure a high level of competence and professional conduct as a means of enhancing the credibility of their respective certificates.¹⁴⁴ Fourth, by providing consumers with the information necessary to identify the relative competence of various firms, certification might relieve the pressure on firms to promote their services. This in turn would enable smaller firms to compete with larger firms on the basis of quality of service.¹⁴⁵

Apart from these strengths, certification schemes also have the following disadvantages. First, there is no guarantee that certified members will act in a professional and competent manner. Much will depend upon the breadth of the certification criteria. For example, if the criteria are narrowly defined in comparison to the range of services that firms may be called upon to perform, then a certification scheme may mislead rather than assist consumers. Second, it may prove difficult for the certifying authority to ensure that the criteria for certification have actually been fulfilled in a uniform fashion. Third, because many consumers may have difficulty distinguishing competent from incompetent inspection firms, they may rely on certification to such an extent that it becomes a *de facto* licensing regime. This transformation would carry with it the practical barriers against free market entry.¹⁴⁶ Fourth, to the degree that the certification criteria are inappropriate, a certification scheme may misinform consumers and discriminate against some inspection firms to the benefit of others. Fifth, a certification scheme would be inherently misleading because it would fail to inform consumers of exactly what services an inspection firm was competent to offer. In addition, it would fail to inform them of the quality of service that they could expect from certified inspection firms and the risks entailed in dealing with uncertified firms. Further, because certification may imply a significant difference in quality between certified and uncertified firms, it may be particularly misleading at the margin.¹⁴⁷ Sixth, a certification scheme may be inadequate in that it fails to prevent incompetent firms from offering their services to the public. Seventh, because a certification regime does not prevent consumers from retaining the services of uncertified inspection firms, potential third parties will be left without protection. Finally, if the authority to certify is assumed by a pro-

¹⁴⁴ However, too many rival organizations empowered to grant certificates might cause considerable confusion among prospective purchasers. The underlying assumption is that private organizations rather than government would be responsible for certifying home inspection firms. This assumption is made on the basis that in the early stages of the profession's growth, certification of home inspection firms would not be considered a high priority of government.

¹⁴⁵ In the result, the competitive forces within the profession would be enhanced. See Trebilcock, Tuohy and Wolfson, *supra* note 105, at 74.

¹⁴⁶ Gellhorn, *The Abuse of Occupational Licensing* (1976), 44 U. Chi. L. Rev. 6 at 21 *et seq.*

¹⁴⁷ Trebilcock, Tuohy and Wolfson, *supra* note 105, at 75.

fessional body of home inspectors, the certified members may try to transform the certification regime into a licensing scheme as a means of limiting competition and enhancing the profession's prestige and authority.

4. A Licensing Regulatory Regime

Licensing would be the most market-interventionist form of regulation because it would permit only licensed firms to perform inspections.¹⁴⁸ The responsibility for licensing could be assumed by a government agency or be delegated to a professional body of home inspectors. Several benefits attach to licensing over other forms of regulation. First, in contrast to the other regulatory regimes, licensing prevents some firms from offering their services to the public. Second, because a licensing regime focuses on the qualifications of inspection firms rather than on their actual conduct and performance, its administrative costs may be considerably less than other regulatory alternatives. Third, because a licence to perform inspections would likely be considered very valuable, the prospect of its suspension or revocation for negligent or unprofessional conduct would deter incompetence and act as a strong incentive to maintain high standards.¹⁴⁹ Fourth, a licensing regime may be superior to other regulatory alternatives in alleviating a prospective purchaser's costs of information. The licensing body will be in a better position to collect information concerning the competence of aspirants to the profession. Thus, a licensing regime may help to dispel the uncertainty faced by the public in retaining small, relatively unknown inspection firms. As a consequence, the public will not be as likely to have a general preference for large firms. As well, market forces tending toward higher concentration within the profession would be weakened.

A licensing regime also has numerous potential weaknesses.¹⁵⁰ First, the underlying assumption that there is a high correlation between the fulfilment of the licensing criteria and competently performed inspections deserves serious re-examination once the criteria have been established. Second, because a licensing scheme assumes a static market for inspection services, its licensing criteria may become inordinately rigid and arbitrary. The potential

¹⁴⁸ Friedman, *supra* note 143; Gellhorn, *supra* note 146; Moore, *The Purpose of Licensing* (1961), 4 J. Law & Econ. 93; Maurizi, *Occupational Licensing and the Public Interest* (1974), 82 J. Pol. Econ. 399; Leffler, *Physician Licensure Competition and Monopoly in American Medicine* (1978), 21 J. Law & Econ. 165; Zerbe and Urban, *Towards a Public Interest Theory of Regulation*, U. Wash., mimeo (1978).

¹⁴⁹ Reiter, *supra* note 128, at 5.

¹⁵⁰ For discussion of problems raised generally by public standard setting see, e.g., Oi, *The Economics of Product Safety* (1973), 4 Bell J. Econ. & Mgt. Sci. 3; Sands, *How Effective is Safety Legislation?* (1968), 11 J. Law & Econ. 165; Cornell, Noll and Weingast, *Safety Regulation*, United States National Science Foundation, mimeo (1976); Spence, *supra* note 111; Goldberg, *The Economics of Product Safety and Imperfect Information* (1974), 5 Bell J. Econ. & Mgt. Sci. 683; Peltzman, *An Evaluation of Consumer Protection Legislation: The 1962 Drug Amendments* (1973), 81 J. Pol. Econ. 1049; Peltzman, *The Effects of Automobile Safety Regulations* (1975), 83 J. Pol. Econ. 671.

for innovative changes in response to shifting consumer expectations or changes in scientific knowledge may be limited. Moreover, after obtaining a licence, there may be little competitive pressure for firms to respond to market forces or to upgrade their quality of service. Third, a licensing scheme implies that only firms which have satisfied the licensing criteria are competent to perform inspections. This analysis fails to consider substitution effects.¹⁵¹ Consumers who do not wish to retain licensed inspectors may find unlicensed substitutes of indeterminate quality. Several problems may arise as a result. The overall quality of inspection services, net of substitution effects, may be lower than it would be in an unlicensed market. In addition, consumers may become confused about the quality of substitutes unless they too are licensed. Also, if consumers continually rely on substitutes, tension may arise between the substitutes and licensed inspectors concerning their respective jurisdictions. Fourth, consumers may not maximize their personal welfare under a licensing scheme if they are forced to retain the more expensive services of licensed inspection firms instead of the presumably less expensive services of unlicensed substitutes. Fifth, a licensing scheme requiring the satisfaction of only one set of criteria may mislead consumers because licensed firms may be retained to perform a variety of tasks requiring a range of skills far exceeding the minimum needed for a licence. If in response to this problem, various licences are made available requiring different or increasingly sophisticated skills, consumers may become puzzled and manpower mobility within the profession may be impeded. Sixth, it may prove difficult to clearly define the scope of the licences granted. Seventh, because members of the inspection profession may be allowed to determine the licensing criteria, there is a risk that the standards may gradually be set increasingly higher. An underlying purpose of such a move could be to limit the number of successful entrants to the profession as a means of protecting the economic interests of the existing members.¹⁵² Finally, once implemented, a licensing scheme is difficult to remove without vigorous resistance from, and real losses being suffered by, the members of the profession.¹⁵³

5. Choosing an Appropriate Regulatory Framework

Regulation of the inspection profession beyond the existing civil liability regime requires evidence of market failure. Market failure alone, however, does not automatically mean that further intervention is necessary. Other regulatory regimes may be too costly or may introduce new inefficiencies of their own. For example, they may be premature in view of the stage of the inspection profession's growth, or too drastic in light of the incidence of

¹⁵¹ A problem raised by the economic theory of second best. See Lipsey and Lancaster, *The General Theory of Second Best*, Rev. Econ. Stud. (1956-57).

¹⁵² Tuohy and Wolfson, "The Political Economy of Professionalism: A Perspective," *Four Aspects of Professionalism* (Ottawa: Consumer Research Council Canada, 1977) 41 at 64.

¹⁵³ Tuohy, *Private Government, Property and Professionalism* (1976), IX Can. J. Pol. Sci. 668.

current problems. The costs and benefits of the *status quo* must be weighed against the costs and benefits of any new regulatory regime. Any assessment of costs and benefits should also take into account the underlying social costs and benefits. For example, problems such as what level of risk should consumers be prepared to accept, what fees should they be expected to pay and what number of firms should be allowed to perform inspections, will have to be examined and resolved.

In theory, the existing civil liability regime could function smoothly in combination with any of the others discussed. Similarly, a standard-setting and enforcement regime could operate in conjunction with certification or licensing. In addition, civil liability and standard-setting regimes could complement either a certification or a licensing scheme. By definition, however, certification and licensing could not co-exist. With this background in mind, the challenge is to select the most appropriate combination of regulatory regimes for the inspection profession.

In view of its weaknesses, the existing civil liability regime should not be the exclusive form of regulation. However, it should not be abolished because specific regulatory systems alone might be inadequate.¹⁵⁴ In view of a civil liability regime's advantages, the issue becomes whether other regulatory systems should be implemented to complement it.¹⁵⁵

A limited version of a standard-setting and enforcement regime at this stage of the profession's growth would likely result in significant benefits being derived by both inspection firms and the public. Since such a regime does not involve a dramatic regulatory intervention into the free market for inspection services, it is unlikely to introduce substantial costs or inefficiencies of its own. The standards would represent a level of competence and performance that each firm could strive to maintain constantly. Because the profession itself would promulgate the standards, they would likely be more reasonable, sensitive and acceptable than they would be if imposed by the courts. The standards could also serve to make the practices of firms more uniform. Moreover, the mere setting of standards may raise the general level of conduct and performance within the profession which would indirectly enhance the image of each firm. Finally, the profession might avoid obtaining a poor reputation if the standards were buttressed by appropriate sanctions.

The public would also benefit. Disappointed clients might secure relief more quickly by complaining to the regulatory body rather than by choosing to litigate. As well, the regulatory body would have the superior background and experience to evaluate an inspection firm's behavior. Many of the disadvantages to this type of scheme can be mitigated if a gradual approach to its implementation is pursued. Such an approach would recognize that the inspection profession is at a relatively early stage of its growth. It would also reduce the time and expense initially involved in the development of stand-

¹⁵⁴ Belobaba, *supra* note 118, at 5. In fact, to remove a client's right to sue a negligent inspection firm would be an unparalleled step.

¹⁵⁵ Kretzmer, *supra* note 118, at 69.

ards and minimize the risk that they could become too rigid or unrealistically high.

Given the relative infancy of the inspection profession, a certification scheme would appear to be inappropriate and unrealistic at this time. Neither the government nor inspection firms have sufficient knowledge, expertise and experience to define what the appropriate prerequisites for certification should be. Until such appropriate prerequisites are developed, a certification regime could further confuse and mislead rather than inform consumers. A certification scheme could introduce rigidities into the profession and discourage innovation at a time when the services of firms and expectations of clients are still evolving. As well, there is no evidence that a certification regime is required to bolster competitive forces,¹⁵⁶ nor is there evidence of widespread incompetence or negligence or that clients are suffering losses for which they could never receive adequate compensation.¹⁵⁷ Finally, there is no evidence that the inspection profession is becoming highly concentrated through efforts to dispel information deficiencies or that a degeneration of the market is occurring.

If a certification regime is inappropriate at this stage of the profession's growth, *a fortiori* a licensing regime would also be premature. First, in light of the profession's infancy, exclusion of unlicensed providers of inspection services would be a drastic policy response to the existing problems that the profession faces. Second, the interests of third parties are not so significant that a licensing scheme must be enacted for their protection.¹⁵⁸ Finally, the risk that licensing will dull competitive forces and confuse or mislead the public appears to outweigh heavily a licensing regime's advantages.

6. Implementation of a Standard-Setting and Enforcement Regime

Given the present stage of the inspection profession's growth, the implementation of a standard-setting and enforcement regime would appear to be the most appropriate form of regulation. The first step in implementing such a regime would involve present members of the inspection profession taking the initiative to form a regulatory body charged with the responsibility of establishing standards, developing a code of ethics and creating appropriate sanctions. Various committees of the body could then be set up to work on fulfilling its objects. For example, one committee could discuss proposals for conduct and performance standards. Once it had reached a consensus, it could formulate voluntary standards for the consideration of all of the body's members. Once approved, the standards could be implemented on a trial basis.¹⁵⁹

¹⁵⁶ In fact, the implementation of such a scheme might discourage the free entry of new firms to the profession at a time when the profession is still growing rapidly.

¹⁵⁷ As a consequence, there is little reason to expect that certifying home inspection firms will become a high government priority.

¹⁵⁸ In fact, their interests are almost identical to those of the client himself.

¹⁵⁹ The adoption of even voluntary standards could result in a surprising rise in the level of competence and performance within the profession. See Swan, *supra* note 129, at 13.

Due to its limited financial resources, the regulatory body should at first rely on client-initiated complaints before investigating or reviewing a firm's conduct or performance. A committee should be set up, charged with the responsibility of creating an effective client complaint registration procedure.¹⁶⁰ This would necessarily involve exploring ways of familiarizing clients with the regulatory body's existence and purposes in general, and with the complaints procedure in particular. Although this method of detecting incompetence relies on clients to make complaints, there is no evidence to show that clients do not recognize when they have been victimized by negligent firms.

A second committee could be given the task of ensuring that the sanctions for non-compliance are tailored to reflect the social costs of negligent or incompetent behaviour as closely as possible. It could also serve as the discipline committee to apply its sanctions in actual cases of non-compliance.

This implementation strategy is a gradual one for several reasons. It recognizes the limited resources of its members at this early stage of the profession's growth by delegating responsibilities to various committees staffed by volunteer members. It also recognizes the need to encourage innovation and minimize the risk of introducing rigidities by initially making the standards voluntary and by implementing them only on a trial basis. It allows members to gain experience in complying with the standards and ensures that they are not set at unreasonable levels.

VII. SUMMARY

Purchasers of used houses often discover physical defects after their purchase. If they attempt to secure relief from the vendor through litigation, they are confronted with a phalanx of substantive and procedural problems. In response to these problems, various proposals for reform have been suggested. Most have been rejected or have failed to generate widespread enthusiasm. Over the past few years, however, many purchasers of used houses have turned to home inspection firms to assist them in discovering physical defects before they purchase. The benefits that inspection firms provide are significant.

The inspection profession is not, however, the subject of any regulatory regime apart from that of civil liability. Because of existing and potential problems confronting the profession and its clients, there is a need for additional regulation. In weighing the advantages and disadvantages of various regulatory schemes, a limited version of a standard-setting and enforcement regime functioning in conjunction with the existing civil liability regime appears to be most appropriate. To implement this regulatory framework, a regulatory body must be formed by the existing members of the profession. This body should be charged with the responsibility of developing and enforcing standards and drafting a code of ethics to govern the behaviour of its members.

¹⁶⁰ Reiter, *supra* note 128, at 32.