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THE CASE FOR AN IMPLIED WARRANTY OF QUALITY IN SALES OF COMMERCIAL REAL ESTATE

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Over the past twenty years, numerous courts and commentators have chronicled the demise of the *caveat emptor* doctrine in real property transactions.[1] Developments such as the creation of an implied warranty of quality in sales of new residential property,[2] the expansion of circumstances under which vendors have the duty to disclose defects in property,[3] and the widespread acceptance of an implied warranty of

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1. *See, e.g.*, Bearman, *Caveat Emptor in Sales of Realty—Recent Assaults Upon the Rule*, 14 VAND. L. REV. 541 (1961); Grand, *Implied and Statutory Warranties in the Sale of Real Estate: The Demise of Caveat Emptor*, 15 REAL EST. L.J. 44 (1986); Note, *Commercial Law—Implied Warranties in Sales of Real Estate—The Trend to Abolish Caveat Emptor*, 22 DE PAUL L. REV. 510 (1972) [hereinafter *The Trend to Abolish Caveat Emptor*]; Comment, *Home Sales: A Crack in the Caveat Emptor Shield*, 29 MERCER L. REV. 323 (1977) [hereinafter *Home Sales*].

2. For discussion of the development of this implied warranty, see generally Bearman, *supra* note 1; Grand, *supra* note 1; Haskell, *The Case for an Implied Warranty of Quality in Sales of Real Property*, 53 GEO. L.J. 633 (1965); Tennille, *Remedies for Defective New Homes in California: A Framework for Statutory Change*, 9 W. ST. U.L. REV. 23 (1982); Note, *Liability of the Builder-Vendor Under the Implied Warranty of Habitability—Where Does it End?*, 13 CREIGHTON L. REV. 593 (1979); Note, *Implied Warranties in New Home Sales—Is the Seller Defenseless?*, 35 S.C.L. REV. 469 (1984) [hereinafter *Is the Seller Defenseless?*]; Note, *Defective Housing: Remedies Available to the First and Subsequent Purchasers*, 25 S.D.L. REV. 333 (1980) [hereinafter *Defective Housing*]; Note, *Breach of Warranty in the Sale of Real Property*: Johnson v. Healy, 41 OHIO ST. L.J. 727 (1980). For discussion of related bases of builders' liability for defective homes, see Cherry, *Negligence: An Expanding Cause of Action Against Builders for Used Home Defects*, 26 AM. BUS. L.J. 167 (1988); Note, *Strict Liability in Tort for Builder-Vendors of Homes*, 24 TULSA L.J. 117 (1988) [hereinafter *Strict Liability for Builders*]; Note, *The Implied Warranty of Habitability Doctrine in Residential Property Conveyances: Policy-Backed Change Proposals*, 62 WASH. L. REV. 743 (1987) [hereinafter *Policy-Backed Change Proposals*].

A growing number of states have extended the reach of the implied warranty of habitability to purchasers of relatively new used homes. *See infra* note 68.

3. For discussion of the traditional rule and recent trends, see generally Goldfarb, *Fraud and Non-Disclosure in the Vendor-Purchaser Relation*, 8 W. RESERVE L. REV. 5 (1956); Kafker, *Sell and Tell: The Fall and Revival of the Rule on Nondisclosure in Sales of Used Real Property*, 12 U. DAYTON L. REV. 57 (1986); Keeton, *Fraud—Concealment and Non-Disclosure*, 15 TEX. L. REV. 1 (1936); Note, *When the Walls Come Tumbling Down—Theories of Recovery for Defective Housing*, 56 ST. JOHN'S L. REV. 670 (1982) [hereinafter *When the Walls Come Tumbling Down*]; Note, *Real*

habitability in residential leases[4] evidence the doctrine's erosion. These developments acknowledge the bankruptcy of *caveat emptor*'s "optimistic creed"[5] that the parties have equal knowledge and bargaining power in transactions involving the sale of residential property.[6] However, the doctrine remains viable in other situations. There is no consensus among courts about whether the underlying assumptions of *caveat emptor* are tenable in the sale of commercial or investment property.[7]

Although the application of an implied warranty of quality is now widespread in the sale of new homes,[8] relatively few courts have considered whether implied warranty protection should extend to purchasers of commercial property. Of these courts, some have rejected the application of the warranty based on the assumption that a purchaser of commercial property is capable of acting for his own protection.[9] Other courts, minimizing the significance of the purchaser's investor status, have held that an implied warranty of quality applies in sales of commercial as well as residential property.[10] This Article will demonstrate that an implied warranty of quality should be imposed in sales of commercial

Property—Seller's Liability for Nondisclosure of Real Property Defects: Johnson v. Davis, 14 FLA. ST. U.L. REV. 359 (1986); Note, *Property—Caveat Emptor—Duty to Disclose Limited to Commercial Vendors*, 64 MARQ. L. REV. 547 (1981); *Home Sales*, *supra* note 1; Note, Johnson v. Davis: *New Liability for Fraudulent Nondisclosure in Real Property Transactions*, 11 NOVA L.J. 145 (1986). *See also* Goforth, *Sales of Structurally Defective Homes: The Potential Liability of Sellers and Real Estate Brokers*, 41 OKLA. L. REV. 447 (1988) (discussing the expansion of brokers' and sellers' liability for fraudulent misrepresentation).

4. *See, e.g.*, Javins v. First Nat'l Realty Corp., 428 F.2d 1071 (D.C. Cir.), *cert. denied*, 400 U.S. 925 (1970). *See also* Mallor, *The Implied Warranty of Habitability and the 'Non-Merchant' Landlord*, 22 DUQ. L. REV. 637, 637 n.3 (1984) (reporting that at least 40 jurisdictions have adopted the implied warranty of habitability by statute or judicial decision and listing jurisdictions that had done so as of 1984).

5. Professor Kessler used this term to describe the ideology underlying freedom of contract. Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 630-31 (1943).

6. *See, e.g.*, Humber v. Morton, 426 S.W.2d 554, 557 (Tex. 1968). *See Is the Seller Defenseless?*, *supra* note 2, at 470.

7. The term "commercial property" will be used throughout this Article to mean improved real property that is used for any income-producing purpose, including commercial, industrial, and investment purposes.

8. For a list of states that had adopted the implied warranty of habitability as of 1984, *see* Case Note, *Implied Warranty of Fitness and Habitability—Contract Language Stating No Warranties, Express or Implied, is Effective Disclaimer of Implied Warranty of Fitness and Habitability in Sale of New House by Builder-Vendor*, 15 ST. MARY'S L.J. 673, 679-80 n.27 (1984). *See also* Conklin v. Hurley, 428 So. 2d 654, 656 n.2 (Fla. 1983) (listing jurisdictions adopting the warranty as of 1983).

9. *See infra* notes 79-123 and accompanying text.

10. *See infra* notes 124-46 and accompanying text.

property and will make recommendations about the application of such a warranty. Part I examines the evolution, policies, and scope of the implied warranty of habitability as that warranty has applied to sales of residential property. Part II examines the divergent approaches that courts have used in cases concerning sales of commercial property. Part III then evaluates whether the rationales supporting the implied warranty of habitability apply in sales of commercial property, and contends that they do. Finally, the Article proposes standards for the application of an implied warranty of quality tailored to the issues likely to confront courts with respect to sales of commercial property.

I. THE IMPLIED WARRANTY OF HABITABILITY IN SALES OF RESIDENTIAL REAL ESTATE

A. Evolution of the Implied Warranty of Habitability

The erosion of the *caveat emptor* doctrine in the sale of goods was underway by the early twentieth century,[11] but the doctrine still dominated real property transactions in many states well into the 1960s.[12] Although courts occasionally applied an implied warranty of workmanlike construction to builders in construction contracts,[13] these warranties did not extend to the sale of structures. Despite the tremendous surge of housing development following World War II, courts commonly held that in the absence of an express warranty or a misrepresentation, even professional builder-vendors bore no legal responsibility for the quality or fitness of the structures they sold.[14] Moreover, even a vendor who made express warranties in his contract with the purchaser might escape liability under a separate but related doctrine called the merger doctrine.[15] Under the merger doctrine all agreements entered prior to the

11. *See Strict Liability for Builders, supra* note 2, at 119-27 (discussing the evolution of strict liability in tort).

12. M. FRIEDMAN, CONTRACTS AND CONVEYANCES OF REAL PROPERTY § 1.2(n), at 30-32 (3d ed. 1975); Bearman, *supra* note 1, at 542; Seavey, *Caveat Emptor as of 1960*, 38 TEX. L. REV. 439 (1960); *When the Walls Come Tumbling Down, supra* note 3, at 682-83.

13. *See, e.g.*, Busker v. Sokolowski, 203 N.W.2d 301 (Iowa 1972); Smith & Nelson v. Bristol, 33 Iowa 24 (1871). *See also* Kellogg Bridge Co. v. Hamilton, 110 U.S. 108 (1884) (implied warranty applied to builder of bridge). For further discussion of the early use of implied warranties in construction contracts, see Comment, *Extension of Implied Warranties to Developer-Vendors of Completed New Homes*, 11 URBAN L. ANN. 257, 262 n.19 (1976).

14. *See, e.g.*, Tudor v. Heugel, 132 Ind. App. 579, 178 N.E.2d 442 (1961). See *The Trend to Abolish Caveat Emptor, supra* note 1, at 514 n.23, however, for a discussion of alternative theories of relief sometimes used by courts before the emergence of implied warranties.

15. *The Trend to Abolish Caveat Emptor, supra* note 1, at 512.

execution of a deed were presumed to have been merged in the deed.[16] Thus, an express warranty stated in the contract but omitted from the deed would often be of no effect after the delivery of the deed.[17]

The *caveat emptor* and merger doctrines were both premised on the purchaser's ability to discover and protect himself against defects in property.[18] It is not surprising, then, that the first exception to those doctrines involved situations in which the purchaser did not have the ability to protect himself by prior inspection. In the late 1950s, American courts began to create and apply an implied warranty of quality that did not merge into the deed when a purchaser bought a house that was still under construction at the time of sale.[19] In this initial period of development of the implied warranty, courts carefully distinguished sales of houses still under construction from sales of completed houses on the grounds that the buyer of a completed house had the ability to inspect the structure or bargain for express warranties.[20]

Critics soon attacked the validity of this distinction, arguing that the

16. *See* D. WHALEY, WARRANTIES AND THE PRACTITIONER 228-29 (1981); 7 S. WILLISTON, TREATISE ON THE LAW OF CONTRACTS § 926, at 798-99 (3d ed. W. Jaeger 1963) (stating that "after delivery and acceptance of a deed in performance of a contract for the purchase and sale of land the deed is regarded as the final expression of the agreement of the parties and the sole repository of the terms on which they have agreed"). *See also When the Walls Come Tumbling Down*, *supra* note 3, at 685 n.73 (observing that the purpose of the merger doctrine was to facilitate certainty in real property transactions by ensuring that only one document contained all the limitations on the transaction in question); *The Trend to Abolish Caveat Emptor*, *supra* note 1, at 512 (observing that the merger doctrine helped to prolong the life of the *caveat emptor* doctrine).

17. Courts developed several exceptions to the merger doctrine, however. A provision of the contract of sale would survive the delivery of the deed, for example, if it created rights that were "collateral" to the deed (*i.e.*, unrelated to title, possession, and like matters). *See* M. FRIEDMAN, CONTRACTS AND CONVEYANCES OF REAL PROPERTY § 7.2, at 781-84 (4th ed. 1984). In recent years, courts have held that express and implied warranties of quality are collateral and do not merge into the deed. *See id.* at 786.

18. *The Trend to Abolish Caveat Emptor*, *supra* note 1, at 511. *See also* J. LIEBERMAN, THE LITIGIOUS SOCIETY 39 (1981) (essential prerequisite of *caveat emptor* was knowledge of risk); Comment, *The Case Against Strict Liability Protection for New Home Buyers in Ohio*, 14 AKRON L. REV. 103, 106-07 (1980).

19. Vanderschrier v. Aaron, 103 Ohio App. 340, 140 N.E.2d 819 (1957); Jones v. Gatewood, 381 P.2d 158 (Okla. 1963); Hoye v. Century Builders, Inc., 52 Wash. 2d 830, 329 P.2d 474 (1958). English courts had applied an implied warranty of workmanlike construction to sales of unfinished houses some 20 years earlier. *See* Miller v. Cannon Hill Estates, Ltd., 2 K.B. 113 (1931); Perry v. Sharon Dev. Co., 4 All E.R. 390 (C.A. 1937) (house substantially completed).

20. *See, e.g.*, Fain v. Nelson, 57 Wash. 2d 217, 356 P.2d 302 (1960) (no implied warranty of fitness in sale of apartment building; warranty applies only to sale of buildings under construction; purchaser was experienced with apartment buildings and did not inspect). *See also* Kirk v. Ridgway, 373 N.W.2d 491, 493-94 (Iowa 1985); *The Trend to Abolish Caveat Emptor*, *supra* note 1, at 515-17.

purchaser of a completed structure is equally unable to detect defective conditions.[21] The complexity of houses together with the average home buyer's relative lack of expertise can make inspection relatively meaningless. Even if the homebuyer employs an expert to inspect the house, many defects are undetectable after completion of the structure.[22] Critics also argued that the purchaser of a completed structure is in no better position than the purchaser of an uncompleted structure to protect himself by negotiating an express warranty. Both may be inexperienced, uncounseled laymen who do not recognize the need for contractual protection. Or both simply may lack the bargaining power to negotiate the clause. For these reasons, courts came to see the distinction between these two transactions as untenable.[23]

In the 1964 case of *Carpenter v. Donohoe*,[24] Colorado became the first state to abandon the distinction between uncompleted and completed homes and to recognize an implied warranty of quality in the sale of a completed home. Over the next decade, most states' courts followed suit, rejecting the *caveat emptor* and merger doctrines in sales of new homes by builder-vendors and creating instead a guarantee of quality usually called the implied warranty of habitability or the implied warranty of workmanlike construction.[25]

B. Rationales for Implied Warranty Protection

The logic and rhetoric of the product liability revolution fueled courts' decisions to extend implied warranty protection to sales of completed homes. A judge who imposes strict liability on a seller of goods because of the inherent disparity in knowledge, control, or bargaining power be-

21. M. FRIEDMAN, *supra* note 17, § 1.2, at 58; Bearman, *supra* note 1, at 545.

22. M. FRIEDMAN *supra* note 17, § 1.2, at 58; Note, *The Implications of Implied Warranty Protection for Used Housing*—Gaito v. Auman, 21 WAKE FOREST L. REV. 515, 518 (1986).

23. *See, e.g.*, Carpenter v. Donohoe, 154 Colo. 78, 388 P.2d 399, 402 (1964). One commentator points out that a builder-vendor who built two houses at the same time for sale and happened to sell one before completion would be responsible to that purchaser for a defect in the house, but would not be responsible for defects in the second house if the purchaser bought it immediately *after* completion. M. FRIEDMAN, *supra* note 17, § 1.2, at 58. *See also* Bearman, *supra* note 1, at 544-46 (criticizing the distinction between newly completed housing and uncompleted housing).

24. 154 Colo. 78, 388 P.2d 399 (1964).

25. *See, e.g., id.*; Kirk v. Ridgway, 373 N.W.2d 491 (Iowa 1985); Hartley v. Ballou, 286 N.C. 51, 209 S.E.2d 776 (1974); Jeanguneat v. Jackie Hames Constr. Co., 576 P.2d 761 (Okla. 1978). *See supra* note 8.

The terms "implied warranty of habitability" and "implied warranty of workmanlike construction" are apparently synonymous. *See, e.g., infra* notes 44-46.

tween the seller and a buyer[26] will likely find it inconsistent to apply the *caveat emptor* doctrine when a buyer in the same disadvantaged position invests much more money in real property. The fact that many of the defendants in the early implied warranty cases were mass builders allowed courts to forge a link to product liability principles. Courts made a persuasive analogy between the relationship of builder-vendor and purchaser and the relationship of manufacturer and consumer.[27] Although provisions of the Uniform Commercial Code (UCC) are inapplicable to sales of real property,[28] courts often suggest that the implied warranty of habitability is analogous to a warranty of merchantability in the sale of goods.[29] The analogy seems especially appropriate when new houses are mass produced by a builder-vendor regularly engaged in the business of selling new homes.[30]

Perhaps the most compelling rationale for creating implied warranties in the sale of new homes is that the purchaser is forced to rely on the skill and integrity of the builder.[31] *Caveat emptor*'s assumption that a purchaser is capable of protecting himself by inspecting the structure might have been reasonable in an earlier time, when structures were simpler. Today, however, the complexity of houses makes it very difficult for most laymen to detect hidden defects. Many defects that might exist in a modern house are virtually impossible for a diligent purchaser or even a professional inspector to discover, particularly when the defect exists in some part of the construction that has been sealed or in the structure's

26. The basic dichotomy between a "relatively sophisticated and financially powerful seller dealing with a relatively unsophisticated and financially weak consumer respecting a product whose capacities for inflicting injury are often hidden" provides the rationale for the expansion of products liability law. Dickerson, *The ABC's of Products Liability—With a Close Look at Section 402A and the Code*, 36 TENN. L. REV. 439, 440 (1969).

27. *See, e.g.*, Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 207 A.2d 314 (1965).

28. UCC § 2-102 (1987) provides in part that "[u]nless the context otherwise requires, this Article applies to transactions in goods."

Older cases typically rejected plaintiffs' attorneys' efforts to urge the creation of implied warranties in the sale of real property by analogizing them to warranties in the sale of personal property. *See, e.g.*, Murphy v. Sheftel, 121 Cal. App. 533, 9 P.2d 568 (1932).

29. *See, e.g.*, Hopkins v. Hartman, 101 Ill. App. 3d 260, 427 N.E.2d 1337, 1339 (1981). *See* D. WHALEY, *supra* note 16, at 232 (the warranty of habitability is "kissing kin" to the warranty of merchantability).

30. Petersen v. Hubschman Constr. Co., Inc., 76 Ill. 2d 31, 389 N.E.2d 1154 (1979).

31. *See, e.g.*, Pollard v. Saxe & Yolles Dev. Co., 12 Cal. 3d 374, 525 P.2d 88, 91, 115 Cal. Rptr. 648, 651 (1974); Yepsen v. Burgess, 269 Or. 635, 525 P.2d 1019, 1022 (1974); Licciardi v. Pascarella, 194 N.J. 381, 476 A.2d 1273 (1983). *See also* Bearman, *supra* note 1, at 574; *Policy-Backed Change Proposals*, *supra* note 2, at 745-47.

foundation.[32]

In contrast, the builder has superior knowledge of the details regarding the site preparation, materials, and building practices used in the construction process,[33] and a better opportunity to avoid defects.[34] Builder-vendors encourage the purchaser's reliance by holding themselves out as having superior expertise.[35] If that reliance is misplaced, the purchaser stands to suffer great damage. As courts often note, the purchase of a house is usually the largest single purchase of a person's lifetime.[36]

Another rationale for implying a warranty of quality in the sale of real property is that it facilitates the reasonable expectations of the parties.[37] A purchaser of improved real property usually bargains primarily for structures on the land which are fit for their ordinary uses, and he has certain reasonable expectations about the durability and quality of those structures.[38] Because many buyers either do not realize the need to bargain for an express warranty or cannot effectively negotiate contractual protection against defective construction, imposing an implied warranty against defects may be the only way to ensure that the purchaser receives that for which he bargained. This is especially true when the parties use a standardized form contract which minimizes the purchaser's opportunity to negotiate warranty protection.[39]

In addition, the implied warranty of habitability is based on the rationale that a builder-vendor is usually better able to bear the risk of latent defects in the property than is a purchaser. The builder-vendor has the

32. Bearman, *supra* note 1, at 545.

33. *See, e.g.*, George v. Veach, 67 N.C. App. 674, 680, 313 S.E.2d 920, 923 (1984); House v. Thornton, 76 Wash. 2d 428, 435, 457 P.2d 199, 204 (1969).

34. *See, e.g.*, Conyers v. Molloy, 50 Ill. App. 3d 17, 19, 364 N.E.2d 986, 988 (1977); *George*, 67 N.C. App. at 680, 313 S.E.2d at 923-24 (1985).

35. *See* Terlinde v. Neely, 275 S.C. 395, 398, 271 S.E.2d 768, 769 (1980).

36. *See, e.g.*, Bethlahmy v. Bechtel, 91 Idaho 55, 67, 415 P.2d 698, 710 (1966); Moxley v. Laramie Builders, Inc., 600 P.2d 733, 735 (Wyo. 1979).

37. *See* Haskell, *supra* note 2, at 649-50, arguing that the implied warranty is the implicit understanding of the parties that when a fair price is paid, the buyer should receive a building that is reasonably fit for its ordinary purposes. He notes that "since one does not give money in exchange for illusory value . . . the law should read this term into the contract as one which is implied in fact." *Id.* at 650.

38. *See, e.g.*, Smith v. Old Warson Dev. Co., 479 S.W.2d 795, 799 (Mo. 1972) (en banc) ("Although considered to be a 'real estate' transaction because the ownership to land is transferred, the purchase of a residence is in most cases the purchase of a manufactured product—the house. The land involved is seldom the prime element in such a purchase, certainly not in the urban areas of the state.").

39. *See* Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 530 (1971).

opportunity to insure against the risk of defects and to distribute the cost through increased prices.[40] On the other hand, a purchaser who must make costly repairs as a result of a defect unknown at the time of purchase will have no means of distributing those costs, unless he has insurance that covers the particular risk.

Finally, courts creating the implied warranty of habitability wanted to encourage minimum standards of safety and quality in new construction. While most of the injuries purchasers suffer in connection with defective real property are purely economic, defective construction also presents a potential threat to life and health.[41] Implied warranties operate to discourage "jerrybuilding" and the resulting risk of personal injuries, as well as to improve the quality of new construction.[42]

Although almost all of the cases establishing the implied warranty of habitability in the sale of completed structures involved residential property, this Article contends that the rationales supporting the warranty's creation are equally applicable to sales of commercial real estate.

C. The Nature of the Implied Warranty of Habitability

The implied warranty of habitability is an extracontractual duty placed on those in the business of building or selling real property.[43] The warranty requires that a house sold by such an individual comply with community standards of workmanlike construction[44] and be fit for human habitation.[45] The warranty imposes a form of strict liability on the builder; the complaining party need not establish negligence even in

40. *See, e.g.*, Schipper v. Levitt & Sons, Inc., 44 N.J. 70, 87, 207 A.2d 314, 323 (1965). *See also* R. POSNER, ECONOMIC ANALYSIS OF LAW 140-41 (2d ed. 1977).

41. *See* Barnes v. Mac Brown & Co., Inc., 264 Ind. 227, 230, 342 N.E.2d 619, 621 (1976).

42. *See, e.g.*, Gaito v. Auman, 70 N.C. App. 21, 27, 318 S.E.2d 555, 559 (1984); Humber v. Morton, 426 S.W.2d 554, 562 (Tex. 1968).

43. The duty is limited to those who are in the business of building or selling real property. *See infra* note 71.

44. *See, e.g.*, Henggeler v. Jindra, 191 Neb. 317, 318-19, 214 N.W.2d 925, 926 (1974) (contractor impliedly warrants that "the building will be erected in a workmanlike manner and in accordance with good usage and accepted practices in the community"); Hartley v. Ballou, 286 N.C. 51, 62, 209 S.E.2d 776, 783 (1974) (vendor in the business of selling dwellings impliedly warrants that "the dwelling, together with all its fixtures, is sufficiently free from major structural defects, and is constructed in a workmanlike manner, so as to meet the standard of workmanlike quality then prevailing at the time and place of construction").

45. *See, e.g.*, Columbia Western Corp. v. Vela, 122 Ariz. 28, 33, 592 P.2d 1294, 1299 (Ct. App. 1979); Lyon v. Ward, 28 N.C. App. 446, 450, 221 S.E.2d 727, 729 (1976) ("a builder-vendor impliedly warrants to the initial purchaser that a house and all its fixtures will provide the service or protection for which it was intended under normal use and conditions").

states in which the warranty is described as a guarantee of workmanlike construction.[46] The duration of the warranty is usually measured by a standard of reasonableness that takes into account the parties' reasonable expectations about the durability of the structure and its fixtures.[47]

The implied warranty of habitability does not guarantee perfection, however. It protects only against *latent* defects, not against known defects or those that would be visible upon inspection by a reasonable purchaser.[48] The latency requirement is based on considerations of freedom of contract; it is fair to presume that a buyer purchasing obviously defective property is willing to accept the deficiency because of an attractive

46. *See, e.g.*, Degnan v. Executive Homes, Inc., 215 Mont. 162, 166, 696 P.2d 431, 433 (1985) ("theory behind the implied warranty of habitability is not one of fault or wrongdoing"); George v. Leach, 67 N.C. App. 674, 678, 313 S.E.2d 920, 922 (1984); Rutledge v. Dodenhoff, 254 S.C. 407, 414, 175 S.E.2d 792, 795 (1970). *See* Cosmopolitan Homes, Inc. v. Weller, 663 P.2d 1041, 1045 (Colo. 1983) (en banc) (distinguishing implied warranty of habitability claims from negligence claims). In a few cases, courts have permitted plaintiffs to maintain cases against builder-vendors premised on strict liability in tort, even when the plaintiffs' sole injury was economic. *See* Blagg v. Fred Hunt Co., Inc., 272 Ark. 185, 612 S.W.2d 321 (1981); Avner v. Longridge Estates, 272 Cal. App. 2d 607, 77 Cal. Rptr. 633 (1969); Kriegler v. Eichler Homes, Inc., 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (1969). *But see* Bernstein v. Ainsworth, 220 Neb. 670, 371 N.W.2d 682 (1985) (vendor of improved lot could not be held strictly liable for damages resulting from defects in lot which caused it to be susceptible to flooding).

One issue arising frequently is whether the cause of action lies in contract or tort. The resolution of this issue is important for purposes such as issues of proof, determination of the applicable statute of limitations, and application of attorney fees provisions in sales contracts. Most courts have held that the action lies in contract. *See, e.g.* Woodward v. Chirco Constr. Co., 141 Ariz. 520, 687 P.2d 1269 (1984) (en banc); *Cosmopolitan Homes*, 663 P.2d at 1045; Cabal v. Donnelly, 302 Or. 115, 727 P.2d 111 (1986). *But see* Velotta v. Leo Petronzio Landscaping, Inc., 69 Ohio St. 2d 376, 378-79, 433 N.E.2d 147, 150 (1982) (cause of action arising from failure to perform in a workmanlike manner lies in tort because the duty is imposed by law rather than by contract). *See generally* Note, *The Implied Warranty of Habitability—Contract or Tort?*, 31 BAYLOR L. REV. 207 (1979). One court held, however, that willful and wanton conduct in breaching the implied warranty of habitability can constitute an independent tort and give rise to a claim for punitive damages. Morrow v. L.A. Goldschmidt Assoc., Inc., 126 Ill. App. 3d 1089, 468 N.E.2d 414 (1984).

47. *See, e.g.*, Wagner Constr. Co., Inc. v. Noonan, 403 N.E.2d 1144, 1148 (Ind. Ct. App. 1980); *George*, 67 N.C. App. at 680, 313 S.E.2d at 924. *Cf.* Gaito v. Auman, 70 N.C. App. 21, 318 S.E.2d 555 (1984) (warranty protected first purchaser of five-year-old home; house considered "new" for purposes of warranty throughout the duration of the ten-year statute of limitations period).

Some states have enacted statutes of repose that limit the period of time during which a builder may be vulnerable to claims. *See, e.g.*, IND. CODE ANN. § 34-4-20-2 (West Supp. 1987-88).

48. *See, e.g.*, Richards v. Powercraft Homes, Inc., 139 Ariz. 242, 245, 678 P.2d 427, 430 (1984) (en banc); Fischer v. G & S Builders, 147 Ill. App. 3d 168, 175-76, 497 N.E.2d 1022, 1027 (1986); Briarcliffe W. Townhomes Owners Ass'n. v. Wiseman Constr. Co., 134 Ill. App. 3d 402, 405, 480 N.E.2d 833, 835 (1985); Griffin v. Wheeler-Leonard & Co., Inc., 290 N.C. 185, 200, 225 S.E.2d 557, 567 (1976).

price.[49] In addition, the implied warranty of habitability protects only against relatively substantial defects.[50] As a general rule, the complaint must relate to design or workmanship defects that render the property unsuitable for its intended use.[51]

1. Disclaiming the Implied Warranty of Habitability

After courts recognized the implied warranty of habitability, they had to address whether vendors could disclaim the warranty, and if so, what language would suffice as a disclaimer.[52] Like its cousin in the sale of goods, the implied warranty of habitability is an implied obligation arising out of the parties' contract but imposed by law for reasons of sound public policy. One could argue that just as a seller of goods can disclaim the implied warranty of merchantability relatively easily,[53] a builder-vendor of a new home should be able to disclaim the implied warranty of

49. *See Cosmopolitan Homes*, 663 P.2d at 1045-46. For an analogy in the law of sales, see U.C.C. § 2-316(3)(b) (1987) (implied warranties are disclaimed as to discoverable defects when the buyer examines the goods as fully as he desires or refuses to examine the goods before entering into the contract).

50. Bethlahmy v. Bechtel, 91 Idaho 55, 68, 415 P.2d 698, 711 (1966). *See also* Abrams v. Rapoport, 163 Ill. App. 3d 748, 516 N.E.2d 943 (1987) (unusual noises emanating from room not sufficient to show breach of warranty).

51. *See* Dann v. Perrotti & Hauptman Dev. Co., 670 P.2d 448 (Colo. Ct. App. 1983) (fact that tenants could not occupy condominiums because of the absence of an occupancy permit did not constitute a breach of the implied warranty of habitability, where no proof of defect in property; warranty of habitability not intended to remedy procedural defects). *Cf.* Hinson v. Jefferson, 287 N.C. 422, 215 S.E.2d 102 (1975) (implied warranty of habitability guaranteed that land conveyed subject to restrictive covenants could be used in accordance with the limited uses specified in the covenants).

52. As one court put it, "[w]here an implied warranty is recognized, can the disclaimer be far behind?" Conyers v. Molloy, 50 Ill. App. 3d 17, 19, 364 N.E.2d 986, 989 (1977). For a general discussion of contract disclaimers in the sale of real property, see Abney, *Disclaiming the Implied Real Estate Common-Law Warranties*, 17 REAL EST. L.J. 141 (1988); Anderson, *Disclaiming the Implied Warranties of Habitability and Good Workmanship in the Sale of New Houses: The Supreme Court of Texas and the Duty to Read the Contracts You Sign*, 15 TEX. TECH. L. REV. 517 (1984); Larson, *The "As Is" Disclaimer and the Sale of New Houses*, 13 REAL EST. L.J. 238 (1984); Note, *The Implied Warranty of Habitability in the Sale of New Homes: Disclaiming Liability in Illinois*, 1987 U. ILL. L. REV. 649.

53. Section 2-316 of the Uniform Commercial Code, which lays down the ground rules for exclusion and modification of warranties of quality, provides that express disclaimers of the implied warranty of merchantability must mention the word "merchantability" and, if in writing, must be conspicuous. U.C.C. § 2-316(2) (1987). It further provides that notwithstanding the preceding requirements, implied warranties can be disclaimed by language that by common understanding points the buyer's attention to the exclusion of warranties (*e.g.*, "as is," "with all faults"), by the buyer's full inspection or refusal to inspect when there is a discoverable defect, and by course of dealing, course of performance, or usage of trade. U.C.C. § 2-316(3) (1987). *See generally* Weintraub, *Disclaimer of*

habitability by including an appropriate term in the contract.[54]

Courts agree that the implied warranty is disclaimable.[55] They disagree, however, on what constitutes an adequate disclaimer.[56] Relatively few courts have enforced generally worded disclaimers of the "as is" or "in its present condition" variety.[57] At the opposite extreme, a few courts have applied such exacting standards of specificity to the disclaimer that, despite their assertions, the warranty seems disclaimable in theory only.[58]

Warranties and Limitation of Damages for Breach of Warranty Under the UCC, 53 TEX. L. REV. 60 (1974).

Most courts now hold that the disclaimer of implied warranties is further bounded by the concept of unconscionability. *See* U.C.C. § 2-302 (1987), which provides that "[i]f the court as a matter of law finds the contract or *any clause of the contract* to have been unconscionable at the time it was made the court may refuse to enforce the contract . . . ." (emphasis added). *See also* RESTATEMENT (SECOND) OF CONTRACTS § 208 (1979) (similar language). Even a disclaimer that follows the rules of § 2-316 can be ineffective if it is unconscionable under the circumstances of a particular case. *See, e.g.*, Martin v. Joseph Harris Co., Inc., 767 F.2d 296 (6th Cir. 1985). *See generally* Phillips, *Unconscionability and Article 2 Implied Warranty Disclaimers*, 62 CHI-KENT L. REV. 199 (1985).

54. For example, this argument was made by the defendant builder in Schoeneweis v. Herrin, 110 Ill. App. 3d 800, 805, 443 N.E.2d 36, 40 (1982).

55. *See, e.g.*, Country Squire Homeowners Ass'n. v. Crest Hill Dev., 150 Ill. App. 3d 30, 501 N.E.2d 794 (1986). *See Conyers*, 50 Ill. App. 3d at 22, 364 N.E.2d at 990 ("No court has yet held that disclaimers are against public policy although they have not been favored and are frequently unsuccessful in disclaiming the implied warranty.").

56. *Compare, e.g.*, Colsant v. Goldschmidt, 97 Ill. App. 3d 53, 54-56, 421 N.E.2d 1073, 1075-76, (1981) (contract language "[b]uilder does not assume responsibility for any . . . damages caused by any defects" not sufficient to disclaim implied warranty; burden on seller to show buyer knew he was signing a disclaimer) *with* G-W-L, Inc. v. Robichaux, 643 S.W.2d 392, 393 (Tex. 1982), *overruled by* Melody Home Mfg. Co. v. Barnes, 741 S.W.2d 349 (Tex. 1987) (contract language that there are "no . . . warranties, express or implied" sufficient to disclaim implied warranty; buyer has obligation to read what he signs). A recently enacted Indiana statute codifies the conditions under which a disclaimer of implied warranties will be effective. IND. CODE. ANN. § 34-4-20.5-9 (West Supp. 1987-88).

The mere fact that the vendor gives an express warranty would not disclaim the existence of implied warranties. Like warranties in the sale of goods, warranties in the sale of real property are cumulative. Wingfield v. Page, 278 Ark. 276, 644 S.W.2d 940 (1983); Hoagland v. Celebrity Homes, Inc., 40 Colo. App. 215, 572 P.2d 493 (1977); Gable v. Silver, 258 So. 2d 11 (Fla. Dist. Ct. App. 1972); Bridges v. Ferrell, 685 P.2d 409 (Okla. Ct. App. 1984).

57. Even in the sale of residential property to a consumer purchaser, a court may give preference to the principle of freedom of contract and the purchaser's duty to read what he signs and find an effective waiver of the implied warranty. *See* Bankston v. McKenzie, 287 Ark. 350, 698 S.W.2d 799 (1985) (vendor not liable for defect where property sold "as is"); Perrett v. Dollard, 176 Ga. App. 829, 338 S.E.2d 56 (1985) ("as is" disclaimer enforceable); Tibbits v. Openshaw, 18 Utah 2d 442, 425 P.2d 160 (1967) (disclaimer clause stating that the buyer accepted property "in its present condition" sufficient to disclaim the implied warranty). *See also* Case Note, *supra* note 8.

58. *See, e.g.*, Belt v. Spencer, 41 Colo. App. 227, 228, 230, 585 P.2d 922, 923, 925 (1978) (language of contract provided for one-year express warranty "except for cracking of concrete flat-

Most courts find themselves somewhere in the middle. They maintain that the principle of freedom of contract gives parties the freedom to allocate risks, but recognize that imbalances in bargaining power, knowledge, and sophistication between a builder-vendor and purchaser can make this freedom illusory for the purchaser.[59] As a result, courts consider such factors as the conspicuousness, clarity, and specificity of the disclaimer,[60] the purchaser's subjective knowledge and understanding of the term,[61] and the relative sophistication and bargaining power of the parties[62]—in short, the same factors that courts consider in determining whether any harsh term in a contract between unequal parties is unconscionable.[63]

Courts regard disclaimers of the implied warranty of habitability with intense suspicion when the purchaser is an ordinary consumer. Courts may be more willing to give effect to such provisions if the parties are commercial investors, however.[64] If a purchaser is sophisticated enough

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work"; exclusion ineffective where concrete *heaved* rather than *cracked*); Casavant v. Campopiano, 114 R.I. 24, 28-29, 327 A.2d 831, 833-34 (1974) (language in contract that purchasers agree to take premises "in the same condition in which they are now" not sufficiently specific; sellers liable for damages caused by defective roof). These cases involved substantial structural defects.

59. *See* Abney, *supra* note 52, at 142.

60. Courts have held that the disclaimer clause should be conspicuous or at least written in such a way that one can fairly conclude that the purchaser has read the clause. *See, e.g.*, Briarcliffe W. Townhomes Ass'n. v. Wiseman Constr. Co., 134 Ill. App. 3d. 402, 480 N.E.2d 833 (1985) (warranty can be waived only by conspicuous and clear language specifically disclaiming the implied warranty of habitability; burden is on vendor to prove that purchaser knew the implied warranty did not attach to the sale; disclaimer ineffective unless brought to the attention of the purchaser and agreed to by him); Tassan v. United Dev. Co., 88 Ill. App. 3d 581, 410 N.E.2d 902 (1980). *See also* Swaw v. Ortell, 137 Ill. App. 3d 60, 484 N.E.2d 780 (1984); Shoeneweis v. Herrin, 110 Ill. App. 3d 800, 443 N.E.2d 36 (1982); Tyus v. Resta, 328 Pa. Super. Il, 476 A.2d 427 (1984). Furthermore, the disclaimer should be specific, clear and unambiguous, easily understood, and concise. Belt v. Spencer, 41 Colo. App. 227, 585 P.2d 922 (1987); Hesson v. Walmsley Constr. Co., 422 So. 2d 943 (Fla. Dist. Ct. App. 1982); Tusch Enter. v. Coffin, 113 Idaho 37, 740 P.2d 1022 (1987); Herlihy v. Dunbar Builders Corp. 92 Ill. App. 3d 310, 415 N.E.2d 1224 (1980); *Tassan*, 88 Ill. App. 3d 581, 410 N.E. 2d 902; Conyers v. Molloy, 50 Ill. App. 3d 17, 20-21, 364 N.E.2d 986, 989 (1977); Griffin v. Wheeler-Leonard & Co., Inc., 290 N.C. 184, 225 S.E.2d 557 (1976).

61. *See, e.g., Briarcliffe*, 134 Ill. App. 3d. 402, 480 N.E.2d 833; Colsant v. Goldschmidt, 97 Ill. App. 3d 53, 421 N.E.2d 1073 (1981); Ecksel v. Orleans Constr. Co., 360 Pa. Super. 119, 519 A.2d 1021 (1987).

62. *See, e.g., Colsant*, 97 Ill. App. 3d 53, 421 N.E.2d 1073; Casavant v. Campopiano, 114 R.I. 24, 327 A.2d 831 (1974). For a more thorough discussion of the features of a valid disclaimer of the implied warranty of habitability, see Abney, *supra* note 52, at 142-50; Larson, *supra* note 52, at 244-46.

63. *See* Mallor, *Unconscionability in Contracts Between Merchants*, 40 Sw. L.J. 1065, 1070-73 (1986).

64. *See, e.g.*, Shapiro v. Hu, 188 Cal. App. 3d 324, 233 Cal. Rptr. 470 (1986) ("as is" provision

to protect himself by negotiating favorable contract terms or inspecting the property,[65] a court may conclude that the freedom of contract principle outweighs the policies underlying an implied warranty of habitability. The court therefore might accord greater deference to apparently voluntary contractual allocations of the risk of defects.

2. *Expansion of the Implied Warranty of Habitability*

As with most newly created doctrines, the contours of the implied warranty of habitability are constantly being tested and defined. Now that the implied warranty is widely recognized, most cases reaching the appellate courts today challenge its scope. Given the broad application of the rationales that support the implied warranty, courts have tended to expand its coverage rather than limit it to the facts of the "first generation" cases.[66] Courts have steadily enlarged both the range of transactions in which the implied warranty applies and the content of the warranty. Courts have held that the warranty exists not only in initial sales of newly constructed single family houses and condominiums,[67] but also in initial sales of homes not newly constructed,[68] resales of relatively new homes to subsequent purchasers,[69] and, in at least one case, sales of

excluded vendor's liability for defective condition that was not readily observable); Frickel v. Sunnyside Enter., Inc., 106 Wash. 2d 714, 725 P.2d 422 (1986) (implied warranty of habitability did not apply to sale of apartment complex, especially when contract contained clear and unambiguous disclaimer). *But see Tusch*, 113 Idaho at 46, 740 P.2d at 1031 (implied warranty of habitability applied to sale of duplexes when contract contained only general language that there were no warranties other than those contained within its four corners).

65. *See, e.g., Frickel*, 106 Wash. 2d 714, 725 P.2d 422.

66. *See, e.g.*, Licciardi v. Pascarella, 194 N.J. Super 381, 476 A.2d 1273 (1983) (discussing expansive trends in New Jersey).

67. *See, e.g.*, Gable v. Silver, 258 So. 2d 11 (Fla. Dist. Ct. App. 1972); Briarcliffe W. Townhomes Ass'n v. Wiseman Constr. Co., 134 Ill. App. 3d 402, 480 N.E.2d 833 (1985). The homeowners' association has standing to maintain the action against the builder. *Briarcliffe*, 118 Ill. App. 3d 163, 454 N.E.2d 363.

68. *See* Gaito v. Auman, 70 N.C. App. 21, 318 S.E.2d 555 (1984) (implied warranty of habitability applied in the first sale of a home by a builder-vendor five years after the house was built). *Cf.* Cummings v. Dusenbury, 129 Ill. App. 3d 338, 472 N.E.2d 575 (1984) (implied warranty did not apply to sale of 10-year-old house that vendors had built and used for a number of years and which had been inhabited by tenants).

69. Substantial controversy exists regarding the extension of implied warranties to subsequent purchasers, although the trend appears to be in the direction of eroding the privity requirement. *See* Richards v. Powercraft Homes, Inc., 134 Ariz. 242, 678 P.2d 427 (1984) (en banc); Blagg v. Fred Hunt Co., Inc., 272 Ark. 185, 612 S.W.2d 321 (1981); Redarowicz v. Ohlendorf, 92 Ill. 2d 171, 441 N.E.2d 324 (1982); Barnes v. Mac Brown & Co., Inc., 264 Ind. 227, 342 N.E.2d 619 (1976); Keyes v. Guy Bailey Homes, Inc., 439 So. 2d 670 (Miss. 1983); Lempke v. Dagenais, 130 N.H. 782, 547 A.2d 290 (1988); Hermes v. Staiano, 181 N.J. Super. 424, 437 A.2d 925 (1981); Elden v. Simmons, 631

professionally remodeled older homes.[70]

The class of potential defendants has grown broader as well. While courts have firmly resisted imposing implied warranties on ordinary, nonbuilding vendors,[71] they have imposed the warranty on real estate

P.2d 739 (Okla. 1981); Terlinde v. Neely, 275 S.C. 395, 271 S.E.2d 768 (1980); Gupta v. Ritter Homes, Inc., 646 S.W.2d 168 (Tex. 1983); Moxley v. Laramie Builders, Inc., 600 P.2d 733 (Wyo. 1979). *See also Gaito*, 70 N.C. App. at 29 n.1, 318 S.E.2d at 560 n.1 (dicta). *Cf. Tusch* 113 Idaho 37, 740 P.2d 1022 (purchaser of commercial building not in privity with contractor can maintain breach of implied warranty action against contractor); Degnan v. Exec. Homes, Inc., 215 Mont. 162, 696 P.2d 431 (1985) (initial purchaser not in privity with contractor can maintain implied warranty of habitability action against contractor). *But see* H.B. Bolas Enter. v. Zarlengo, 156 Colo. 530, 400 P.2d 447 (1965); Coburn v. Lenox Homes, Inc., 173 Conn. 567, 378 A.2d 599 (1977); Strathmore Riverside Villas Condominium Ass'n, Inc. v. Paver Dev. Corp., 369 So. 2d 971 (Fla. Dist. Ct. App. 1979); Dunant v. Wilmock, Inc., 176 Ga. App. 48, 335 S.E.2d 162 (1985); Fretschel v. Burbank, 351 N.W.2d 403 (Minn. Ct. App. 1984); Oliver v. City Builders, Inc., 303 So. 2d 466 (Miss. 1974); John H. Armbruster & Co. v. Hayden Co. Builder-Developer, Inc., 622 S.W.2d 704 (Mo. Ct. App. 1981); Herz v. Thornwood Acres "D", Inc., 86 Misc. 2d 53, 381 N.Y.S.2d 761, *aff'd*, 91 Misc. 2d 130, 397 N.Y.S.2d 358 (App. Term 1977); Ins. Co. of N. Am. v. Bonnie Built Homes, 64 Ohio St. 2d 269, 416 N.E.2d 623 (1980); Arvai v. Shaw, 289 S.C. 161, 345 S.E.2d 715 (1986); Brown v. Fowler, 279 N.W.2d 907 (S.D. 1980). *Cf.* Cosmopolitan Homes, Inc. v. Weller, 663 P.2d 1041 (Colo. 1983) (subsequent purchaser can maintain an action against builder for negligence); *Brown*, 279 N.W.2d 907 (same). *See generally* Mallor, *Extension of the Implied Warranty of Habitability to Purchasers of Used Homes*, 20 AM. BUS. L.J. 361 (1982); Comment, *Implied Warranty Protection for Purchasers of Used Homes*: Richards v. Powercraft Homes, Inc., 26 ARIZ. L. REV. 945 (1984); Note, *Liability of Builder-Vendor*: Blagg v. Fred Hunt Co., 35 ARK. L. REV. 654 (1982); Case Note, *Builder-Vendor's Broadened Liability for Selecting an Unsafe Homesite: Homeowner's-Seller's Duty to Warn*, ABC Builders, Inc. v. Philips, 17 LAND & WATER L. REV. 467 (1982); *Defective Housing*, *supra* note 2; Note, *Implied Warranty of Habitability-Protection for the Buyer of a Used Home-Privity of Contract with the Builder not Required*, 1982 S. ILL. U.L.J. 447 (1982); Note, *Builder's Liability for Latent Defects in Used Homes*, 32 STAN. L. REV. 607 (1980); Note, *Real Property—Subsequent Purchasers—Privity Not Necessary Element in Negligence Action Against Builder*, 53 U. CIN. L. REV. 801 (1984).

70. *Licciardi*, 194 N.J. Super. 381, 476 A.2d 1273. *But see* Sousa v. Albino, 120 R.I. 401, 388 A.2d 804 (1978).

71. Courts have steadfastly refused to apply the implied warranty in sales by "ordinary vendors" or "casual sellers." This is consistent with the supporting rationale that builder-vendors have superior knowledge of the construction process and materials, ability to avoid defects, and ability to bear risk. *See, e.g.*, Vetor v. Shockey, 414 N.E.2d 575 (Ind. Ct. App. 1980); Stevens v. Bouchard, 532 A.2d 1028 (Me. 1987); Bernstein v. Ainsworth, 220 Neb. 670, 371 N.W.2d 682 (1985); ABC Builders, Inc. v. Phillips, 632 P.2d 925 (Wyo. 1981). In some cases, courts have refused to apply the warranty to professional builders who have occupied the house first. *See, e.g.*, Klos v. Gockel, 87 Wash. 2d 567, 554 P.2d 1349 (1976); Schepps v. Howe, 665 P.2d 504 (Wyo. 1983). *See also* Hibbler v. Fisher, 109 Idaho 1007, 712 P.2d 708 (Ct. App. 1985)(vendors who had acted as their own general contractor in constructing a trailer park and had hired unlicensed subcontractors were not builder-vendors for purposes of the implied warranty of habitability because vendors were not in the business of building or selling property). *But see Tusch*, 113 Idaho at 48, 740 P.2d at 1033-34 (even though vendors did not construct duplexes, implied warranty should extend from them if they had construction expertise and exercised control over the construction); Haskell, *supra* note 2, at 649-50, 652

professionals and developers,[72] including those who are not mass builders.[73] Courts have also expanded the scope of the warranty beyond fitness of the structure and its fixtures to exterior conditions that directly support the habitability of the house, such as wells and septic tanks.[74]

(urging that the implied warranty of habitability should exist in every sale of real property without regard to whether the vendor is a "merchant").

72. *See, e.g.*, Jordan v. Talaga, 532 N.E.2d 1174 (Ind. Ct. App. 1989) (implied warranty of habitability breached by developer); Hinson v. Jefferson, 287 N.C. 422, 215 S.E.2d 102 (1975) (same).

73. *See, e.g.*, Dillig v. Fischer, 142 Ariz. 47, 688 P.2d 693 (Ct. App. 1984) (experienced contractor currently employed at another job who built house with the intent that his own family occupy it); Mazurek v. Nielsen, 42 Colo. App. 386, 599 P.2d 269 (1979) (builder constructing his first house); Degnan v. Executive Homes, Inc., 215 Mont. 162, 696 P.2d 431 (1985) (contractor who was not in privity with purchasers); *Licciardi*, 194 N.J. Super. 381, 476 A.2d 1273 (broker and architect who bought dilapidated structure and remodeled it for resale); McDonald v. Mianecki, 79 N.J. 275, 398 A.2d 1283 (1979) (contractor); Moxley v. Laramie Builders, Inc., 600 P.2d 733 (Wyo. 1979) (same). *See also Tusch* 113 Idaho at 48, 740 P.2d at 1034 (issue of material fact existed whether vendor who had many years of experience in road construction and who contracted with subcontractors and consulted with contractor regarding site preparation was builder-vendor for purposes of implied warranty of habitability).

74. Courts usually apply the implied warranty to exterior conditions that are closely linked with the function of the structure. *See* Kramp v. Showcase Builders, 97 III. App. 3d 17, 422 N.E.2d 958 (1981) (septic system); Loch Hill Constr. Co., Inc. v. Fricke, 284 Md. 708, 399 A.2d 883 (1979) (well); *Degnan*, 215 Mont. 102, 696 P.2d 431 (land underlying building); George v. Veach, 67 N.C. App. 674, 313 S.E.2d 920 (1984) (septic tank); Lyon v. Ward, 28 N.C. App. 446, 221 S.E.2d 727 (1976) (well); McDonald v. Mianecki, 79 N.J. 275, 298 A.2d 1283 (1979) (potability of water supply). Courts are less likely to extend implied warranty protection to exterior conditions that bear a more collateral relationship to the usefulness of the structure, however. *See* Port Sewall Harbor and Tennis Club Owners Ass'n, Inc. v. First Fed. Savings and Loan Ass'n of Martin County, 463 So. 2d 530 (Fla. Dist. Ct. App. 1985) (roads, drainage areas, and footbridge); San Luis Trails Ass'n v. E.M. Hrris Bldg. Co., Inc., 706 S.W.2d 65 (Mo. Ct. App. 1986) (streets); Campbell v. Randville Constr. Corp., 172 N.J. Super. 93, 410 A.2d 1184 (App. Div.), *certif. denied*, 84 N.J. 405, 420 A.2d 325 (1980) (health of trees on property); Stuart v. Coldwell Banker Commercial Group, Inc., 109 Wash. 2d 406, 745 P.2d 1284 (1987) (common areas of condominium such as walkways and decks or balconies). *But see* Briarcliffe West Townhouse Owners Ass'n v. Wiseman Constr. Co., 134 Ill. App. 3d 402, 480 N.E.2d 833 (1985) (storm drainage problems causing damage to common land in planned unit development, interfering with recreational activities on common land); *Tassan*, 88 Ill. App. 3d 581, 410 N.E.2d 902 (inadequate drainage of surface waters in front of building).

Courts generally have declined to apply the implied warranty of habitability to vendors of unimproved lots, even when the developer created an artificial condition that caused damage to the structure that was ultimately built on the land. *See* Conklin v. Hurley, 428 So. 2d 654 (Fla. 1983) (developers of unimproved lot not liable for damages caused by defective seawall); Bernstein v. Ainsworth, 220 Neb. 670, 371 N.W.2d 682 (1985) (developer who sold unimproved lot not liable for damages resulting from overflow of development's manmade lake; seller of vacant lot does not impliedly warrant the suitability of the lot). The rationale for this position is that purchasers of unimproved lots are better able to inspect for defects and to bargain for express warranties than are purchasers of complex structures. *See Conklin*, 428 So. 2d at 658-59. *See also* Witty v. Schramm, 62 Ill. App. 3d 185, 379 N.E.2d 333 (1978); Cook v. Salishan Properties, Inc., 279 Or. 333, 569 P.2d 1033 (1977) (implied warranties inapplicable to long-term leases of land; lessor does not warrant that

These extensions of the warranty all involve consumer-vendees who have purchased property for their own use. It is not yet clear whether the expansion of the implied warranty of habitability in consumer cases will extend to property purchased for commercial or investment purposes.[75]

II. THE IMPLIED WARRANTY OF QUALITY AND COMMERCIAL PROPERTY: COURTS' DIVERGENT APPROACHES

Despite the volume of commercial property sales transacted each year, surprisingly few courts have considered whether an implied warranty of quality should apply in sales of commercial property. Certainly far fewer disappointed commercial purchasers than residential purchasers have attempted to gain compensation through an implied warranty of quality. In all probability, the small number of commercial cases reflects that parties to a commercial property sale generally behave as experienced businesspersons: they anticipate the possibility of defects, they employ skilled experts to ferret out potential defects, and they allocate the risk of defects between the parties through express warranties, disclaimers, and conditions in their contracts.

The courts that have confronted implied warranty claims by purchasers of commercial property have taken divergent approaches. Some have rejected the application of the implied warranty, based at least in part on the purchaser's status as an "income-seeker" rather than a homebuyer. Not surprisingly, these courts focused on the presumed ability of com-

land fit for construction of residence); Jackson v. River Pines, 276 S.C. 29, 274 S.E.2d 912 (1981). *But see* Avner v. Longridge Estates, 272 Cal. App. 2d 607, 77 Cal. Rptr. 633 (1969) (developer-vendor of lot liable for defects in tracts of lots on hillside properties).

75. Most of the courts considering the issue have limited the implied warranty of habitability in the lease of property to residential tenancies, and have rejected its application to commercial tenancies. *See, e.g.*, Hoban v. Masters, 36 Conn. Super. 611, 421 A.2d 1318 (1980); Gehrke v. Gen. Theatre Corp., 207 Neb. 301, 298 N.W.2d 773 (1980); Fireman's Fund Ins. Co. v. BPS Co., 23 Ohio App. 3d 56, 491 N.E.2d 365 (1985). *See also* Muro v. Superior Court, 184 Cal. App. 3d 1089, 229 Cal. Rptr. 383 (1986) (strict liability in tort not applicable to lessor of commercial or industrial property). *But see* Four Seas Inv. Corp. v. Int'l Hotel Tenants Ass'n, 81 Cal. App. 3d 604, 146 Cal. Rptr. 531 (1978); Golden v. Conway, 55 Cal. App. 3d 948, 128 Cal. Rptr. 69 (1976). *Cf.* Pawco, Inc. v. Bergman Knitting Mills, Inc., 283 Pa. Super. 443, 424 A.2d 891 (1980) (contract law rather than property law should be applied to commercial leases, so tenant should be able to defend action for rent due by alleging landlord's breach of contract). For more detailed discussion of this issue and challenges to the general rule, see generally Levinson and Silver, *Do Commercial Property Tenants Possess Warranties of Habitability?*, 14 REAL. EST. L.J. 59 (1985); Note, *Modernizing Commercial Lease Law: The Case for an Implied Warranty of Fitness*, 19 SUFFOLK U. L. REV. 929 (1985).

mercial purchasers to protect themselves.[76] Other courts have applied an implied warranty to sales of commercial property. Those courts downplay the purchaser's status and emphasize the applicability of the rationales underlying the creation of the implied warranty.[77] The dispute centers on the proper role of the *caveat emptor* doctrine in modern law: should the doctrine remain the "default position" of our legal system, allocating risks in the absence of agreement or specific judicial exception, or should the doctrine be abandoned as a standard for allocating risks?

A. Cases Rejecting the Application of an Implied Warranty

Strikingly, all of the cases rejecting the application of implied warranties to commercial property involve complicating facts that could, independent of the commercial nature of the property, justify a refusal to apply warranty protection. Yet, the courts grounded their opinions at least in part on the fact that the property was purchased for commercial or speculative purposes, and all of them viewed the implied warranty of habitability narrowly, as a highly fact-specific exception to the rule of *caveat emptor*.[78]

In *Hopkins v. Hartman*,[79] for example, the Illinois Court of Appeals held that the rule of *caveat emptor* is relaxed only for consumers, not for investors.[80] In this case, the defendants built a duplex primarily with their own labor and, after renting it to tenants for two years, sold it to the plaintiffs. The plaintiffs continued to rent out the property for five more years when they learned of serious structural defects in the duplex.[81] They repaired the defects and sued the vendors for breach of the implied warranty of habitability. The trial court entered judgment for the plaintiffs, but the Illinois Court of Appeals reversed on the ground that the plaintiffs were not within the class of purchasers protected by the warranty.[82]

Citing language from the opinion originally establishing an implied

76. *See, e.g., Conklin*, 428 So. 2d at 659.

77. *See, e.g.*, Hodgson v. Chin, 168 N.J. Super. 549, 403 A.2d 942 (1979).

78. *See, e.g.*, Hopkins v. Hartman, 101 Ill. App. 3d 260, 262, 427 N.E.2d 1337, 1338 (1981), stating that "[t]he warranty created in *Petersen* is at once a broad one but narrow in its application."

79. 101 Ill. App. 3d 260, 427 N.E.2d 1337 (1981).

80. *Id.*

81. The floor had begun to sag and pull away from a wall. Inspection of the crawl space revealed that the main supports had nearly rotted away. Repair of these defects cost $5280.28. *Id.* at 261, 427 N.E.2d at 1338.

82. *Id.* at 262-63, 425 N.E.2d at 1339.

warranty of habitability in Illinois,[83] the court stated that the warranty was designed to protect only the relatively unsophisticated buyer making a large investment in a structure intended for use as a residence.[84] According to the court, a purchaser for investment purposes has ample opportunity to investigate and consider the merits of the property and to make a calculated judgment about how profitable it will be.[85] The residential purchaser, in contrast, often operates under pressure brought about by job transfer, changed family circumstances, or other factors over which he has no control.[86] The court rejected the plaintiffs' argument that they had relied on the defendants' skill and experience, pointing out that they had possessed sufficient opportunity to obtain a second opinion about the condition of the property.[87]

Although the *Hopkins* court primarily emphasized the plaintiffs' investor status, the court could have reached the same result on less sweeping grounds. That the defendants built the duplex primarily with their own labor indicates that they were amateurs or casual sellers rather than the professional sellers to whom the warranty applies.[88] The court recited no facts that would suggest that the defendants were in the business of building and selling real estate; as a secondary ground for its holding, the court noted the defendants had built and used the property for their own income-producing purposes and not for resale.[89] In several other cases,

83. *Id.*, quoting passage from Petersen v. Hubschman Constr. Co., 76 Ill. 2d 31, 40, 389 N.E.2d 1154, 1158 (1979):

> Many new houses are, in a sense, now mass produced. The vendee buys in many instances from a model home or from predrawn plans . . . . The vendee is making a major investment, in many instances the largest single investment of his life . . . . The vendee has the right to expect to receive that for which he has bargained and that which the builder-vendor has agreed to construct and convey to him, that is, a house that is reasonably fit for use as a residence.

84. 101 Ill. App. 3d at 262-63, 427 N.E.2d at 1339.

85. *Id.* The court stated that if the warranty were extended to an investor in real estate, by extension of logic the Board of Governors of the New York Stock Exchange should warrant that no common stock traded there will ever decrease in value. *Id.* Note, however, that the plaintiffs in *Hopkins* complained that the property was defective, not that its value decreased because of changing market conditions.

86. *Id.*

87. *Id.*

88. For discussion of courts' refusals to impose implied warranties on casual sellers, see *supra* note 71.

89. As an alternative ground for refusing to extend implied warranty protection to the plaintiffs, the court pointed to the fact that the defendants had built the duplex for their own use rather than building and marketing the structure in the manner in which merchandise is sold. *Hopkins*, 101 Ill. App. 3d at 263, 427 N.E.2d at 1339. The implied rationale for this distinction is that there is no compelling reason to abolish the *caveat emptor* doctrine because (1) the building of a structure by a

the fact that a builder built the property for his own use prevented the application of implied warranties, even for residential property.[90] In addition, the property had been rented for seven years when the repairs became necessary. Because rental property is often subjected to more wear and tear than owner-occupied property, the court could have concluded that a reasonable time had elapsed and that the implied warranty of habitability was no longer effective.[91]

In another commercial property case, *Hays v. Gilliam*,[92] the Tennessee Court of Appeals held that no implied warranty of habitability existed in the sale of a renovated apartment building. The defendant in *Hays* had rebuilt a fifteen-year-old single family house that had been destroyed by fire, modifying it over a period of years into a six-unit apartment building.[93] After purchasing the building and taking possession, the plaintiff discovered that the sewage system and some of the electrical wiring were significantly inadequate. He brought an action for breach of implied warranty, and the trial court awarded him damages.

The Tennessee Court of Appeals reversed, holding that no implied warranties existed under these circumstances because an implied warranty of habitability applied in the sale of *new* and not-yet-constructed *dwellings*.[94] The court distinguished one who purchases a remodeled structure from one who purchases a new structure because the latter lacks knowledge about the way in which the structure was built and has no opportunity to observe how it will stand the passage of time.[95]

In addition, the court distinguished the plaintiff's case from those to

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defendant who plans to use it himself rather than resell it is not analogous to the mass production and marketing of goods, and (2) it is unlikely that a builder who builds for his own uses would be tempted to cheat himself by using shabby construction and materials.

90. Hibbler v. Fisher, 109 Idaho 1007, 712 P.2d 708 (Ct. App. 1985); Klos v. Gockel, 87 Wash. 2d 567, 554 P.2d 1349 (1976); Schepps v. Howe, 665 P.2d 504 (Wyo. 1983).

91. For discussion of the duration of the implied warranty of habitability, see *supra* note 47.

92. 655 S.W.2d 158 (Tenn. Ct. App. 1983).

93. The contract of sale contained no warranties or representations about the quality of the property. *Id.* at 159.

94. The *Hays* court adopted the implied warranty of habitability as formulated by the North Carolina Supreme Court in Hartley v. Ballou, 286 N.C. 51, 209 S.E.2d 776 (1974). The court also cited Dixon v. Mountain Constr. Co., 632 S.W.2d 538 (Tenn. 1982), a previous Tennessee case involving the sale of a house still under construction at the time of contracting. *Hays*, 655 S.W.2d at 160.

95. 655 S.W.2d at 160 (quoting Pollard v. Saxe & Yolles Dev. Co., 12 Cal. 3d 374, 115 Cal. Rptr. 648, 525 P.2d 88 (1974)). Note, however, that the *Pollard* court recognized an implied warranty of quality when the plaintiff had purchased income-producing property. *See infra* notes 123-27 and accompanying text.

which the implied warranty applies on the ground that the plaintiff had purchased the property as an investment, and thus was not a "naive home buyer."[96] The court took the position that such a purchaser has the responsibility to use all means of self-protection at his disposal. The plaintiff could and should have inquired about the condition of sewage facilities and any other construction that could not be examined, and should have demanded assurances about the quality of the property.[97] The court also was concerned that extending implied warranties for the protection of investors such as the plaintiff would create "a morass of controversy and uncertainty through which no clear, reliable road may be charted."[98] The court thus concluded that the case fell squarely within the rule of *caveat emptor*.[99]

The relative knowledge, sophistication, and bargaining power of the parties was also a central issue in *Conklin v. Hurley*.[100] In *Conklin*, the purchasers of waterfront building lots brought suit against the developer of the lots for breach of the implied warranty of habitability when the seawall the developer had constructed collapsed. The plaintiffs had purchased the lots with the intent to resell them to other investors or homebuilders. Although the trial court found that the developer breached an implied warranty of habitability, the Florida Supreme Court disagreed. It held that the implied warranty did not extend to the facts of this case for two reasons[101]: the warranty does not apply to developed but unimproved land[102] and the plaintiffs were investors.[103] The court stated that "[t]hose who speculate in land, as a class, simply do not need the sort of protection"[104] that the implied warranty of habitability affords, because people who regularly trade in the real estate market enjoy a stronger bargaining position than do homebuyers.[105] According to the

96. 655 S.W.2d at 160-61.

97. *Id.* at 161.

98. *Id.*

99. *Id.*

100. 428 So. 2d 654 (Fla. 1983).

101. The Florida Court of Appeals had certified the following question to the court: "Do implied warranties of fitness and merchantability extend to first purchasers of residential real estate for improvements to the land other than construction of a home and other improvements immediately supporting the residence thereon, such as water wells and septic tanks?" *Id.* at 655 (citing Hurley v. Conklin, 409 So. 2d 148, 151 (Fla. Dist. Ct. App. 1982)).

102. 428 So. 2d at 659. *See supra* note 74.

103. 428 So. 2d at 659. Apparently the court of appeals did not certify this question to the supreme court.

104. *Id.*

105. *Id.*

court, an investor can always choose to invest his excess capital elsewhere. In contrast, the typical family looking for a residence is seeking a basic necessity and often is pressured by time constraints and career demands.[106] The court presumed that investors are likely to be more knowledgeable about real estate and that the economic consequences of buying defective real estate are likely to be less disastrous for the investor than for the homebuyer.[107] It concluded that the loss of expectancy experienced by these investors was not the sort of loss courts intended to protect against by creating the implied warranty of habitability.[108]

The presence of a disclaimer clause in the sales contract was a complicating factor in the Washington Supreme Court's recent decision in *Frickel v. Sunnyside Enterprises, Inc.*[109] In this case, the plaintiffs—seeking an investment that would give them retirement income—approached the defendant builder and property manager[110] about purchasing a partially completed apartment complex that the defendant was in the process of building for its own ownership and management.[111] The plaintiffs were unsophisticated investors in real estate; their only other purchase had been the acquisition of their home thirty years earlier.[112] The parties reached an agreement and executed a contract containing a clause acknowledging that the seller made no covenants respecting the conditions of any structures and stating that the purchaser assumed the hazard of damage to or destruction of any structure.

Four years later, some problems developed with outside stairways. Three years after that, the plaintiffs learned that the foundations were inadequate and improperly designed. Extensive repairs were necessary at a cost of $330,000 to prevent a foundation failure.[113] The plaintiffs then brought an action against the defendant for breach of the implied warranty of habitability and the trial court entered judgment in their favor.

On appeal, the Supreme Court of Washington framed the issue narrowly, asking whether a builder of an apartment complex built for the builder's own inventory rather than for resale guarantees to an unsolic-

106. *Id.*

107. *Id.*

108. *Id.*

109. 106 Wash. 2d 714, 725 P.2d 422 (1986) (en banc).

110. Sunnyside had built more than 100 units for itself. *Id.* at 715, 725 P.2d at 423.

111. The complex consisted of five buildings, four of which had been in use for some time and the last of which had just been framed in. *Id.*

112. *Id.* at 728, 725 P.2d at 430 (Pearson, C.J., dissenting).

113. The normal life expectancy of such buildings is 50 to 60 years. *Id.* at 716, 725 P.2d at 424.

ited buyer that the buildings sold are free from design errors.[114] The court's first objection to applying the implied warranty of habitability was that the defendants were not merchant-type sellers and the plaintiffs were not consumer-type buyers.[115]

The court implied that because the defendants did not build the structure for the purpose of resale, the sale was a "casual or personal" one.[116] The plaintiffs, on the other hand, were investors rather than buyers of a new home. *Caveat emptor*, said the court, is premised on the existence of an "arm's length transaction between buyers and sellers of comparable skill and experience."[117] The implied warranty of habitability is an exception that has been carved out of *caveat emptor* when there is a disparity of skill and experience between the parties, a situation exemplified by the relationship between a new home buyer and a builder-vendor.[118] For the new home buyer, judicial intervention is necessary because such a buyer is not usually knowledgeable in construction practices and is forced to rely upon the skill and integrity of the builder.[119] The court noted that even though the plaintiffs were relatively inexperienced investors in commercial property, they had sought out the property and were counseled by a lawyer.[120] The *Frickel* court concluded that they could and should have protected themselves by inspection and contract negotiations.[121]

The disclaimer language in the contract also persuaded the court that it should not impose a warranty because the allocation of risks had been the subject of an express contractual provision. The court found the disclaimer enforceable, even though it was "boilerplate."[122] While the court made clear that it was not stating that implied warranties can never attach to the sale of an apartment complex, it concluded that it saw no reason to impose a guarantee on the sellers when neither party negotiated

114. *Id.*

115. *Id.* at 717-20, 725 P.2d at 424-25.

116. *Id.* at 718, 725 P.2d at 424-25.

117. *Id.* at 719, 725 P.2d at 425.

118. *See id.*

119. *Id.* at 720, 725 P.2d at 425.

120. *Id.*

121. *Id.*

122. *Id.* at 721, 725 P.2d at 426. *Accord* Shapiro v. Hu, 188 Cal. App. 3d 324, 233 Cal. Rptr. 470 (1987) ("as is" clause enforceable in sale of used commercial property).

Generally, boilerplate disclaimers are not enforced in cases concerning residential property. *See* Abney, *supra* note 52, at 147-48. *See also supra* notes 57-62.

for or expected such a guarantee.[123]

The central message of *Hopkins*, *Hays*, and *Frickel* is that investors have the ability to protect themselves against defects in building construction and do not need the protection of implied warranties. Such purchasers have the means and the leisure to inspect the property fully, the sophistication to recognize the existence of a defective condition, the bargaining power to negotiate a favorable express warranty term, and, if all of the above fail, the capital to absorb a loss that would be ruinous to ordinary homebuyers.

B. Cases Applying Implied Warranties to Sales of Commercial Property

Courts imposing an implied warranty of quality in sales of commercial property emphasize the similarities between the residential cases establishing the implied warranty and the commercial cases. To these courts, the commercial purchaser's ability to protect himself is not significantly superior to that of the ordinary home buyer.

Interestingly, one of the earlier and more influential cases noting the existence of the implied warranty of habitability involved a sale of income-producing property. In *Pollard v. Saxe & Yolles Development Co.*,[124] a purchaser of five apartment buildings brought suit against the developer of the units because of significant defects he noticed when he took possession.

The California Supreme Court ultimately held that the purchaser's action was barred by his failure to give timely notice of the defect.[125] In broad dicta that made no distinction between commercial and residential property, however, the court stated that builders and sellers of new construction should be held to their implied representation "that the completed structure was designed and constructed in a reasonably

123. *Frickel*, 106 Wash. 2d 714, 720, 725 P.2d 422, 426.

124. 12 Cal. 3d 374, 525 P.2d 88, 115 Cal. Rptr. 648 (1974).

125. The plaintiff waited more than three years after learning of the defects to give notice of the defects to the developer. The court observed that the notice requirement applicable to warranty actions under § 2-605 of the UCC serves a number of sound commercial purposes: allowing the defendant to repair the item, reducing damages, avoiding the selling of defective products in the future, negotiating settlements, and protecting against stale claims. The court determined that this notice requirement applied by analogy to warranty actions involving defective real property, and held that the plaintiffs' unreasonable delay in giving notice of defect barred their cause of action for breach of warranty. *Id.* at 380, 525 P.2d at 92, 115 Cal. Rptr. at 652.

workmanlike manner."[126] This implied warranty is justified by the buyer's reliance on the seller's skill and judgment, the seller's presumed knowledge, and the ordinary expectations of the parties.[127] The court emphasized the buyer's inability to inspect the property without disturbing the finished product and the construction trade's understanding of this reliance.[128]

In a more recent case, *Hodgson v. Chin*,[129] the plaintiffs approached the defendant about buying his building and the parties later entered a contract for the sale of the building.[130] The purchasers discovered a number of construction defects when they took title to the property and brought suit for breach of warranty. Affirming the trial court's judgment for the plaintiffs, the New Jersey appellate court found that the application of implied warranties to the sale of this commercial building was a logical extension of the precedents creating the warranty in sales of residential structures.[131] The court emphasized that the buyers in this case were small business persons who were obviously buying in reliance on the building being fit for its intended use.[132]

The most sweeping opinion extending the implied warranty to income-producing property is *Tusch Enterprises v. Coffin*.[133] Prior to purchasing three duplexes, the plaintiff inspected them and noticed no major defects. About one month after the sale, however, significant structural defects became apparent. The plaintiff brought a breach of warranty action against the vendor of the units[134] and the contractor who built them.

126. *Id.* at 380, 525 P.2d at 91, 115 Cal. Rptr. at 651. Note that this warranty is not one of habitability, but of sound design of the property.

127. *Id.* at 379, 525 P.2d at 91, 115 Cal. Rptr. at 651.

128. *Id.*

129. 168 N.J. Super. 549, 403 A.2d 942 (1979).

130. The Chins rejected the first proposed contract, which contained an "as is" clause. The parties finally settled on a contract that guaranteed the roof, plumbing, and heating systems for one year. *Id.* at 551-52, 403 A.2d at 943.

131. *Id.* at 555, 403 A.2d at 945.

132. *Id.* The court noted that a different result might apply in the sale of a large commercial building. *Id.*

133. 113 Idaho 37, 740 P.2d 1022 (1987).

134. Though the vendor, Vander Boegh, might seem to be a nonbuilding vendor and thus exempt from the application of the implied warranty of habitability, the court pointed out that he had many years of experience in road construction and that the contractor, Coffin, relied on his expertise in preparing the site. Vander Boegh also contracted with Coffin as well as subcontractors and periodically visited the site during the construction phase and consulted with Coffin about the use of fill dirt on the site. The court found that there was at least a question of fact about whether Vander Boegh was a builder-vendor. *Id.* at 48-49, 740 P.2d at 1033-34.

The trial court granted summary judgment in favor of the defendants, and the plaintiff appealed.

Although the sales contract in *Tusch* contained disclaimer and merger clauses,[135] the Idaho Supreme Court held that the disclaimer was ineffective. The court observed that the implied warranty of habitability is a creature of public policy, and can be waived only when the vendor proves that the purchaser *knowingly* waived the warranty.[136] The purported waiver of the implied warranty in this case was ineffective because it did not mention the warranty of habitability by name and contained only general language stating that there were no warranties other than those contained in the four corners of the document.[137]

The court next considered whether an investor-buyer was within the class of persons who may maintain an implied warranty of habitability action. It refused to restrict the implied warranty to buyers who personally reside in dwellings after they purchase them.[138] The *Tusch* court stated that the identity of the person who inhabits the structure is unimportant because the implied warranty requires that the *structure* be fit for habitation.[139] The fundamental question whether the buyer received what he bargained for depends on the quality of the dwelling and the expectations of the parties, not the status of the buyer as ultimate user.[140] The court pointed out that the UCC warranty sections do not distinguish between buyers who purchase goods for their own use and buyers who

135. The real estate contract provided:

> 12. EXCLUSIVE TERMS: This contract is the entire agreement between the parties and all other agreements heretofore entered into, either written or oral, are hereby either abrogated or contained in this agreement. All prior oral agreements and conditions are expressly waived unless stated in this agreement and the parties expressly understand they have no mutual understanding or agreement other than as herein set forth.
>
> 13. WARRANTIES: The Purchasers have fully inspected the above described premises and know just exactly what they are purchasing. Sellers warrant that they have a good and sufficient title, and that the premises have no code violations or governmental restrictions as of May 15, 1979, and that further as of May 15, 1979, Sellers warrant that they know of no defects in the sewers, plumbing, electrical items, and mechanical items in and about the property. Other than as set forth in this paragraph, Sellers make no further warranties with regard to the condition of the sewer lines, utility poles, fences, curbs, sidewalks, streets, patios or any other mechanical item of any description whatsoever within the described premises.

Id. at 44, 740 P.2d at 1029.

136. *Id.* at 46, 740 P.2d at 1031. Other courts have required proof of the purchaser's subjective knowledge of a disclaimer term. *See supra* note 60.

137. *Id.* at 46, 740 P.2d at 1031.

138. *Id.*

139. *Id.*

140. *Id.*

purchase goods for income, and stated that it saw no reason to afford greater protection to purchasers of chattels than to purchasers of real property.[141]

The court in *Tusch* also rejected the contention that it should deny the plaintiff implied warranty protection because investor-buyers can more easily hire experts to evaluate buildings prior to purchase.[142] Given that the implied warranty of habitability covers only latent defects that manifest themselves after purchase, the expertise or sophistication of the purchaser is relevant only to determining whether a defect should be considered latent.[143] The court stated that it is unrealistic to expect buyers to consult geotechnical and other experts about defects that are not apparent.[144] Noting that the builder created the defect and had the superior ability to avoid it,[145] the court held that the implied warranty of habitability applied under the facts of this case.[146]

The courts that have extended the implied warranty of habitability to sales of commercial property as in *Tusch* and *Hodgson* have emphasized the protection of the purchaser's reasonable expectations. These courts reject the assumption that purchasers of commercial property have the ability to protect those expectations by inspecting the property and bargaining for contractual protection. This is especially true in sales of relatively modest commercial properties purchased by individuals or small entities.[147] The courts applying the warranty impliedly recognize that there may be a vast difference among purchasers of commercial property in their ability to protect their expectations under a contract.

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141. *Id.*

142. *Id.* at 47, 740 P.2d at 1032.

143. *Id. See* Haskell, *supra* note 2, at 651, *cited with approval* in *Tusch*, 113 Idaho at 47 n.6, 740 P.2d at 1032 n.6.

144. 113 Idaho at 47, 740 P.2d at 1032.

145. *Id.*

146. *Id.* The court limited the holding to the facts before it, stating that the implied warranty extends to *residential* dwellings purchased for income-producing purposes which have never been occupied by the buyers. *Id.*

147. In Hodgson v. Chin, the court emphasized that the plaintiffs were small businesspersons and specifically reserved judgment on whether the warranty would be extended to large commercial buildings. 168 N.J. Super 549, 555, 403 A.2d 942, 945 (1979). *See also* Chubb Group of Ins. Co. v. C.F. Murphy & Assoc., 656 S.W.2d 766, 782 (Mo. Ct. App. 1983) (implied warranty of habitability not applicable in action by tenants not in privity with builder of large commercial building).

III. THE CASE FOR AN IMPLIED WARRANTY IN SALES OF COMMERCIAL PROPERTY

In considering whether to impose an implied warranty of quality in sales of new commercial property, courts must determine the extent to which commercial parties should be held responsible for protecting their own interests. Courts that reject the application of the warranty conclude that these purchasers, unlike homebuyers, assume the risk of latent defects when they contract. The crucial factor in this allocation of risks has been the status of the purchaser. The commercial nature of the property did not lower the purchaser's expectations. Rather, the assumed characteristics of commercial purchasers persuaded the courts that there was no compelling reason to provide legal protection to these purchasers' expectations of receiving property free of hidden defects. However, this Article contends that differences between residential and commercial purchasers do not justify the extension of warranty to the former group but not the latter.

A. Rationales Supporting the Imposition of an Implied Warranty in the Sale of New Commercial Property

Although a disappointed purchaser of commercial property might not elicit as much sympathy from courts as a hapless homebuyer, the rationales underlying the recognition and expansion of an implied warranty of habitability in sales of residential property apply with equal force to sales of commercial property.

Purchasers of commercial property, like buyers of residential property, are forced to rely on the skill and expertise of the builder or developer of their property to the extent that they are unable to discover defects in the property. Such a purchaser may be more likely than a residential purchaser to have the means to employ a trained expert to examine the property prior to purchase. However, even a sophisticated commercial party likely would not hire an independent expert to examine new construction, because the purchaser's reasonable expectations about the quality of new construction are usually high. Furthermore, completion of the structure limits what even a trained expert can discover. Significant defects may exist in the foundation or sealed elements of the structure and go undiscovered by an expert.[148] This problem is especially true of larger and more complicated commercial property, such as a high-rise apart-

148. *See supra* notes 31-32 and accompanying text.

ment building or retail complex. As in sales of residential property, the builder-vendor is in the best position to know the methods and materials used in the construction.

Not only does a builder-vendor have superior knowledge about the structure and superior ability to avoid defects, in many cases the builder-vendor will also be a superior risk bearer because he is in a position to carry insurance against his errors and omissions. The purchaser may not be insured for the particular defect. While a commercial purchaser can pass on repair costs to tenants, clients, or customers, this puts the purchaser—who did not cause the defect—at a competitive disadvantage in the marketplace. There seems little reason to place the burden on the purchaser, even a relatively sophisticated purchaser, for defects caused by an equally sophisticated builder-vendor.

Many purchasers of commercial property may be able to protect themselves against the risk of latent defects by negotiating express warranties or favorable prices. However, bargaining power and sophistication about legal matters varies widely among commercial parties. That the plaintiffs in the cases discussed earlier did not attempt to bargain for express warranties and, in some cases, signed contracts with "boilerplate" disclaimers suggests that many buyers of commercial property are little more sophisticated about warranty protection and exclusion than the ordinary homebuyer. Although several courts have said that a buyer of commercial property has more bargaining power than a typical homebuyer,[149] that assertion depends on factors such as the purchaser's reason for purchasing the commercial property, the market for the property, and the characteristics of the individual purchaser.

In addition, application of an implied warranty of quality is necessary to facilitate the commercial purchaser's reasonable expectations. Such purchasers, like purchasers of residential property, expect that they will receive that for which they bargained and paid: a structure free of hidden defects that prevent its use for its intended purposes. Nothing suggests that these expectations are different because the property is purchased to produce income rather than to provide a home.

Application of an implied warranty of habitability in sales of commercial property also would encourage a higher standard of quality in construction of commercial buildings and higher standards of ethical dealings between the parties in commercial transactions. The need to

149. *See, e.g.*, Conklin v. Hurley, 428 So. 2d 654, 659 (Fla. 1983).

encourage minimum standards of good workmanship in residential structures purchased for investment purposes and leased to tenants is obvious. Reasonable standards of habitability are just as important to the person who leases a house or apartment as to the person who purchases the structure. Courts should encourage builder-vendors of commercial property to meet such standards because the health and safety of the person occupying the structure, including employees who occupy a nonresidential commercial structure, should be protected. To deny that protection to the ultimate user of the structure because the owner purchased the property for investment purposes makes little sense.

In addition, just as the analogy between the buyer of goods and purchaser of new homes supported the creation of the implied warranty of habitability,[150] the analogy between the UCC's implied warranty of merchantability and the implied warranty of habitability supports the application of similar protection in the sale of commercial property. The UCC provides that the warranty of merchantability is implied in every contract for the sale of goods by a merchant seller.[151] Although some provisions of the UCC distinguish between a merchant and nonmerchant buyer,[152] the warranty of merchantability applies regardless of the characteristics of the buyer. The implied warranty of habitability reflects a belief that purchasers of real property should be entitled to as much protection as the purchaser of goods. There is no reason to limit warranty protection to a particular "consumer" class of purchasers and deny that protection to "merchant-like" investment purchasers in the sale of real property. As in the sale of goods, courts should focus upon the product, not the purchaser.

Courts should not assume that there is a relevant distinction between purchasers who invest in commercial property and "simple, gullible folks unable to protect themselves."[153] People who buy real property for business purposes vary widely in their experience, knowledge, sophistication, bargaining power, wealth, and access to outside advisers and experts.[154] Some courts seem to consider commercial property to be, by definition, a luxury rather than a necessity.[155] In fact, many who purchase commer-

150. *See, e.g.*, Wawak v. Stewart, 247 Ark. 1093, 449 S.W.2d 922 (1970); Conyers v. Molloy, 50 Ill. App. 3d 17, 364 N.E.2d 986 (1977).

151. U.C.C. § 2-314 (1987).

152. *See, e.g.*, U.C.C. §§ 2-209(2), 2-207(2), and 2-205 (1987).

153. Standard Lumber & Mfg. Co. v. Johnstun, 285 F.2d. 301, 304 (9th Cir. 1960).

154. *See* Mallor, *supra* note 63, at 1074-87 (1986).

155. *See, e.g.*, *Conklin*, 428 So. 2d at 659 (the investor enjoys a stronger bargaining position than

cial property do so to earn a livelihood.[156] Furthermore, the rationales underlying recognition of the implied warranty suggest that, as a policy matter, purchasers of commercial property, like those who purchase residential property, should be entitled to receive that for which they bargain: property that is safe and habitable, and that meets reasonable standards of good workmanship. New construction developed or sold by one in the business of selling real property should be accompanied by an implied warranty of quality, irrespective of the type of property involved or the purchaser's motive for buying the property.

B. Application of the Implied Warranty of Quality in Sales of Commercial Property

In the commercial property context, the implied warranty of quality should be viewed as a warranty of habitability for residential property purchased for investment purposes, and as a warranty of good workmanship for nonresidential property.[157] Although sound policy supports the application of an implied warranty to sales of all types of new construction, sales of commercial property are likely to pose some special challenges.

It is probably no accident that most commercial property implied warranty cases involve relatively small business and investment concerns. An implied warranty of quality is likely to have more importance for small businesses than for large corporations. A sophisticated, experienced, and wealthy purchaser is more likely to have legal counsel at its disposal. A sale of commercial property to such a party usually will be attended by intense inspection and legal scrutiny.[158] Attorneys representing the parties are likely to bargain for warranties or disclaimers of warranties, and liability for latent defects is likely to be one of the risks contemplated and provided for in the contract of sale. As a result, the

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the homebuyer; the typical family buying a home is buying a necessity, while the investor can always choose to invest his excess capital elsewhere).

156. *See, e.g.*, Hodgson v. Chin, 168 N.J. Super. 549, 403 A.2d 942 (1979) (small businesspersons bought property for relocation of their Chinese take-out restaurant and gift shop).

157. *See* Frickel v. Sunnyside Enter., Inc., 106 Wash. 2d 714, 733, 725 P.2d 422, 432 (1986) (en banc) (Pearson, C.J., dissenting) (claim of commercial property purchaser is analogous to claim for breach of the implied warranty of merchantability); Hopkins v. Hartman, 101 Ill. App. 3d 260, 262, 427 N.E.2d 1337, 1338 (1981) (warranty of habitability approaches one of merchantability). *See generally* Haskell, *supra* note 2.

158. This is not always the case, however. *See, e.g.*, Fairmont Foods Co. v. Skelly Oil Co., 616 S.W.2d 548 (Mo. Ct. App. 1981).

determination of whether contractual disclaimers of the warranty are enforceable is likely to become a crucial issue in resolving implied warranty cases between vendors and purchasers of commercial property.

Courts traditionally have recognized that sellers and buyers of equal bargaining power should be able to allocate the risks associated with the sale of property. This should continue to be true with disclaimers of implied warranties in the sale of commercial property. Although courts usually apply exacting standards for an effective disclaimer of the implied warranty of habitability with respect to residential property,[159] courts should relax those standards with sophisticated and knowledgeable commercial property purchasers, such as large corporations. For example, although "as is" disclaimers are usually ineffective to disclaim the implied warranty of habitability in sales of new residences,[160] a conspicuous clause using such a commonly understood commercial term should be sufficient against a commercial party who is truly knowledgeable and experienced and who is represented by counsel. However, when the parties are of unequal stature, unconscionability standards sensitive to the individual buyer's sophistication, experience, bargaining power, and knowledge should be used to determine whether a disclaimer should be enforced.[161]

In the absence of an effective contractual disclaimer of implied warranties, an implied warranty of quality should exist in sales of new commercial property. The rationales underlying imposition of an implied warranty of habitability in the sale of residential property apply with equal force to the sale of new commercial property. The law should protect the purchaser's expectations without regard to the size or expertise of the purchaser. The builder-vendor should be responsibile for latent defects in the property as he is in the best position to know about and bear the risk for such defects.

While courts should impose an implied warranty of quality in the sale of new commercial property, they should continue to limit the protection afforded by the warranty to latent defects. Courts should consider the sophistication, knowledge, and expertise of the purchaser in determining whether a particular defect is latent or should have been discovered upon inspection. As a result, powerful corporate purchasers will be protected only against those defects that are beyond the range of their reasonable

159. *See supra* notes 58-62 and accompanying text.
160. *See* Abney, *supra* note 52, at 148.
161. *See* Mallor, *supra* note 63, at 1085-88.

inspection.[162] In light of the high expectations purchasers have about new construction, however, courts should not place an unreasonable burden on the purchaser of commercial property to investigate and discover defects which are not readily observable. The responsibility for nonobservable defects in the sale of new commercial property should rest upon the builder-vendor, regardless of the relative sophistication of the purchaser.

IV. CONCLUSION

Most courts today protect purchasers of residential property by imposing a judicially created warranty of habitability in the sale of a new home. The judicial trend is toward expansion of the warranty to the sale of used homes and to subsequent purchasers. By placing an extracontractual duty on sellers in the business of selling real property to supply structures that meet reasonable standards of construction and are fit for their ordinary purpose, the courts recognize the need to enforce the reasonable expectations of the parties, as well as acknowledge the purchaser's necessary reliance on the builder's superior knowledge and skill. Imposition of a warranty of habitability also ensures minimum standards of safety and quality in housing. While the warranty in the sale of new housing appears firmly established, some courts have refused to extend an implied warranty to the sale of commercial property on the theory that commercial investors can protect themselves through investigating the property and obtaining express warranties in the contract.

Upon closer examination, however, the policies underlying imposition of a warranty of habitability in sales of residential property also apply in sales of commercial property. Many commercial investors are infrequent and relatively unsophisticated purchasers who rely on the seller's knowledge and expertise. They are not unlike purchasers of residential property who "invest" in their property by reselling and upgrading their homes through a succession of sales and purchases. Even in commercial property transactions between large businesses, the builder-vendor often will have superior knowledge of possible defects in the structure which may be unobservable or undiscoverable by the purchaser. Many defects, such as defects in the foundation, are undetectable after the structure is completed. Inspection is also more difficult because commercial structures such as apartment buildings and office buildings are usually much

162. *See supra* notes 48-49 and accompanying text.

larger and more complex than the average home. A purchaser of commercial property may be experienced and sophisticated in legal matters and thus able to protect himself against latent defects by express warranties in the contract. However, courts should only enforce disclaimers of the implied warranty based on standards of unconscionability that address the specific knowledge, experience, and bargaining power of the purchaser, and circumstances surrounding the transaction.

Imposition of an implied warranty of quality in the sale of commercial property is supported by those policies underlying the retreat from the *caveat emptor* doctrine in sales of residential property. An implied warranty would ensure that the purchaser of such property, like the purchaser of residential property, can expect to get that for which he bargains. An implied warranty would require that the seller bear the risk of defects and help guarantee a minimum standard of reasonable construction in commercial buildings. Some courts have been willing to extend these protections to the purchasers of commercial property. Other courts should continue the trend.