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THE EMERGING LAW IN RESIDENTIAL REAL ESTATE RESALE DISCLOSURES -- IS IT STYMIED!

by

Saul S. Le Vine*

Introduction

In 1985, the California legislature enacted the first statute requiring sellers of residential real property and participating brokers to disclose to prospective purchasers comprehensive information relative to the condition, value and desirability of the property offered for sale. As a result of this legislation, a substantial number of other states passed legislation mandating some form of disclosure by sellers but not by brokers. Many states are currently considering a more limited form of mandatory property-condition disclosure legislation.

The California legislation[1] essentially codified the state's unique common law requirement that both sellers and brokers discover and disclose all information material to the value and desirability of the property offered for sale.[2] In the states where this has been enacted however, the prevailing form of limited disclosure legislation has used the local common law which is far less than the California standards.[3] The desirability of this movement toward enacting property condition disclosure legislation can be most usefully evaluated only after a comparative analysis of the common law, the various legislative regulatory schemes and the effects of the latter on the evolution of the former.

Common Law

An examination of the common law development of inspection and disclosure duties on sellers, brokers and buyers in the residential real estate sales market concludes that the common law has been developing in a fashion which creates greater duties of fairness and commercial reasonableness on sellers and brokers. Various states have also imposed an explicit duty of inspection or disclosure on sellers or brokers.[4] These requirements have taken the form of being enacted by statute in many states. In some states regulatory agencies covering real estate brokers have been promulgated.[5]

History – Common Law

The right to buy, own and sell property is inherent and much protected individual rights under common law in this country. These rights have been reflected in the applicable provisions

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of the Fifth and Fourteenth Amendments of the Constitution.[6] It has always been consistently held that property rights in connection with the sale of residential real property by its owner was not burdened with the imposition of affirmative disclosure duties by the judicially created traditional common law.[7]

The case history seems to have created the duty to evaluate the property on the buyer rather than the seller or his agent (broker). It was held that mere non-disclosure of material facts would normally not be a ground for action in the nature of misrepresentation.[8] This formed the concept of the traditional *caveat emptor*, let the buyer beware or take care.[9]

Also serving to insulate the seller from liability and relating to *caveat emptor* is the doctrine of "merger" in a real estate transaction. This doctrine holds that all warranties and representations made in connection with a sale, are considered to be merged into the deed, unless specifically expressed in writing to survive delivery of the deed.[10] The deed is considered full compliance and performance of the obligations created in the Contract of Sale.[11] Once the buyer accepts the deed, the Contract ceases to exist and the rights of the seller and buyer are regulated by the deed.[12]

The merger doctrine satisfies and extinguishes all contract covenants that relate to title, possession, quantity or conditions of the land.[13] Traditionally, a purchaser of a resale residence had no remedy against the seller under an implied warranty of habitability theory, which theory was generally applied to the sale of newly constructed homes.[14]

In 1992, a New Jersey Appellate Court broke new ground by allowing a buyer to recover against the seller of a resale home with a defective septic tank. The Court held that "an implied warranty of habitability should also apply to the sale of a used home", because it is based on "current notions of what is right and just."[15] This law had been established that the elements of intentional misrepresentation are:

1. a false representation of fact;
2. knowledge by the defendant that the representation is false or a reckless disregard for the truth or falsity of the statement;
3. the knowledge to induce the plaintiff to rely on the information;
4. plaintiff's justifiable reliance upon such representation; and
5. resultant damage from such reliance.[16]

The primary difference between negligent misrepresentation and intentional misrepresentation is that in a negligent misrepresentation suit the plaintiff does not have to prove that the defendant made the false representation with the intention to deceive, or that he or she knew the disclosed information was false and just prove lack of reasonable care.[17]

The Illinois courts have recognized that an action is maintainable if it alleges the elements of a duty owed, a breach of such duty and an injury resulting from such breach.[18]

Influencing the concept of mandating disclosure through legislation has been a very gradual expansion of the scope of acknowledging common law fraud to include the non-

disclosure of material information by sellers and brokers.[19] The courts have increasingly imposed a duty to speak, and coupled with the duties to speak have found liability for non-disclosure which is equivalent to false disclosure.[20]

It must be noted that while courts began to hold that non-disclosures may satisfy the elements of a false statement of a material fact, the remaining tort elements of culpability, reasonable reliance, causation and damage have remained essential to the recovery under common law fraud.

Under traditional common law, obligations imposed on the seller of real property created a duty to prospective purchasers not to make any false representations or actively conceal any defects or material facts.[21] That traditional duty did not, however, generally require sellers to affirmatively disclose such material facts. Mere silence without a duty to speak has never been actionable.[22] However, courts have increasingly found that certain circumstances, particularly partial disclosure, create a duty to speak.[23] Therefore, if the seller is asked about or speaks about a particular subject, he or she must make a full and fair disclosure as to that subject so as not to mislead the buyer.[24] Also rather well established is the obligation of complete disclosure based on a finding of an agency, fiduciary, confidential or other relationship of trust existing legally or factually between the parties. In several cases in various states, there were findings that there were no fiduciary duties between the parties where the seller did not have actual knowledge of the defect. In New York, as noted in my companion paper, the holdings of a vendor-builder was liable for fraudulently concealing massive foundation cracks in a home sold to a purchaser.[25]

A majority of state courts have expanded the scope of the duty of a seller of residential real property to disclose material facts to a prospective buyer.[26] One of the leading cases is *Lingsch v. Savage*.[27] The California Court of Appeals concluded: [Where it was] "presented with an instance of mere nondisclosure, rather than active concealment occurring between parties not in a confidential relationship...that it is now well settled in California that where the seller knows of facts materially affecting the value or desirability of the property which are known or accessible only to him and also knows that such facts are not known to, or within reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer. Failure of the seller to fulfill such duty of disclosure constitutes actual fraud."[28]

In a similar case, the New Jersey Supreme Court reversed a ruling of summary judgment in favor of a seller of real property infested with roaches, holding that "current principles grounded on justice and fair dealing...clearly call for a full trial below."[29] In support of its decision, the court noted that:

The statement may often be found if either party to a contract of sale conceals or suppresses a material fact which he is in good faith bound to disclose then his silence is fraudulent. The attitude of the courts toward nondisclosure is undergoing a change. Contrary to Lord Cairn's famous remark, it would seem that the object of the law in these cases should be to impose on parties to the transaction a duty to speak whenever justice, equity and fair dealing demand it. This statement is made only with reference to instances where the party to be charged is an actor in the transaction. This duty to speak does not result from an implied representation by silence, but exists because a refusal to speak constitutes unfair conduct.[30]

In a third case, *Johnson v. Davis* which involved property with a defective roof, the Florida Supreme Court affirmed a lower court's award of rescission reasoning that:

"Modern concepts of justice and fair dealing have given our courts the opportunity and latitude to change legal precepts in order to conform to society's needs. Thus the tendency of the more recent cases has been to restrict rather than extend the doctrine of *caveat emptor*. The law appears to be working toward the ultimate conclusion that full disclosure of all material facts must be made whenever elementary fair conduct demands it."[31]

These cases illustrate a trend in state courts to expand the duty of the seller to disclose and thereby to make a nondisclosure as actionable as a false disclosure. In other words, the plaintiff must establish all of the several elements of common law fraud as previously set forth.[32]

In either case, the materiality of the nondisclosure is critical.[33] A fact is material as a matter of common law fraud if "a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question."[34] Specifically in the area of real estate fraud, state courts generally relied on that classic definition held that a material fact is one "to which a reasonable man might be expected to attach importance in making his choice of action." A Florida Court held that a material fact is one that substantially affects the value of the property.[35]

Although materiality is a mixed question of law and fact, courts have found the following conditions to be material so that a seller's failure to disclose them is actionable: prior termite damage, active termite damage, illegal and condemned building, defective roof, defective well, radioactive mine tailings, filled soil, defective septic system, building code violation, lot requiring retaining wall prior to constructing a building, generally deteriorated condition of the property, wood beetle damage, water rights, contaminated well, basement flooding, drain tile underneath house, structural defects, artisan well underneath property, prior fire damage, tilting house, sewer connection charges, house insulated with ureaformaldehyde insulation, defective earth-sheltered home, and flood damage.

Although this list is extensive, a few courts have found that sellers have a duty to disclose only where the defect or condition (whether or not material) is dangerous or poses a threat to health and safety.[36] Some states sellers are not liable for damages caused by defects existing at the time of sale. The courts acknowledge that they are required to "disclose to the purchaser any concealed condition known to him that involves an unreasonable danger. Failure to make such disclosure or efforts to conceal a dangerous condition, render the vendor liable for resulting injuries."[37] Similarly, a Pennsylvania Appeals Court, in holding the sellers liable for failing to disclose a defective sewage disposal system, affirmed that "the modern view...holds that where there is a serious and dangerous latent defect known to exist by the seller, then he must disclose such defect to the unknowing buyer or suffer liability for his failure to do so."[38] The facts of this case reflect that the seller may not have known of the dangerous condition, and suggest that the element of culpability may be satisfied by reckless disregard or negligence where an unsafe condition exists.[39]

Some courts have relieved the seller of liability when the contract contains an "as is" clause. Generally, an "as is" clause will be upheld if the defects are "obvious" or "reasonably discernible." In the absence of fraud, mutual mistake, or warranty, courts will respect an "as is" clause.[40]

In some jurisdictions, the existence of an "as is" clause in a contract of sale for real estate will not relieve the vendor of his obligation to disclose a condition which substantially affects the value or habitability of the property. When the seller has actual knowledge of the condition and it and would not be disclosed by a reasonable and diligent inspection to the purchaser, the failure to disclose has constituted fraud.[41]

Consumer protection laws are typical required disclosure statutes. They usually list prohibited acts and allow damages or rescission to an injured party.[42] Under the Connecticut Unfair Trade Practice Act, a buyer of residential real estate was awarded rescission in addition to monetary and punitive damages for injury resulting from the seller" nondisclosure of defects. The court stated that the seller was obligated to disclose the denied request for a subsurface sewage system permit.[43]

In cases of passive concealment by the seller of defective real property, there is an exception to the rule of *caveat emptor*...which imposes a duty on the seller to disclose material facts which are known or should be known to the seller and which would not be discoverable by the buyer's exercise of ordinary care and diligence.

Brokers have very little incentive (indeed, significant disincentives) to provide information to the buyer. Brokers are usually agents of the seller, but in many cases are effectively representing the buyers and therefore full disclosure should be compelled. It is suggested that brokers should not be allowed to continue to expect immunity from buyers' causes of action, and that brokers should be compelled to disclose to the buyer all available information.

Presently, a growing number of courts require brokers participating in the sale of residential real estate to disclose facts materially affecting the value or desirability of the offered property, so long as the facts are known by the broker (structural defects), and neither known by the prospective purchaser, nor available to her through a reasonable inspection.[45] Any failure to disclose in accordance with that judicially imposed duty constitutes actionable fraud, provided, of course, that the remaining essential elements of culpability, reasonable reliance, causation, and damages can be established by the complaining purchaser.

In view of the customary lack of any sort of confidential relationship between a prospective purchaser and the selling broker, it has been difficult for common law courts to logically impose a duty to disclose on the broker, or even to extend the seller's duty to the real estate broker. Although some courts have refused to hold a broker liable on such grounds, most agree with the Lingsch court that an actionable real estate fraud case "does not require privity of contract."

Obligations to Disclose under the Statute

In 1984, a California Court of Appeals ruled in the landmark case of *Easton v. Strassburger*[46] that a real estate broker acting for a seller of residential real property has an "affirmative duty to conduct a reasonably competent and diligent inspection of the residential property listed for sale and to disclose to prospective purchasers all facts materially affecting the value or desirability of the property that such an investigation would reveal."[47] At the time Easton was decided, state courts, including those in California, had repeatedly analyzed the applicability of the common law torts of fraudulent concealment, intentional misrepresentation, and negligent misrepresentation to cases of nondisclosure of property defects. Since an essential element for the establishment of common law fraud in a nondisclosure (rather than a false disclosure) case is the existence of a duty to disclose, erosion of the early doctrine of *caveat emptor* required the courts to define and rationalize the imposition of such a duty on the owner, the selling broker, or others participating in the sale of the offered property.[48]

No court, in California or elsewhere, however, at the time of Easton had yet interpreted a broker's duty to disclose known defects as including an obligation to conduct a reasonably competent and diligent inspection of the property. Further, no court had found, based on the imposition of such a duty, that a broker is liable to a buyer for negligently failing to disclose such discoverable information. The California Courts took a major step forward in expanding, if not creating, a remedy for not only a seller's but also a real estate broker's negligent failure to disclose reasonably discoverable defects or other adverse material information to a prospective buyer of the residential resale real property.

In July of 1985, California became the first state to enact legislation specifically covering this area of controversy. The legislature acted largely in response to outcries from real estate brokers who reacted to the Easton court's expansive view of their duties to inspect and disclose. Under the sponsorship and lobbying of the California Association of Realtors, the California legislature approved the first, and still the most comprehensive real property condition disclosure legislation.[50] It became effective on January 1, 1986, with respect to brokers and January 1, 1987, with regard to sellers. The legislature intended to "codify and make precise," but arguably also to limit certain obligations under the Easton decision.

The California legislature chose largely to embrace rather than reject, the expanded property condition disclosure requirements laid down by the Easton court. As explained below, however, in an effort to set objective, easily understood guidelines for making full and fair disclosure, the legislature may have created statutory scheme that falls short of what Easton requires. As a consequence, the courts as having effectively limited the impact of the Easton opinion may interpret the statute. Since California's enactment of its mandatory property condition disclosure legislation in 1985, other states have adopted a form of such regulation, which in every case were very much "watered down" versions of the legislation.

<u>The California Statutory Approach</u>

Two statutes (collectively the "California Act") were enacted in response to Easton. The first is entitled "Article 1.5 Disclosures Upon Transfer of Residential Property" (the "Disclosure Article"). [51] The second is entitled "Article 2. Duty to Prospective Purchaser of Residential Property" (the "Broker Duty Article"). [52] The statutes are applicable to all sales, exchanges and

related transfers for value of residential real property or residential stock cooperatives containing four or fewer dwelling units. The Broker Duty Article, of course, only applies to such sales, exchanges and transfers involving a licensed real estate broker. The California Act, unlike most of the other States, applies to all sales of new or never occupied residences as well as to all resales.[53]

Given the Easton holding, it is noteworthy that neither the statutorily mandated form nor any other provision of the California Act requires the seller to disclose any defects or other facts not specifically called for, even if they are material to the Purchaser's assessment of the value or desirability of the property. However, the Disclosure Article makes clear that, "the specification of items for disclosure in this article does not limit ... any obligation for disclosure created by any other provision of law or which may exist in order to avoid fraud, misrepresentation, or deceit in the transfer transaction." In other words, while the new law mandates that specific information on a prescribed written form must be actually delivered to the prospective purchaser, it does not by its more limited scope effect any limitation on the broader duty to disclose "all facts materially affecting the value or desirability of the property, recognized by the Easton opinion."[54]

After defining the affirmative disclosure duties of brokers participating in a regulated sale, the California legislature, presumably in response to the uncertainties sounded by representatives of the real estate brokerage industry, added certain clarifying provisions to the statute. For example, Broker Duty Article Section 2079.2 explains that the standard of care owed by any broker subject to Section 2079's inspection and disclosure requirements is "the degree of care that a reasonably prudent real estate licensee would exercise and is measured by the degree of knowledge through education, experience and examination, required to obtain a license."[55] In passing over the reasonably prudent person standard, applicable to most common law tort claims including misrepresentation, in favor of this higher reasonably prudent licensed, educated, experienced, and examined real estate broker standard, the California legislature adopted the philosophy seemingly underlying the Easton decision.[56] That philosophy holds that a broker who presents himself to prospective purchasers and to the public as an experienced, licensed professional in the field of residential real property transactions, and who financially benefits as a result of so doing, should be held to a standard of care consistent with that position. While this stricter standard varies from that normally applied under ordinary negligence law (reasonable prudent person standard), it is well established in the analogous area of the federal regulation of sales of securities. There, the public investor (like the homebuyer) is less able than the broker to obtain the relevant information about the proposed investment. As a practical matter, he is forced to rely on the selling broker.

The Disclosure Article offers no remedy of recession and restitution once the transaction has been completed.[57] It does allow a purchaser to recover the actual damages suffered, as a result of any person's willful or negligent failure to comply with any of the statute's requirements. As against the seller, then, who, as noted above, is required to disclose only in response to the form's enumerated list of questions, a purchaser may recover damages under the statute only if the seller willfully or negligently failed to deliver the disclosure statement, failed to answer any of the enumerated questions, or falsely answered one or more of those questions. As mentioned above, this remedy is in addition to, and in no way replaces or limits, any common

law remedy, whether or not grounded in Easton, that may be available to a damaged purchaser.[58] As against brokers, a purchaser may recover damages under the Disclosure Article if the broker willfully or negligently failed to adequately complete the visual inspection of the premises or failed to make complete disclosure of material facts discoverable from the inspection required in the Broker Duty Article.

The Disclosure Article makes clear that, irrespective of whether the defendant is a seller or a broker, there is no liability for any false or omitted information unless it was within the actual knowledge of the defendant or, in the case of information supplied by a public agency or a recognized expert, unless he or she failed to exercise ordinary care in obtaining and transmitting it. No seller or broker can be found liable for an innocent misstatement or omission; he or she must be found guilty of no less than negligence in fulfilling the duties of investigation and disclosure as described in the statute. Consistent with the common law, if the seller or broker exercised due diligence by meeting the required standard of care, no liability will attach. The affirmative defense of due diligence is reinforced by Section 2079.5, which makes it clear that a buyer must exercise reasonable care to protect himself and cannot recover from a broker who fails to point out a defect or other adverse fact that should have been discovered by a reasonably attentive and observant buyer. Indeed, further reinforcement can be inferred from the statutorily required suggestion of the mandated disclosure statement that buyers and sellers should consider having the property professionally inspected. The statutorily available due diligence defense and its recognition of the corresponding purchaser duty of exercising ordinary care is consistent with the common law, even as expanded by Easton. Section 1102.4 allows reasonable reliance on such experts as licensed engineers, land surveyors, geologists, structural pest control operators, contractors and others.

Neither the California Act nor any of its five earlier legislative undertakings require the seller of residential real property to make any disclosure of material information not specifically called for by the applicable disclosure document. However, disclosure to prospective buyers of all known or reasonably discoverable material information is required of seller and brokers by the Easton decision and of brokers by the Broker Duty Article of the California Act. Furthermore, disclosure of all known "material defects" (though not other material information) is required of brokers by the Maine and New Hampshire Rules. It is noteworthy that other statutes also impose upon sellers this more open-ended duty to disclose any other known material defects, in addition to the items specifically enumerated in the statute.[59] While these acts facially go further than the Disclosure Article of the California Act, the common law in most jurisdictions already prohibits the fraudulent concealment of known defects and increasingly requires disclosure of those defects that are reasonably ascertainable by sellers of real property and participating brokers.

Historically, the sale of residential real property, like the sale of other real and personal property of all sorts, was regulated largely by the common law torts of fraudulent concealment, intentional misrepresentation, and negligent misrepresentation. The elements of real estate fraud are a characteristic and strength of the common law, and the courts to accommodate the realities of the marketplace have from time to time adopted them. As a result the courts in the Easton case recognized a duty to be imposed upon the sellers of residential real property, and imposing the same duty on any and all participating brokers, to inspect the offered real property and to

disclose not only any defects discoverable during that inspection, but also "all facts materially affecting the value or desirability of the property"[60] to any and all prospective purchasers. This expansion of real estate fraud to provide a common law damage remedy for buyers in California would, in the normal course, have been further refined by case law in that state. No doubt it would also have been adopted by at least some other state courts that have long regarded the California courts to beat the forefront of tort law evolution. Instead, the major consequence of the Easton decision was the enactment of the California Act. The impact of that legislation on the scope and direction of the law of real estate fraud has been and continues to be enormous. Essentially the evolving Easton approach, even to the extent, preserved in the California codification, now stands stymied.

The California Act largely codified and thereby ratified the expanded duties owed by the sellers and brokers of residential real property. The Disclosure Article goes further than the judicially created law by affirmatively requiring the preparation and delivery of a disclosure statement containing prescribed detailed useful information, and by providing a buyer with a remedy for any damages caused by a violation of that requirement. While the statutory disclosure requirement clearly helps the buyer obtain at least some useful information, and presumably makes him aware of the right to obtain correct and complete information, it adds only modestly to the broad run from the earlier of the date of the discovery of the actionable misstatement or omission on the date on which it should reasonably have been discovered.

Unlike the Disclosure Article, there is no provision in the Broker Duty Article stating that it is in addition to the broader duty and corresponding remedy afforded a prospective buyer by the Easton opinion. Accordingly, it could be argued that the California legislature was persuaded and that it intended to ratify only a portion of Easton, thereby limiting the scope of the broker's duty of inspection and disclosure to that expressly detailed in that Article.[61] Under this analysis, one effect of the statute is to reduce the risk of liability that existed after Easton to a broker who provides false or incomplete disclosure. As a practical matter, such an interpretation of the statute would be to afford protection to the broker at the expense of the buyer, and perhaps more importantly, at the expense of the seller to whom the buyer would be forced to look exclusively for his or her remedy. Until the intent of the legislature is determined by the California courts faced with facts that would cause a broker to be found liable under Easton but not under the statute, the effect of the statute on the then-existing common law in this critical area of broker liability is a continuing uncertainty.

In most jurisdictions other than California, the early well-established doctrine of *caveat emptor* remained substantially intact, precluding or at least slowing any judicial creation and expansion of disclosure duties necessary to support a remedy for nondisclosure. In general, an uninformed, rather than misinformed buyer's only legal remedy law in the doctrine of fraudulent concealment of a known defect to the limited extent that it existed under the applicable state law. It therefore eliminated for the foreseeable future, any judicial attempt to move in the direction of imposing any duty of disclosure whatsoever on members of the real estate industry. To the limited extent that a purchaser of real estate is benefited by the Prevailing Disclosure Act, all costs of that benefit fall on the individual seller rather than on the real estate professional.

Another category of relevant statutes is that of the various consumer protection acts, where again, the presumed purpose was to afford legal recourse to inadequately protected consumers.[62] In those somewhat analogous areas, the lawmakers seem to have concluded that the protection of the then inadequately protected investor or consumer was necessary and desirable, that the disclosure form of regulation was effective, and that the costs of compliance were not unreasonably burdensome to the sellers and their agents, as compared to the resulting benefits for the protected class and the marketplace generally.

The Prevailing Disclosure Act has the appearance of being enacted in order to provide needed protection to the purchasers of residential real estate. Therefore, it too should be evaluated and measured against possible alternatives by balancing its benefits with its costs to all concerned parties.

As set forth above, the purchaser of residential real estate has a common law remedy against the seller and participating brokers for damages proximately caused by the misrepresentation or fraudulent concealment of known material defects. Prior to the enactment of the Prevailing Disclosure Act, neither sellers nor brokers in states other than California, Maine and New Hampshire had any duty to make any disclosure unless they had knowledge of a material defect. Furthermore, they had no duty to inspect or to take other action to discover the existence of any material defects.

As a practical matter, the buyer must undertake the same inspection of the premises as was necessary in the absence of the Prevailing Disclosure Act to protect against overpaying and to establish the element of reasonable reliance for a possible fraud claim. An unfortunate affect of the statute is that upon receiving a disclosure document with a formal and legalistic appearance, the buyer may assume that he or she is fully informed and forego such an investigation.

Another cost to the buyer is the increase in price resulting from the burdens of complying with the mandated disclosure requirements. A seller may reasonably believe that the complexities of the new law preclude her selling the property without the services of a broker, and will therefore increase the price to cover the broker's commission. Ironically, however, the imposition of greater duties of inspection and disclosure on the broker was short-circuited by the passage of the Prevailing Disclosure Act, which at the same time makes the broker more essential.

Practically, however, the seller is forced or believes he is forced to engage a real estate broker in order to handle the required compliance at a cost that the seller may not be able to fully pass on to the buyer. The increased cost is at least a small burden on an individual's inherent right to acquire and sell real property, especially since many sellers list with brokers in any event. Again, ironically, while the broker becomes almost indispensable as a result of the statutory compliance obligations, that same statute not only fails to impose any new duties of inspection or disclosure on the broker but also even fails to acknowledge any duties arguably still existing at common law. Accordingly, the statutory limit on a broker's potential liability to a defrauded purchaser has shifted the risk of any such liability dramatically from the broker to the seller.

As a matter of substance, the seller's burden is only marginally increased since he or she is already obligated under common law principles to disclose all known defects. In addition, the seller gains some benefit since he cannot be held liable for any damage caused by a disclosed defect or condition.

As mentioned above, the National Association of Realtors has been the prime impetus behind the passage of the Prevailing Disclosure Act.[63] It comes as no surprise, therefore, that the benefits to the broker and the brokerage industry are enormous. Simply put, the statute enhances the dependence of a seller of residential real estate on the services of a broker, effectively limits the broker's liability for nondisclosure to the purchaser, and prevents the imposition of a duty on the broker to inspect and disclose to the purchaser the discoverable fruits of that inspection. The imposition of such a duty would likely occur through judicial development in the absence of the statutes' enactment. The Prevailing Disclosure Act provides some small-added disclosure to the purchaser.[64] All of these effects occur at the expense of the seller rather than the broker, without a single cost to the broker. It would be difficult to envision a statutory scheme better designed to further the special interests of the real estate brokerage industry.

Another factor that bears on defining the parameters of any required inspection is the scope of the inspection. The key question is whether the inspection should cover only readily accessible areas or consist of a more complete investigation. Again, this is related to the identity of the inspector. A seller inspection cannot be expected to extend beyond readily accessible areas; a professional home inspector will look for hidden defects and examine hard to reach areas. The real question arises if a statute requires a broker inspection. Based on an assumed level of expertise, it would be fair to require brokers to perform a more complete inspection. However, brokers are not as competent or experienced as professional home inspectors to perform a truly complete inspection are.[65] Clearly, if the public policy goal of disclosure legislation is to fully inform the buyer of potential defects, a full, rather than a visual inspection is preferable. Following the scope of inspection logic would argue for broker inspection at a minimum and a professional inspection as preferable.

If policy moves in the direction of a professional inspection, the legislature must deal with the issue of cost. Inspection and disclosure by the seller is cost-free to the parties and provides the buyer with no additional protection. Although it is true that the broker may be liable for negligence or misfeasance if he does the inspection himself. Brokers are compensated almost universally on a commission basis, based on a percentage of the sales price. The commission covers all of the broker's activities in marketing the property, assisting the buyer and closing the transaction. The broker must undertake some level of property inspection for no other reason than to become familiar with the property and to make suggestions to the seller to repair or improve the house so it "shows" better. Requiring the broker to undertake a more complete physical inspection of the property for disclosure purposes does not materially add to the time or effort that he or she devotes to the property.

On the other hand, the old adage "you get what you pay for" might apply to opting for a broker inspection solely because it imposes no additional cost on the transaction. The best protection comes from a professional inspection. Depending on the market area, type of property, and the items included in the inspection, home inspection costs typically range from

$500 to $1000. If the legislature mandates a professional inspection, it should allocate the cost of the inspection in the legislation.

Most of the existing disclosure legislation applies the duty to sales of existing residences rather than newly constructed houses. This seems to be the correct approach. In most states, sales of newly constructed dwellings are covered by well-established warranty doctrines of merchantability, fitness and habitability. Several states have enacted legislation requiring that builders expressly or implicitly warrant the new home. Even where warranties are not statutorily mandated, many builders offer warranties as a marketing tool. In addition, state or local building inspectors during construction inspects all new construction. While such inspections do not assure absence or defects, they do provide adequate protection to the purchaser.

Conclusion

The cases and the statutes that followed will not shed a great deal of light upon how the courts will interpret or should interpret the statutes in the future, but they seem to be a step in the right direction. The decisions following the statutes in various states seem to construe ambiguous portions, both in the construction cases and the resale cases to the benefit of the purchasers. However, the statutes have created the ability to have limited liability and thus create generous defense portions of the statutes, which inevitably yield inequitable results.

The statutes in residential construction cases have created the ability to significantly reduce the impact of the statute and have created different standards for builders in the construction cases, brokers in the limitation of their liability, and sellers in their ability to remain silent and not discuss defects which are not easily visible to the average purchaser.

The unimpeded development of the common law would provide sufficient buyer protection without the necessity of state legislation. The Prevailing Disclosure Act weakens buyer protection compared to that developed by the common law. There are some benefits to legislation, however, but only if the legislation is comprehensive and clear in mandating an inspection and disclosure duty. The best solution is a statute mandating that the seller or listing broker retain and provide an inspection report by a professional home inspector. Such an inspection should include all material elements of the house, including physical systems and other items located in inaccessible areas.

One benefit of a statutory solution over continued development of the common law is that legislation would specify what items and systems must be inspected, which would make the disclosure obligation more uniform and less subject to interpretation. The item by item development of the common law leaves areas of uncertainty. What areas must be disclosed, what types of defects and the materiality of the defect must all is developed through litigation. One major advantage of legislation would be to clearly establish the types of things that must be disclosed, thus making the disclosure duty less subject to interpretive difficulties. A clearly defined disclosure obligation coupled with a professional inspection should serve to rationalize the seller's disclosure obligation and provide a high level of protection for the buyer.

As a result of the statutory allowable modifications, builder-vendors have been able to limit their liability substantially by contractual agreements.

A companion paper prepared by me entitled DOES THE STATUTORY "HOUSING MERCHANT IMPLIED WARRANTY" OF GENERAL BUSINESS LAW – ARTICLE 36-B COMPLETELY SUPERSEDE THE COMMON LAW VERSION?" is also being distributed covering the resultant statutory changes in New York, after the courts have expanded consumer/purchaser rights and duties.

END NOTES

1. Cal. Civ. Code Sections 1102-1102.15, 2079-2079.10.
2. *Easton v. Strassburger*, 199 Cal. Rptr. 383 (Cal.Ct. of App.1984).
3. *Id.*
4. Cal. Health & Safety Code Sec. 25359.7 and Conn. Gen. Stat. Ann. Sections 22a-134 and;
5. Maine and New Hampshire Rules.
6. U.S. Const. amends. V, XIV.
7. *Herbert v. Saffell*, 877 F.2d 267 (4th Cir.) 1989, and Comment, Real Estate Broker Liability To Purchasers, Robert M. Zeit, 63 Temp. Law Rev. 165 (1990).
8. *Peek v. Gurney*, L.R. 6H.L. 377, 403 (1873) and *Wilhite v. Mays*, 232 S.E.2d 141,142-143 (Ga. Ct. of App.).
9. *Kellogg Bridge Co. v. Hamilton*, 110 US 108, 116 (1884).
10. *Andreychak v. Lent*, 607 A.2d 1346, (N.J. Superior Ct. App. Div.1992).
11. *Id.*
12. *Id.*
13. *Knight v. Breckheimer*, 489 A. 2d 1066, 1068 (Conn. App. Ct. 1985).
14. *Haygood v. Burl Pounders Realty Inc.*, 571 So. 2d 1086 (Ala. 1990).
15. *Andreychak v. Lent*, 607 A.2d 1346 (1992).
16. Restatement of Torts (Second) section 525 (1989).

17. *Lyons v. Christ Episcopal Church*, 389 NE 2d 623,625 (Ill. App. Ct. 1979).
18. *Id.*
19. Restatement of Torts (Second) (1989).
20. *Lingsch v. Savage*, 29 Cal. Rptr. 201,206 (Cal. Ct. App 1963).
21. Restatement of Torts (Second) (1989).
22. *Jarvis v. Bellefeuille*, No. 577 1991 WL 253086 (Mass. App. Div. 1991).
23. *Burman v. Richmond Homes, Ltd.*, 821 P.2d 913,919 (Colo. Ct. App 1991).
24. *Id.*
25. *Haberman v.Greenspan*, 368 NYS2d 717,719 NY Sup. Ct. 1975; *Remel v. Chasebrook Constr. Co.*, 135 So.2d 876,882 (Fla. Dist. Ct. App. 1961).
26. Relief for Innocent Misrepresentation: A Retreat from Traditional Doctrine of *Caveat Emptor* 19 Real. Est. LJ 130 1990.
27. *Lingsch v. Savage*, 29 Cal. Rptr. 201,206 (Cal. Ct. App 1963).
28. *Id.* at 204.
29. *Weintraub v. Krobatsch*, 317 A.2d 68,75 (N.J. 1974).
30. *Id.* at 72.
31. *Johnson v. Davis*, 480 So. 2d 625,629 (Fla. 1986).
32. Restatement of Torts (Second) Section 525 (1989) Second.
33. *Reed v. King*, 193 Cal. Rptr 130,131 (Cal. App 1983); *Harlan v. Smith*, 507 So.2d 943, (Ala.Civ. App 1986).
34. Restatement of Torts (Second) Sec. 538(1989).
35. *Stewart v. Thrasher*, 610 NE 2d 799,804 (Ill App. Ct. 1993) and Hill, 725 P.2d1119.
36. *Catucci v. Ouellette*, 592 A.D.2d 962 (Conn. App. Ct. 1991) and *Scharf v. Tiegerman*, 561 NYS2d 271,272-72 N.Y. App. Div. 1990.
37. Restatement of Torts (Second) Sec. 353.

38. *Anderson v. Harper*, 622 A. 2d 319, Pa. Super. Ct.; appeal denied 634 A.2d 222(1993).

39. *Id.* at 324.

40. *Atkins v. Kirkpatrick*, 823 SW 2d 547 (Tenn 1991).

41. *Stemple v.Dobson*, 400 S.E.2d 561,567 (W. Va 1990).

42. *Catucci v. Ouellette*, 592 A2d 962,964 (Conn. App.Ct 1994)
Conn. Gen. Stat ANN Section 4-110g(a).

43. Holcomb, 365 N.W.2d at 512.

44. *Cooper v. Jevne*, 128 Cal. Rptr 724,727.

45. *Lingsch v. Savage* @ 205.

46. *Easton v. Strassburger* (199 Cal. Rptr. 383 (Cal. Ct. App [1984]).

47. *Id.* at 390.

48. *Id.*

49. *Id.* at 387-388.

50. Cal. Civ. Code sections 1102-1102.15.

51. *Id.*

52. *Id.* sections 2079-2079.10.

53. *Id.* at sec. 1102.

54. *Id.* at sec. 1102.8.

55. *Id.* at section 2079.2.

56. *Easton v. Strassburger* at 388-392.

57. Cal. Civ. Code section 1102.13.

58. *Id.* at 1102.8.

59. Delaware, Maryland, and Rhode Island.

60. *Easton v. Strassburger* at 390.

61. Cal. Civ. Code Sections 2079-2079.9 (1994).

62. Uniform Deceptive Trade Practices Acts (several states).

63. Cal. Civ. Code.

64. *Id.*

65. Kevin C. Culum, *Comment Hidden-But-Discoverable Defects; Resolving the Conflicts Between Real Estate Buyers and Brokers*, 50 Mont. Law Rev. 331,343 (1989).