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# Consumerism and Land Sales

Leonard Levin\*

## I. INTRODUCTION

The recent discovery of the risk of radon contamination in homes and other structures has created the potential for increased litigation between unsuspecting buyers and equally unsuspecting sellers and their brokers to determine who must bear the loss required for corrective measures.<sup>1</sup> Since the problem is a relatively new one, there is little litigation on the subject.<sup>2</sup> The purpose of this brief study is to examine the growth of seller and broker liability for defects in the condition of the premises, and to suggest a probable outcome, particularly with respect to cases involving the risk of radon contamination.

## II. AN OVERVIEW

In recent years, there has been a development of consumerism in connection with real estate sales. It is undoubtedly true that when rights in real estate are involved, changes in judicial attitude occur much more slowly than in other contexts.<sup>3</sup> Much of this delay stems from concern for preserving stability and predictability in the context of interests in land, since such interests are likely to continue in an unchanged form over long periods of time.<sup>4</sup> Nevertheless, the ex-

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1. For a discussion of the source and scope of this problem in Pennsylvania, see *Radon Gas: Ramifications for Real Estate Transactions in Pennsylvania*, 91 DICK. L. REV. 1113 (1987). See also Sherman, *Radon Testing, Case Law Unclear*, 117 N.J. L.J., May 22, 1986, at 22, col. 3; Sherman, *Radon and Real Estate: Potentially Costly Mixture*, 118 N.J. L.J., Nov. 27, 1987, at 1, col. 1 [hereinafter *Radon and Real Estate*]; Galen, *Lawyers Grapple with Radon Issue*, NAT'L L.J., Jul. 21, 1986, at 3.

2. See Galen, *supra* note 1.

3. See, e.g., *T. S. Foulke & Co. v. Boutwell*, 242 Ala. 526, 527-28, 7 So. 2d 490, 491 (1942); *Smith v. Glen Alden Coal Co.*, 347 Pa. 290, 302, 32 A.2d 227, 233-34 (1943); *Menne v. City of Fond Du Lac*, 273 Wis. 341, 345, 77 N.W.2d 703, 705 (1956).

4. See generally *supra* note 3. It should be noted that the concern is often implicit rather than explicit. Perhaps one of the best statements of judicial conservatism in connection with real estate interests is the famous dictum of Sir William Black-

panding concept of consumer protection, fueled by the abandonment of the ideal that the rugged individualist is the best protector of his own interests, has begun to permeate the marketplace.

The concept of implied warranty in the sale of personal property matured and became firmly accepted by the end of the nineteenth century.<sup>5</sup> Occasionally, the development of implied warranty in the personalty context has been offered as an analogy for the development of such a theory in the area of real estate transactions.<sup>6</sup> However, there are important differences in the development of this area of law in these two settings which should not be overlooked. A significant number of commercial transactions are made by professional sellers who are dealers in such goods. Indeed, the present Uniform Commercial Code specifically restricts the implied warranty of merchantability to sales by a "merchant" or dealer in goods of such kind.<sup>7</sup> In contrast, the typical seller of real estate (except for the builder/developer) is usually not involved in the business of dealing in real estate. The transfer of realty is most likely to represent, if not a unique experience, certainly one that is unlikely to recur with much frequency for the seller as well as the purchaser. It is common for both the seller and the buyer to be assisted by a broker; however, in the technical aspects of the transaction, both the seller and the buyer are likely to be completely inexperienced in the matter of real estate transactions.

The development of consumerism in the landlord-tenant relationship has also been offered as being analogous to the growth of consumerism in the context of real estate transactions. In this area, there has been a rapid and remarkable increase in the judicial recognition of an implied warranty of habitability continuing during the term of a lease in residential housing.<sup>8</sup> To a lesser degree, a similar trend has emerged requiring the suitability of leased premises for their intended purpose in a commercial context.<sup>9</sup>

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stone, declared in the late 18th century: "The law of real property in this country is now formed into a fine artificial system, full of unseen connections and nice dependencies, and he that breaks one link of the chain, endangers the dissolution of the whole." HARGROVE, TRACTS RELATING TO THE LAW OF ENGLAND 489 (1787).

5. See generally 2 WILLISTON ON SALES §§ 15-16 (4th ed. 1974 & Supp. 1987).

6. See, e.g., *Gable v. Silver*, 258 So. 2d 11 (Fla. Dist. Ct. App. 1972), *aff'd*, 264 So. 2d 418 (Fla. 1972) (holding that the judicial trend is to apply implied warranties to real estate transactions).

7. U.C.C. § 2-314(1). See U.C.C. § 2-104 (defining "merchant" for purposes of the Uniform Commercial Code).

8. *Javins v. First Nat'l Realty Corp.*, 428 F.2d 1071 (D.C. Cir. 1970). The rule has been widely adopted in other states, and is the rule in Pennsylvania. See *Pugh v. Holmes*, 486 Pa. 272, 405 A.2d 897 (1979). RESTATEMENT (SECOND) OF PROPERTY § 5.1 (1977) adopts the implied warranty of habitability as the preferred rule in residential lease situations.

9. The landlord's responsibility, however, has generally been predicated on other grounds. See *Reste Realty Corp. v. Cooper*, 53 N.J. 444, 251 A.2d 268 (1969) (liability

Comparisons between the landlord-tenant relationship and land sales, however, have limited utility because of the significant differences between the two transactions. In a lease situation, the landlord has a continuing and significant economic interest in the land throughout the term of the lease. Under such circumstances, it is not unreasonable to regard the landlord as the party in the best position to maintain the premises during the term of the lease. This is particularly relevant in the case of either multi-tenant structures, or residential leases in which the tenant may lack the economic resources to maintain the premises. On the other hand, both buyers and sellers of realty are more likely to be persons of relatively equal economic power. Moreover, it seems clear that in connection with such a sale, both buyer and seller contemplate a complete termination of the seller's responsibility and the buyer's assumption of such responsibility, at least as of the time of the settlement when the price is paid and the deed delivered.<sup>10</sup> The principle of allocating increased responsibility to sellers of real estate transactions is thus *sui generis*. The trend in the context of sales of goods and landlord-tenant relationships is not a suitable comparison. This article will first explore the methods employed by courts, legislatures, and the parties themselves to expand the responsibility of the seller. It will then project the probable outcome of the current trend toward increasing such responsibility.

### III. MARKETABILITY OF TITLE AND TITLE COVENANTS CONTAINED IN A DEED

With respect to defects in title, mechanisms were created at a relatively early date imposing liability upon the seller. Thus, prior to settlement, the seller was presumed to warrant that the title to be conveyed was "marketable."<sup>11</sup> Even after settlement, most communities deemed the grantor's deed, either by its express terms or

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based on breach of warranty of quiet enjoyment); *Millikin Inc. v. Allen*, 21 Wis. 2d 497, 124 N.W.2d 651 (1963) (liability based on inadequacy of water supply, a violation of local health regulation). The RESTATEMENT (SECOND) OF PROPERTY discusses the problem but declines to take a position. See RESTATEMENT (SECOND) OF PROPERTY § 5.1 (1977); cf. *Cameron v. Calhoun-Smith Distrib. Co.*, 442 S.W.2d 815 (Tex. Civ. App. 1969) (rejecting liability of landlord for faulty drainage and sewage system in commercial lease setting, and holding that tenant cannot withhold rent even though premises uninhabitable).

10. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 235 (1981); see also *Downing v. Stiles*, 635 P.2d 808 (Wyo. 1981) (denying defendants use of the defense of commercial frustration to avoid fully performing all conditions of a contract).

11. *Messer-Johnson Realty Co. v. Security Sav. & Loan Co.*, 208 Ala. 541, 542, 94

through force of statute, to contain normal warranties against defects in the title conveyed.<sup>12</sup>

On the other hand, when it came to the condition of the buildings or other improvements on the land, it was generally assumed that the buyer could protect himself against costly defects by inspecting the property before the sale. It was also assumed that the parties intended to deal "at arms length." These assumptions find their best expression in the maxim "caveat emptor," or let the buyer beware.<sup>13</sup>

It seems unlikely that any of these assumptions are persuasive today. With the increased complexity involved in building construction, it seems doubtful that anyone other than an expert could by inspection determine all of the possible defects to a piece of realty. This is particularly true of defects such as dangerous radon contamination which can only be determined by expert testing devices.

There is one other complicating factor present with regard to the condition of the premises which is not present in connection with a defect of title. The Doctrine of Merger provides that if defects of title do exist, the vendor's obligation, absent some express agreement to the contrary, terminates as soon as the deed is delivered and accepted without substitution of any warranties not contained in the deed.<sup>14</sup> On the other hand, if an obligation of the seller exists with regard to defects in the condition of the premises, a good argument can be made that the buyer's rights are not terminated by the delivery and acceptance of the deed at closing. Since a deed does not purport to deal with the condition of the premises, the acceptance of the deed should not extinguish any rights regarding pre-existing defects of the premises.<sup>15</sup> Thus, if a buyer discovers that a substantial defect

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So. 734, 735 (1922); *Lohmeyer v. Bower*, 170 Kan. 442, 452, 227 P.2d 102, 110 (1951) (defining marketable title).

12. See generally Levin, *Warranties of Title—A Modest Proposal*, 29 VILL. L. REV. 649 (1983-84).

13. See, e.g., *Tison v. Eskew*, 114 Ga. App. 550, 151 S.E.2d 901 (1960) (holding that where defects in construction of a house were not concealed by the seller, the buyer must assume all damages resulting from such defects); cf. *Elderkin v. Gaster*, 447 Pa. 118, 288 A.2d 771 (1972) (recognizing the general rule, but refusing to apply it to a builder-seller); see also *infra* note 26 and accompanying text. For a discussion tracing the history of caveat emptor, see Hamilton, *The Ancient Maxim, Caveat Emptor*, 40 YALE L.J. 1133 (1931).

14. *Fanger v. Leeder*, 327 Mass. 501, 99 N.E.2d 533 (1951); *Fulk v. Williams*, 37 S.W.2d 511 (Mo. 1971). See generally 77 AM. JUR. 2d *Vendor & Purchaser* §§ 292-293 (1975 & Supp. 1987).

15. Generally, the rule of merger does not apply to agreements deemed to be collateral to the sale. Undertakings regarding the condition of the premises have usually been deemed collateral. See *Levin v. Cook*, 186 Md. 535, 47 A.2d 505 (1945) (holding that an independent collateral agreement to the transfer of a deed of sale may be admissible as long as it does not conflict with the provisions of the deed.); *Allen v. Currier Lumber Co.*, 337 Mich. 696, 61 N.W.2d 138 (1953); *Bradley v. Braker*, 69 Montg. Co. L. Rep. 38 (1952) (holding that seller's express warranty did not merge into the deed thereby terminating seller's obligation once the premises were delivered to buyers);

did exist prior to closing, such as termite infestation or radon contamination, the buyer does not lose any of the rights he would have had under the agreement of sale simply because he has gone through closing and accepted the seller's deed. The buyer's right to sue would thus continue up to the period of the applicable statute of limitation.

#### IV. SPECIFIC CONTRACT CLAUSES

When the seller and the buyer anticipate the risk of a particular defect, it can be dealt with by the inclusion of a specific clause in the sales contract. Such clauses have become standard in regions in which termite infestation is prevalent.<sup>16</sup> Other common clauses deal with major structural defects or may (with or without legislative prodding) guarantee a particular zoning classification and lawful use.<sup>17</sup>

These contractual clauses are of two types. One type requires the seller to guarantee protection against a given hazard and as a condition precedent to settlement to obtain appropriate expert certification that he has done so. Termite and zoning clauses are common examples of this type. The other type of express contractual provision commonly employed provides for inspection and determination by the buyer's own experts as to whether or not a defect of the type stated exists. Settlement is conditioned on the absence of such defects. Clauses relating to structural defects are typically of this

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Dunseath v. Hallauer, 41 Wash. 2d 895, 253 P.2d 408 (1953). Additional cases dealing with merger of the underlying agreement into the deed following settlement are collected in Annotation, *Deed as Superseding or Merging Provision of Antecedent Contract Imposing Obligations Upon Vendor*, 84 A.L.R. 1008 (1933), 38 A.L.R. 2d 1315 (1954).

16. A typical "termite clause" might read as follows:

At least — days prior to settlement, Seller shall furnish Buyer with a certificate and assignable service warranty issued by a reputable exterminating company at regular rates, certifying that there are no wood infesting insects present and no visible unrepaired damage caused by such insects. If infestation or need of repairs is found, Seller agrees to cause the removal and/or repair thereof, provided that the total cost thereof does not exceed \$—. If Seller does not timely procure the required certificate, Buyer shall have the option, exercisable at any time prior to the settlement date, to terminate this agreement and be repaid all deposit monies, including title company charges, and there shall be no further liability or obligation by either of the parties hereunder.

See 7 DUNLAP-HANNA PENNA FORMS § 4540.28 (1986).

17. See, e.g., PA. STAT. ANN. tit. 21 § 611 (Purdon Supp. 1987) (requiring seller's certification that there are no current zoning violations). For a typical form guaranteeing to the buyer that the contemplated use is lawful, see 7 DUNLAP-HANNA PENNA FORMS § 4540.32 (1986).

character.<sup>18</sup>

In several areas of the country, it has recently been discovered that natural emissions of radioactive radon gas may create serious health hazards in basements and other closed areas of a residence.<sup>19</sup> In areas of the country where the public has been made aware of the problem of radon contamination, buyers and sellers of real estate have begun to insert "radon clauses" into their contracts.<sup>20</sup> The use of radon clauses has the potential of reducing litigation in this area.

Theoretically, a similar problem could arise out of the use of asbestos as a building material. Its use as a means of insulation and/or fireproofing was common before the discovery that it presents a serious health hazard. Although there has been considerable litigation concerning the liability of suppliers of asbestos materials and their successors,<sup>21</sup> few cases have emerged involving the sale of real estate containing an asbestos hazard. This absence of litigation was likely due to the fact that the hazard was unknown at the time of installation and it has been readily apparent and easily removable.

When sales agreements contain clauses relating to a defect such as radon contamination, determining the rights of the parties under these agreements can be problematic. Since there are very few cases construing the parties' rights under these circumstances, very little guidance is available. From the plain meaning of such a clause, it would seem to be clear, even in the absence of decided cases, that should such a defect be discovered, the purchaser could assert the breach of the promise contained in the clause as grounds for rescission of the conveyance and restoration of the status quo ante.

Whether the buyer may proceed with the transaction and hold the seller or broker responsible for damages attributable to the defect is also unclear since most clauses do not directly address this issue.<sup>22</sup> If the transaction were to be analogized to commercial transactions under the Uniform Commercial Code, a right to damages might exist as an alternate remedy and the buyer could possibly take advantage of an election of remedies.<sup>23</sup> On the other hand, if the transaction were analogized to a situation where the buyer pursues damages for a

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18. It should be noted that the inclusion of clauses conditioning the sale of the property on the buyer's personal satisfaction and/or permitting the buyer to avoid the contract by reason of his dissatisfaction do not render the buyer's obligation illusory. The buyer's power to avoid the contract is deemed to be based on objective standards, and thus the buyer's right to avoid the contract is not absolute. *See, e.g., Herzog v. Ross*, 196 S.W.2d 268 (Mo. 1946); *see also* Annotation, *Vendor's Failure to Make Improvements*, 67 A.L.R. 809 (1930).

19. *See Radon and Real Estate*, *supra* note 1, at 24.

20. *See generally supra* note 1.

21. *See, e.g., Hall v. Armstrong Cork Inc.*, 103 Wash. 2d 258, 692 P.2d 787 (1984); *Standal v. Armstrong Cork Co.*, 356 N.W.2d 380 (Minn. Ct. App. 1984).

22. *See generally supra* note 16.

23. U.C.C. § 2-714 (1972). *See also id.* § 2-715.

title defect discovered at or before settlement, the buyer might be required to elect either to rescind the contract or to accept the title subject to the defect.<sup>24</sup>

In any event, to the extent that defects are anticipated and these clauses employed, litigation would seem likely to be reduced notwithstanding the foregoing ambiguities. Moreover, the use of these clauses provides a novel illustration of contract drafters' acknowledgement of the current trend toward increasing the seller's responsibility for the condition of the premises. In this connection, an interesting analogy can be drawn with respect to the development of the warranty deed and the usual assumption that the grantor will have responsibility thereunder for defects in the title conveyed.<sup>25</sup> In the eighteenth century, conveyancers who wished to avoid the "caveat emptor" principle of the time began including lengthy and prolix statements guaranteeing the title conveyed by the grantor.<sup>26</sup> These provisions eventually crystallized into the modern statutory rules whereby the grantor of a warranty deed is deemed to extend to the grantee a set of warranties with regard to the title conveyed—whether or not the express language of the deed mentions any particular warranties.<sup>27</sup> It may be that the current use of termite or similar clauses expanding the responsibilities of the grantor may in the future give rise to such responsibilities solely as a result of transferring a particular type of deed.

## V. IMPLIED WARRANTY AS BASIS FOR LIABILITY

As discussed previously, warranties that the subject matter of an agreement fulfills a buyer's expectations are routinely implied in sales of personal property. Perhaps the most common implied warranties are the warranty of merchantability and of fitness for a particular purpose.<sup>28</sup>

Implied warranties have also become commonplace in the area of landlord-tenant law. For example, in leases of residential property, a

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24. See generally 77 AM. JUR. 2d *Vendor & Purchaser* § 290 (1975 & Supp. 1987).

25. For a brief survey of the history and development of warranties in deeds, see Levin, *supra* note 12, at 649.

26. See generally W. RAULE, A PRACTICAL TREATISE ON THE LAW OF COVENANTS FOR TITLE (5th ed. 1887).

27. See generally 20 AM. JUR. 2d *Covenants, Conditions, Restrictions* § 75 (1965 & Supp. 1987). For a typical statute, see 21 PA. CONS. STAT. §§ 5-6 (1925 & Supp. 1987).

28. As to the warranty of merchantability, see U.C.C. § 2-314 (1972). As to the warranty of fitness for a particular purpose, see U.C.C. § 2-315 (1972).



warranty that the premises are habitable is frequently implied.<sup>29</sup> To a lesser extent, in leases of commercial property, many courts imply a warranty that the premises are fit for the intended purposes of the lease.<sup>30</sup>

In real estate *sales* transactions, however, warranties relating to the quality of the improvements have only been widely employed in one narrow context. Several decisions have held that a developer of residential property who constructs the dwellings and then sells them as homes, impliedly warrants that the premises offered for sale are habitable.<sup>31</sup> Put another way, it might be said that the developer impliedly warrants that, in undertaking construction, he will perform the job in a good and workmanlike manner. Thus, defects substantial enough to affect the utility of the premises, such as a leaky roof, a wet basement, or a defective foundation, would be indicative of fault on the part of the builder-seller in failing to perform in a good and workmanlike fashion.<sup>32</sup> Viewed in this manner, the warranty in question should be as applicable to structures built for commercial purposes as well as those designed for residential use.<sup>33</sup> A few cases focusing upon transactions involving residential homes have extended the implied warranties beyond faulty construction, and have imposed liability on the developer for such errors as site selection and/or the unavailability of a source of water for household use.<sup>34</sup> A similar rationale might be employed in cases of radon

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29. See, e.g., *Javins v. First Nat'l Realty Corp.*, 428 F.2d 1071 (D.C. Cir. 1970); *Pugh v. Holmes*, 486 Pa. 272, 405 A.2d 897 (1979); see also RESTATEMENT (SECOND) OF PROPERTY *Landlord & Tenant* § 5.1 (1977).

30. See *supra* note 9 and accompanying text.

31. *Petersen v. Hubschman Constr. Co. Inc.*, 70 Ill. 2d 31, 389 N.E.2d 1154 (1979); *Elderkin v. Gaster*, 447 Pa. 118, 288 A.2d 771 (1972); see also U.L.T.A. § 2-309(b) (1975). California applies a variation of the strict liability in tort concept in this context. See, e.g., *Becker v. IRM Corp.*, 38 Cal. 3d 454, 698 P.2d 116, 213 Cal. Rptr. 213 (1985). This implied warranty, however, has not been universally adopted. See, e.g., *Tison v. Eskew*, 114 Ga. 550, 151 S.E.2d 901 (1960) (builder-seller not responsible for structural defect absent proof of actual concealment).

32. *Brownell v. Quinn*, 47 Ill. App. 2d 206, 197 N.E.2d 721 (1964); *Weinberg v. Wilensk*, 26 N.J. Super. 301, 97 A.2d 707 (1953); *Raab v. Beatty*, 96 Pa. Super. 574 (1979). (holding that a house built upon an old tree stump which eventually caused cracks in the foundation and walls was not built in a workmanlike manner).

33. See, e.g., *Salem Realty Co. v. Batson*, 256 N.C. 298, 123 S.E.2d 744 (1962). Nevertheless, there has been considerable resistance to the extension of the implied warranty concept beyond the setting of consumer purchases of residential property. See *Hopkins v. Hartman*, 101 Ill. App. 3d 260 (1981), 427 N.E.2d 1337 (rejecting any implied warranty in purchase of housing units as rental property for investment). *Contra Tusch v. Coffin*, 740 P.2d 1022 (Idaho 1987) (imposing liability under similar circumstances).

34. If radon contamination is known to exist in the community, the seller may be under a duty to treat it the same as any other defect in the premise. See generally *Elderkin*, 447 Pa. at 118, 288 A.2d at 771; see also *House v. Thornton*, 457 P.2d 199 (Wash. 1969) (home built on land which would not support foundation).

contamination.<sup>35</sup>

There is little authority for extending the implied warranty of habitability in the sale of new residential property to the sale of used housing, except for a few decisions extending the builder-seller's responsibility to not only the original vendee, but to subsequent remote purchasers.<sup>36</sup> An argument can also be made for extending liability to sellers who are not engaged in the business of selling property in the usual sense, but instead participate in the process of *rehabilitating* residential premises before offering them for sale. In this case, just as in the case of new construction, an absolute liability upon the seller-developer may be posited, not only because he has control over the factors which go into the warranty, such as quality of construction and site selection, but also because if the contract with the purchaser is entered into before construction is commenced or fully completed, the buyer theoretically lacks the ability to protect himself through inspection.<sup>37</sup>

## VI. FRAUD OR NONDISCLOSURE AS A BASIS FOR LIABILITY

Another line of authorities, employing common law concepts, has attached liability to the seller who participates in fraud or fraud-like conduct, in an effort to provide relief to the buyer of property containing a material defect. Clearly, if the seller is aware of a material defect, but nevertheless specifically misrepresents the status of the premises by representing them as being without the defect, a common law case of fraud against the vendor will lie. The vendee will be able to select from the alternative remedies of either rescinding the contract or suing the vendor for damages for deceit.<sup>38</sup> Similar options are available to the buyer under common law concepts when the seller, instead of directly misrepresenting the truth, deceives the buyer by actively concealing the defect either verbally or by conduct,

35. As a result, nondisclosure of such defects could result in liability for the seller. See generally *supra* note 1.

36. See, e.g., *Tusch*, 740 P.2d at 1022; *Keyes v. Guy Baily Homes Inc.*, 439 So. 2d 670 (Miss. 1983); *Moxley v. Laramie Builders, Inc.*, 600 P.2d 733 (Wyo. 1979). See generally 63 AM. JUR. 2d *Products Liability* § 222 (1984 & Supp. 1987).

37. See, e.g., *Miller v. Cannon Hills Estates*, 2 K.B. 113 (1931). A few jurisdictions apparently limit the rule's application to cases in which the purchaser is unable to protect himself by inspection. Thus, they have refused to extend the liability of the seller-builder in cases where the construction has been completed before the contract of sale is entered into. Cf. *Druid Homes, Inc. v. Cooper*, 272 Ala. 415, 131 So. 2d 884 (1961).

38. For an exhaustive collection of cases, see Annotation, *Fraud Predicated Upon Vendor's Misrepresentation of Physical Condition of Real Property*, 174 A.L.R. 1010 (1948).

which has the result of discouraging the buyer from making further investigation. The seller may also be held liable where he in some other way makes it less likely that the buyer will discover the defect for himself.<sup>39</sup>

Many recent cases have taken this theory even further. These decisions have held that in any case in which the seller actually knows of a significant defect, at least if it is such that he should be aware of the fact that the buyer is unlikely to discover it for himself, the seller owes an affirmative duty to disclose the defect.<sup>40</sup> Under the circumstances, the transaction is really not at arm's length, and therefore the parties are not treated as dealing on the basis of equality. Thus, a failure by the seller to make a necessary disclosure confers upon the buyer substantially the same rights as if there were actual common law fraud. This rationale has been most commonly employed when the premises conveyed are infested with termites. However, this rationale is equally applicable to other defects, such as radon contamination, of which the seller is aware and of which he certainly knows that the buyer is ignorant and unlikely to discover.<sup>41</sup>

It is axiomatic that such claims require an element of reliance by the purchaser, so that one who is aware of the risk but nevertheless deliberately accepts it cannot proceed against the seller on the basis of fraud or misrepresentation.<sup>42</sup> Several cases arising under these circumstances have established the principle that the defect must be one which is latent and which the buyer could not have reasonably

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39. *Sullivan v. Ulrich*, 326 Mich. 218, 40 N.W.2d 126 (1940). See generally RESTATEMENT (SECOND) OF TORTS § 529 (1976).

40. *Obde v. Schlemeyer*, 56 Wash. 2d 449, 353 P.2d 672 (1960); *Sorrell v. Young*, 6 Wash. App. 220, 491 P.2d 1312 (1971). See generally RESTATEMENT (SECOND) OF CONTRACTS § 161(b) (1979) (imposing a duty of disclosure if, but only if, the ignorance or mistake of one party known by the other is as to a matter which is "a basic assumption" of the contract). In the illustrations to the section, the drafters of the Restatement indicated that termite infestation or other serious defects in the premises may be regarded as a mistake which qualifies as the type of "basic assumption" which triggers the rule. *Id.* illustration 5.

Not all authorities support the position that such a duty of disclosure exists, however. Many of the older decisions deny relief in the absence of misrepresentation or active concealment. See, e.g., *Hendrick v. Lynn*, 37 Del. Ch. 402, 144 A.2d 147 (1958); *Fegeas v. Sherrill*, 218 Md. 472, 147 A.2d 223 (1958); *Swinton v. Whitinsville Sav. Bank*, 311 Mass. 677, 42 N.E.2d 808 (1942) (all of which reject any duty to affirmatively disclose defects when the parties are deemed to be dealing "at arms length").

41. See generally *Obde*, 56 Wash. 2d at 449, 353 P.2d at 672 (plaintiffs recovered damages for fraudulent concealment of termite infestation); *Sorrell*, 6 Wash. App. at 220, 491 P.2d at 1312 (applying same rationale as that used in *Obde*, to case where vendor failed to disclose that the unimproved lot was filled land and hence unsuitable for building foundations, except at large additional cost).

42. *Secor v. Knight*, 716 P.2d 790, 794 (Utah 1986) (denying relief to purchaser who was aware of restrictions on use of property but accepted seller's implied assurance that the restrictions would not be enforced). See generally RESTATEMENT (SECOND) OF TORTS § 537 (1977) (indicating requirement of reliance for action based on fraudulent misrepresentation).

discovered for himself.<sup>43</sup> Nevertheless, although there is little direct authority on the point, an argument could be made that despite a buyer's failure to use reasonable diligence to discover a defect, if the buyer is, in fact, unaware of the defect and the seller knows of the buyer's ignorance, the seller or his broker should still be required to make disclosure to the buyer.<sup>44</sup> To allow otherwise would enable the vendor to take advantage of the buyer's ignorance.

Occasionally, the difficult question arises as to what constitutes notice of the defect by the seller. Suppose, for example, that although there is no direct evidence of the seller's knowledge, there is evidence that the seller is aware of facts sufficient to put a reasonable man on inquiry of the defect. In one case in which this problem arose, the court rendered its decision without directly addressing the question.<sup>45</sup> The seller had previously treated the premises for termites. However, at the time of the treatment, he denied the contractor permission to take up the flooring of a basement apartment despite having been warned by the contractor that the treatment may not have solved the problem.<sup>46</sup> After determining that the property was infested with termites, the buyer brought an action against the seller for fraudulent nondisclosure.<sup>47</sup> The court permitted the buyer to recover, treating the case precisely the same as if there were affirmative evidence that the seller had actually known of the termite infestation at the time of the sale.<sup>48</sup> The foregoing rule should be applicable regardless of whether the improvements are new or used, and without regard to whether the structure is intended for residential or commercial use.

In summary, it is important to realize that the rule under consider-

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43. *Obde*, 56 Wash. 2d at 452, 353 P.2d at 674-75; *Sorrel*, 6 Wash. App. at 224, 491 P.2d at 1315.

44. Although no case has been found precisely on point dealing with realty conveyances, the RESTATEMENT (SECOND) OF TORTS § 545A (1977) suggests that contributory negligence is not a defense to an action based on misrepresentation. The provision has found considerable approval in the case law. *See, e.g.*, *Sedco Int'l v. Cory*, 522 F. Supp. 254, 329 (S.D. Iowa 1981), *cert. denied*, 459 U.S. 1012 (1982); *Morgan, Olmstead, Kennedy & Gardner, Inc. v. Schipa*, 585 F. Supp. 245, 248 (S.D.N.Y. 1984).

45. *Obde*, 56 Wash. 2d at 449, 353 P.2d at 672. *Compare* *Tusch v. Coffin*, 740 P.2d 1022 (Idaho 1987). *Roberts v. Barbagallo*, — Pa. Super. Ct. —, 531 A.2d 1125 (1987) (holding that the rule which deems information acquired by the agent attributable to the principal is applicable to impose liability onto the seller in a real estate transaction in which the broker has actual knowledge of a dangerous condition and fraudulently conceals such from buyers).

46. *Id.* at 451, 353 P.2d at 674.

47. *Id.* at 450, 353 P.2d at 673.

48. *Id.* at 454-55, 353 P.2d at 676.

ation can be triggered only by establishing: (1) affirmative knowledge of the defect on the seller's part; (2) ignorance of the defect on the buyer's part; and (3) knowledge or at least reason to know on the seller's part that the buyer is ignorant of the defect.

## VII. INNOCENT MISREPRESENTATIONS

A misrepresentation, by definition, is normally not treated as being fraudulent if the person making the statement does so in good faith and thus lacks the mental element of scienter.<sup>49</sup> Relief may nevertheless be afforded to a party who relies upon an innocent misrepresentation providing that the misrepresentation is a statement which is material, that is, intended to induce reliance.<sup>50</sup> In this context, a representation about the condition or character of the premises being sold would qualify as a material one.<sup>51</sup> If such a statement is made carelessly or negligently—even though made in good faith, it may furnish a basis for either rescission or for damages. The measure of damages will be the difference between the amount paid for the property and the value of the property received.<sup>52</sup>

Moreover, Prosser has suggested the possibility of liability for innocent misrepresentations even in the absence of negligence.<sup>53</sup> He recommends that whenever a seller makes a material false representation which is intended to induce reliance, either rescission or a claim for damages should be permitted. The measure of damages would be the difference between the amount paid and the value of the property received.<sup>54</sup> Liability would be imposed upon the seller for any statement regarding the quality of the premises conveyed that turned out to be false, even if made in good faith and without scienter or negligence. Thus, if a seller were to say that the premises were without flaw, liability might be imposed upon him for such a latent defect as radon contamination even if the seller neither knew nor reasonably *could* have known of it.<sup>55</sup> Stated differently, his affirmative representation is deemed an assumption of risk of liability as to all defects—known or unknown.

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49. RESTATEMENT (SECOND) OF TORTS § 526 (1977).

50. *See, e.g., Shaffer v. Thacher Co. Ltd.*, 716 P.2d 163 (Haw. App. 1986) (applying the rule to negligent misdescription of property boundaries). *See generally* RESTATEMENT (SECOND) OF TORTS § 552 (1977).

51. *See supra* note 50.

52. RESTATEMENT (SECOND) OF TORTS § 552B (1977).

53. *Id.* at § 552C. *See also Ott v. Midland*, 600 F.2d 24, 32 (6th Cir. 1979) (citing section 552C of the Restatement with approval).

54. RESTATEMENT (SECOND) OF TORTS § 552C (1977).

55. *Id.*

## VIII. INNOCENT NONDISCLOSURES

To summarize, a trend has begun to develop in the law imposing liability upon a seller for defects in the transferred property whenever: (1) there is a specific clause guaranteeing against the defect;<sup>56</sup> (2) the property being sold is newly constructed and the seller is the builder or developer;<sup>57</sup> (3) the seller, by word or conduct, commits actual fraud;<sup>58</sup> (4) the seller has knowledge of the defect and fails to disclose, even though he knows that the buyer is not aware of it;<sup>59</sup> or (5) the seller assumes responsibility by making an affirmative representation as to the condition of the premises.<sup>60</sup>

Beyond these factual situations, there exist other instances in which the seller is unaware of substantial defects in the premises at the time of the sale. It is readily apparent that many radon cases will fall within this category. A question thus arises as to whether responsibility should be extended to the seller in this class of case. If the seller is not only unaware of the defect, but has no reason to know of it, no rational basis can be seen for imposing the risk upon such seller rather than the buyer. Under the circumstances, the parties are in a relatively even position. Unlike the merchant-seller of goods, the risk of the seller of realty cannot simply be treated as a cost of doing business, to be shared by all persons as part of the cost of the goods sold, and thus computed into the price. Moreover, except for the case of the builder-developer, the seller of real estate is unlikely to be engaged in the business of buying or selling.

On the other hand, much can be said for a rule which imposes a duty upon a seller to utilize his best efforts to discover defects. From his closer association with the property, the seller would seem to be in a better position to inspect than would the buyer, who has only a limited opportunity for an inspection and determination of the risk of these defects. Hence, a good argument can be made for extending the seller's responsibility to disclose to the buyer not only known defects, but also defects which the seller could discover by a reasonable investigation. At the present time, few decided cases have adopted such a theory. As previously noted, however, at least one case has extended the duty of disclosure to a situation in which the seller knew or

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56. See *supra* text accompanying notes 16-18.

57. See *supra* text accompanying notes 31-34.

58. See *supra* text accompanying note 38.

59. See *supra* text accompanying notes 40-48.

60. See *supra* text accompanying notes 50-55.

should have known of the defects.<sup>61</sup>

It is only a slight additional extension of the existing rules of seller liability to impose a duty upon a seller to use reasonable care to determine the existence of such defects. Moreover, "termite clauses" and "certification of lawful use clauses" illustrate the validity of extending this type of liability by contract.<sup>62</sup> Similarly, construing a seller's representation of the condition of the premises as an assumption of responsibility for defects, known or unknown, is a tacit recognition of the appropriateness of such responsibility.<sup>63</sup> An analogy might even be drawn to the lessor's obligation, upon renting premises, to determine the existence of any dangerous latent defects which the tenant is unlikely to discover for himself. Although the traditional wisdom limited such a duty to known defects, the present trend is to extend this rule to instances in which the lessor lacks actual knowledge of defects but had reason to know that such defects existed.<sup>64</sup>

Moreover, there is a line of cases which imposes a duty of inquiry on the real estate broker to satisfy himself that the property contains no substantial defects which the broker might have discovered by using ordinary care.<sup>65</sup> In *Easton v. Strassburger*,<sup>66</sup> for example, a California Court of Appeal held that a broker must disclose to a buyer any known material defects which are not known by the buyer.<sup>67</sup> The broker, who is generally the only professional involved in the transaction, may owe a greater responsibility to the buyer than even the seller in these jurisdictions. Nevertheless, like the lessor, the seller appears to be in a better position to discover and to correct the defect than the purchaser.<sup>68</sup>

As previously noted, one of the recent problems arising in the sale of real estate involves the buildup in basements or building foundations of potentially hazardous radioactive gas emitted from natural

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61. *Obde v. Schlemeyer*, 56 Wash. 2d 449, 353 P.2d 672 (1960). See *supra* notes 45-48 and accompanying text. But cf. *Hughes v. Stusser*, 68 Wash. 2d 707, 415 P.2d 89 (1966) (decided by same court and rejecting any duty of disclosure where seller lacked actual knowledge of termite infestation).

62. See *supra* notes 16-17 and accompanying text.

63. See *supra* text accompanying notes 50-55.

64. See, e.g., *Johnson v. O'Brien*, 258 Minn. 502, 506, 105 N.W.2d 244, 247 (1960) (extending a landlord's duty to warn tenants of latent defects not only when he actually knows of them but also when he has sufficient information that would naturally arouse the suspicions of a reasonable person to such defects); see also RESTATEMENT (SECOND) OF TORTS § 358B (1977).

65. See *infra* note 67 and accompanying text.

66. 152 Cal. App. 3d 90, 109, 199 Cal. Rptr. 383, 395 (1984).

67. *Id.* See also Annotation, *Real-Estate Broker's Liability to Purchaser for Misrepresentation or Nondisclosure of Physical Defects in Property Sold*, 46 A.L.R. 4th 546 (1986).

68. See *supra* text accompanying note 61.

sources.<sup>69</sup> Presently, there are no reported decisions dealing with this issue. Therefore, whether the seller or his broker owe a duty to buyers of real estate to discover and disclose the existence of radon contamination can only be analyzed in terms of the general principles outlined in this Comment.

Certainly, if the seller knows of the hazard, it is clear that a duty exists to disclose this fact to the buyer.<sup>70</sup> If the seller is also unaware of the problem, a more difficult question arises. If the problem is a novel one in the seller's community, and the seller has no knowledge of the defect at the time of the sale and no reason to suspect any latent defects, there would be little basis for imposing liability upon the seller.<sup>71</sup> On the other hand, if the existence of the problem is common knowledge in the community, so that a reasonable person would know of the problem at the time of the sale, it would be appropriate to impose the responsibility to investigate upon the vendor. The vendor's favorable position to determine the existence of the problem makes this added responsibility seem reasonable.<sup>72</sup>

#### IX. BROKER'S RESPONSIBILITY

Theoretically, the question of the broker's responsibility is somewhat more complex than that of the seller. There is considerable ambiguity in the broker's status as a middleman representing for some purposes the interest of the seller and for others, the buyer.<sup>73</sup> Thus, when a defect in the premises makes a loss inevitable, does the broker owe a duty to the seller or buyer or to both to help avoid or minimize such loss?

The real estate broker may be the only experienced professional involved in the transaction. As an experienced professional, the broker is more likely to be trained to foresee the possibility of problems. Conceptually, however, the question is fraught with difficulty. Since most brokers receive almost all of their compensation from the commission paid by the seller, they ought to be regarded as the agent of

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69. See *supra* note 1 and accompanying text.

70. See *supra* note 40 and accompanying text.

71. See *supra* text accompanying note 45.

72. See, e.g., *Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984) (finding duty to investigate by parties most favorably situated to do so).

73. See generally Comment, *The Real Estate Broker's Fiduciary Duties: An Examination of Current Industry Standards and Practices*, 12 PEPPERDINE L. REV. 145 (1984).



the seller and thus duty-bound to the seller only.<sup>74</sup> In the absence of actual fraud or fraudulent concealment in which the broker is a participant, it is difficult to find a theoretic basis for imposing responsibility by the broker to the buyer. While it is true that an agent is liable for his own torts,<sup>75</sup> in the absence of tortious conduct, an agent for a disclosed principal incurs no personal contractual liability such as that arising out of warranty or similar contractual duty.<sup>76</sup>

Nevertheless, under current practice, the broker frequently purports to represent both buyer and seller, and may even exact an obligation from the buyer for the payment of a service fee for preparation of the deed and other routine matters involving the conveyancing and closing process.<sup>77</sup> Were lawyers involved in such a relationship, the situation would clearly be totally unacceptable under the Code of Professional Responsibility.<sup>78</sup> The practice is apparently accepted among brokers.

Without regard to the wisdom of permitting this type of dual agency, its mere existence suggests a reasonable argument for imposing upon the broker the same responsibility to the buyer as is owed by the seller. In fact, there is substantial authority for imposing responsibility upon the broker not only in cases in which he is guilty of outright fraud, but also in situations in which the broker is deemed to have acted in good faith but negligently.<sup>79</sup> Thus, there have been cases in which liability has been imposed upon a broker when he misrepresents the character of the premises even though he acts

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74. *Seligson v. Young*, 189 Pa. Super. 510, 151 A.2d 792 (1959). See generally H. REUSCHLEIN & GREGORY, AGENCY & PARTNERSHIP § 17 (1979).

75. See generally RESTATEMENT (SECOND) OF AGENCY § 343 (1957); see also *Perkins v. Gross*, 26 Ariz. 219, 223, 224 P. 620-21 (1924) (purchaser entitled to bring action against broker for misrepresentation as to the construction of a house); *Spargnapani v. Wright*, 110 A.2d 82, 84 (D.C. 1954) (purchaser allowed to recover where broker's uninformed representations proved incorrect); *Schechter v. Brewer*, 344 S.W.2d 784, 788 (Mo. Ct. App. 1961) (purchaser allowed to recover where broker misrepresented condition of the building's foundation).

76. RESTATEMENT (SECOND) OF AGENCY § 320 (1958); *Cox & Co. Inc. v. Giles*, 267 Pa. Super. 411, 406 A.2d 1107 (1979) (agent for disclosed principal not personally liable under contract between principal and third party).

77. See 12 AM. JUR. 2d *Brokers* § 172 (stating that such a dual relationship is appropriate so long as there is full disclosure). For relevant cases collected, see Annotation, *Acceptance by Principal of Services of Broker With Knowledge that He Acted also for the Other Party as Affecting Broker's Right to Compensation*, 80 A.L.R. 1075 (1932).

78. See, e.g., MODEL CODE OF PROFESSIONAL RESPONSIBILITY DR 5-105 (1981) which specifically cautions, "A lawyer shall decline proffered employment if the exercise of his independent professional judgment on behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve him in representing differing interests . . . ." *Id.* DR 5-105A.

79. For an exhaustive collection of cases involving the responsibility of the real estate broker to the purchaser, see Annotation, *Real Estate Broker's Liability to Purchaser for Misrepresentation or Nondisclosure of Physical Defects in Property Sold*, 46 A.L.R. 4TH 547 (1986).

innocently.<sup>80</sup>

Should the broker be responsible for nondisclosure of a defect to the buyer when the broker has made no affirmative statement with respect to the condition of the premises and there is no proof that the broker actually knew of the defect? In *Easton v. Strassburger*,<sup>81</sup> a California Court of Appeal broke new ground in imposing upon the broker an affirmative duty to investigate the condition of property listed with that broker, and to disclose any defects such an investigation does or would reveal. Thus, liability was imposed in favor of the buyer when the broker failed to ascertain and therefore disclose to the buyer the fact that the foundation of the residence was on filled land rather than natural soil, creating a greater risk of shifting of the ground and a corresponding weakening of the foundation.

Since *Easton*, there have been no other decisions which impose liability upon a broker for mere nondisclosure of defects of which the broker had no knowledge. However, several decisions in various jurisdictions have cited *Easton* in dicta, and thus appear to support *Easton*.<sup>82</sup>

Under *Easton*, it seems clear that the broker's responsibility is not simply to make disclosure of known defects but also to use due care to examine and discover foreseeable defects. In a community in which radon contamination is known, such duty might include not only the making of an investigation, but also either warning the buyer of the problem or making certain that an appropriate clause be included in the agreement protecting the buyer against the risk of the defect.<sup>83</sup>

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80. *Id.* See *Amato v. Rathbun Realty, Inc.*, 98 N.M. 231, 647 P.2d 433 (1982); *Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982). *Cf.* *Young v. Joyce*, 351 A.2d 857 (Del. 1975) (liability predicated on consumer fraud statute). It should be noted, however, that not all courts agree with this reasoning. Several decisions, representing what may be regarded as a more traditional point of view, have exonerated the broker absent proof that he acted in bad faith. See, e.g., *Baker v. Surman*, 361 N.W.2d 108 (Minn. Ct. App. 1985); *Vendt v. Duenke*, 210 S.W.2d 692 (Mo. App. Ct. 1948); *Suzuki v. Gateway Realty of America*, 207 Neb. 562, 299 N.W.2d 762 (1980).

81. 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984). See also *Lingsch v. Savage*, 213 Cal. App. 2d 729, 29 Cal. Rptr. 201 (1963); *cf.* *Saporta v. Barbagelata*, 220 Cal. App. 2d 463, 33 Cal. Rptr. 661 (1963) (purporting to require knowledge of broker to impose liability, reversing lower court's grant of summary judgment to permit trial on issue of broker's responsibility for nondisclosure).

82. See generally Annotation, *supra* note 67.

83. See *Anderson v. San Francisco Rent Stabilization and Arb. Bd.*, 192 Cal. App. 3d 1336, 237 Cal. Rptr. 894 (1987) (Kline, P.J., dissenting); *Heliotis v. Schuman*, 181 Cal. App. 3d 646, 226 Cal. Rptr. 509 (1986). For cases in other jurisdictions, see *Gouveia v.*

## X. CONCLUSION

Presently, the seller's responsibility for defects in the premises that are not covered by warranty clauses in the agreement, arises when the seller: (1) is a builder or developer of new construction and the defects materially affect either habitability or the contemplated use of the building; (2) is aware of a serious latent defect and fails to disclose it; or (3) whether acting fraudulently or not, affirmatively represents the character of the premises.

Similarly, the broker has been found responsible for his own affirmative fraud or misrepresentation. Moreover, authority exists for imposing upon the broker, as a professional, an affirmative duty to ascertain whether or not there are any substantial defects in the property and to disclose the existence of any such defects to the buyer as well as the seller. It is not entirely clear whether the seller has a similar affirmative duty to ascertain the existence of defects in the premises of which he is unaware.

Beyond this, the creation of absolute insurer's liability for either seller or broker seems to be impractical and to impede real estate transactions unnecessarily. On the other hand, commonly accepted notions of honesty and decency suggest that the current trend toward extending the liability of both seller and broker beyond its traditional bounds is appropriate. Both the seller and the broker are in a better position to discover a defect in the premises than the buyer. Thus, even if they do not affirmatively know of the defect, it makes sense to require them to take reasonable precautions to determine the existence of defects which are reasonably discoverable. Even in the absence of a specific clause in the sales contract, it would thus be appropriate to require both seller and broker to assume responsibility for a possible termite infestation even if they did not actually know of it, so long as it could be established that termite infestation was a common occurrence in the area. A similar conclusion could be reached with respect to major plumbing, heating or roofing problems.

On the other hand, if the defect is one which would not be reasonably foreseeable or discoverable, or if after a reasonable investigation the seller and broker remain ignorant of the defect, no absolute liability should be imposed. In these circumstances, there is either no duty, or the duty has been adequately met.

As to radon contamination, no firm answer can be given. However, it may be posited that liability of both seller and broker could well turn on whether or not the seller or his broker should reasonably have anticipated the problem when the agreement of sale was en-

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Citicorp Person-To-Person Fin. Center Inc., 101 N.M. 572, 686 P.2d 262 (1984); *Secor v. Knight*, 716 P.2d 790 (Utah 1986).

tered into after taking into consideration the local communal awareness or lack of awareness of the problem. Such a modest recognition of responsibility serves to redress the balance between the buyer on the one hand and the seller and broker on the other. It also conforms to modern notions of honesty and decency in business dealings.

