

BROKER'S LIABILITY FOR SALE OF DEFECTIVE HOMES THE DECLINE OF CAVEAT EMPTOR



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When the buyer of a home in today's market discovers shortly after he has moved in that there is a defective condition, such as a malfunctioning air-conditioner or faulty plumbing, his first consideration is how to pay for it. Since the typical buyer of a single family residence has generally put most of his assets into the down payment, he is usually not in a financial position to make extensive repairs. Accordingly, he will look elsewhere for a "deep pocket."

The first person he will look to is the seller. However, the seller has no doubt taken the money he has received from his equity in the home and reinvested in another home which, in the event of suit, will probably be homesteaded. The seller may also have relocated too far away to comfortably be reached by legal process. This leaves the real estate broker as the

most likely target. Because the real estate broker is highly visible, continues to be in business, and is easily reached by service of process, he often becomes the eventual target of a lawsuit.

Lawsuits against brokers who assist in the sale of defective housing generally fall into two categories, both of which have expanded in recent years. As noted in *Pollard v. Saxe & Yolles Development Company*:¹

"It seems . . . that there are two relevant trends in California law: A trend toward extension of the kinds of contracts in which

* The author wishes to express his appreciation to Joel Yodowitz for his assistance in the preparation of this article.

¹32 Cal.App.3d 390 (1973), vacated 12 Cal.3d 374 (1974).

the law will apply warranties and a trend toward imposing liability upon builder-sellers of real property.”

Of the two theories, the fraud cause of action has been more fully developed. Fraud can take one of three forms: (1) intentional misrepresentation or the suggestion, as a fact, of that which is not true, by one who does not believe it to be true; (2) fraudulent concealment or the suppression of that which is true, by one having knowledge of the fact; and (3) the unintentional or negligent misrepresentation or the positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true.²

The intentional misrepresentation is perhaps the most clear form of fraud. Consider, for example, the situation where the defendant represented to the plaintiff that the real property being sold was a solid lot and did not contain fill, when in fact the lot contained some 19 feet of fill.³

The case law is abundantly clear that it is not even necessary to make a positive assertion with regard to the defect to be liable. Knowledge of the defect and the failure to advise the prospective buyer of it may also give rise to a cause of action for fraud. Thus, in

*Saporta v. Barbagelata*⁴ it was alleged that the defendant real estate broker knew that the house being sold was infested with termites and failed to advise the buyer of this. In holding that a cause of action was stated against the defendant broker, the Court noted that:

“The principles controlling the conduct of a real estate agent or broker in the sale of real estate are well established in this State. He is not only liable to a buyer for his affirmative and intentional misrepresentations to a buyer, but he is also liable for mere nondisclosure to the buyer of defects known to him and unknown and unobservable by the buyer.”⁵

The assertion of something as a fact that is not a fact may give rise to liability through fraud even where the broker making the statement believed the statement to be true when made, if there was no basis in fact for the assertion.⁶ For example, in *Cooper v. Jevne*⁷ the defendant sales agents in connection with the sale of a new condominium unit represented the units to be “luxurious” and having “outstanding investment potential.” Although the statements of the sales persons were opinions and as such ordinarily would not constitute action-

²Civ. Code § 1572.

³*Rothstein v. Janss Invest. Corp.*, 45 Cal. App.2d 64 (1941).

⁴220 Cal.App.2d 463 (1963).

⁵*Id.* at 474.

⁶Civ. Code § 1572(2).

⁷56 Cal.App.3d 860 (1976). Although this article focuses on the broker, the Cooper case also shows the vulnerability of architects and engineers. The potential liability of the developer is discussed in the text accompanying notes 23-25, *infra*.

able fraud or deceit, the Court went on to state that "if a person advances an opinion in which he does not honestly or cannot reasonably believe, then action for an affirmative fraud will lie if the remaining elements of the tort are present."⁸ The Court observed that the sales agents were aware of the problems with the development, knew of the alleged substantial structural defects in the condominiums and thus could not honestly have held the opinion that these homes were luxurious or outstanding investments. Hence, "Even if the sales agents stated their opinions sincerely, it was reckless and unreasonable to do so in light of their alleged knowledge."⁹ This case has established that it is very dangerous to issue opinions as to the condition of property unless one is on firm factual footing.

Failure to investigate before making a representation puts the broker at his peril. Thus, in *Spargnapani v. Wright*,¹⁰ the broker had represented the heating system of the home to be in good condition, the oil burner to be practically new and heat to be plentiful. After taking possession, the buyer discovered that the heating plan was unusable because of a cracked boiler which had been covered and concealed by the prior owner. The Court held that, even if the broker innocently represented that the heating plant was in workable condition, the buyers could still recover in fraud, and noted that fraud includes the expression of knowledge when there is none.

Because of the increasing number of lawsuits asserting fraud against brokers in the sale of homes, some brokers have considered the use of disclaimer provisions in sales documents in an attempt to make sales on an "as is" basis. This, however, is not a panacea. There is ample evidence that the courts will, given the appropriate circumstances, discard the disclaimer language. A prime example of this may be found in *Lingsch v. Savage*,¹¹ where the sales documents provided that the sale of the property in question was to be "in its present state and condition" and that "no representations, guarantees or warranties of any kind or character have been made by any party hereto, or their representatives which are not herein expressed." The Court found that at the time that the sale was entered into the defendants knew that the building was in disrepair and had been condemned by city officials. After discussing the liability of a seller with knowledge of facts materially affecting the value or desirability of the property and failing to disclose them, the Court turned to the argument that the disclaimer language precluded liability:

"Defendant's first contention is in essence that the complaint on its face precludes actionable fraud since under the contract incorporated therein the plaintiffs agreed to purchase the property 'in its present state and condition'. A provision in a contract of sale that the buyer takes the property in the condition in which it is, or 'as is', does not neces-

⁸*Id.* at 866.

⁹*Id.* at 866.

¹⁰110 A.2d 82 (D.C.Muni.App.Ct. 1954).

¹¹213 Cal.App.2d 729 (1963).

sarily confer on the seller a general immunity from liability for fraud. It is fairly well established in respect to sales of personal property that such a provision 'does not prevent fraudulent representations relied on by the buyer from constituting fraud which invalidates the contract or is a ground for damages'. The same rule has been applied where such a provision has been included in a contract for the sale of real property."¹²

Of interest, the Court's analogy to a rule of law applicable to the sale of personal property is an approach being increasingly used in applying commercial code type warranties to the sale of real property.¹³

The enlargement of the concept of fraud in the sale of real estate is particularly unfortunate for the broker since the nature of the tort increases the likelihood of the imposition of punitive damages and the allegation of punitive damages alone is sufficient to permit the plaintiff to discover the defendant's personal financial condition.¹⁴ Errors and omissions in insurance policies generally limit protection for recoveries for fraud.

In searching for a way to protect the buyer of a home while avoiding placing the stigma of fraud upon the broker, the courts have in recent years sought to expand the commercial code concept of implied warranty to the sale

of real property. Comm. Code § 2314 sets forth the implied warranty of merchantability. Goods are considered to be of merchantable quality when it is reasonably fit for the ordinary purposes for which goods of that type are used. It is important to note that the warranty applies only if the seller is a "merchant;" this eliminates warranty protection of a buyer of second-hand goods from a private party. This section is applicable only to the sale of personal property, not real property. Thus, the courts, while unable to apply strictly the Code provisions, have sought to accomplish the same objective by applying common law rules. In doing so, the courts have disregarded the new versus resale dichotomy, inasmuch as that rule would apply only to a miniscule percentage of sold homes. Likewise, the "merchant" criteria may also be discarded.

Under the common law, the sale of real property was on the basis of "caveat emptor."¹⁵ The basic unfairness of such a doctrine in the context of modern sales transactions caused one legal commentator to note:

"The law has evolved to the incongruous state where it offers greater protection to the purchaser of a seventy-nine cent dog leash than it does to the purchaser of a 40,000 dollar house. If the dog leash is defective, the purchaser can get his money back and he may be able to

¹²*Id.* at 740-741 (Citations omitted).

¹³See text accompanying notes 17-19, *infra*.

¹⁴*Coy v. Superior Court*, 58 Cal.2d 210, 223 (1962).

¹⁵*Green v. Superior Court*, 10 Cal.3d 616 (1974).

recover damages if he loses his dog because of the defective leash. If the purchaser of a house is required to replace the heating unit two months after the purchase, he probably has no recourse against the seller. Quality is generally at the risk of the buyer of real property absent an express warranty or fraud."¹⁶

In reacting to this incongruity, the courts slowly began to apply Commercial Code concepts to real property transactions. In *Aced v. Hobbs-Sesack Plumbing Co.*,¹⁷ Aced contracted with plaintiff owners to build a home with a radiant heating system installed in a concrete slab floor. Aced subcontracted a portion of the work to Hobbs. The work done by Hobbs proved to be defective, the owner sued Aced and Aced cross-complained against Hobbs. Aced argued that the heating equipment and work done by Hobbs was subject to an implied warranty of merchantability. The Court, noting that the Hobbs contract provided that he would "furnish the necessary labor and materials," stated that this language suggested that the contract between the parties was one for labor and material rather than a contract to sell and that there was "no sale in situations where the person supplying the labor and materials incorporated the product into a building;" thus, it would not come under the provisions of the then Uniform

Sales Act.¹⁸ The Court, however, went on to state that "there may nevertheless be an implied warranty" and that "for historical reasons warranties have become identified primarily with transactions involving the sale or furnishing of tangible chattels but they are not confined to such transactions."¹⁹ Thus, Hobbs could be liable for the defective equipment.

In 1968 the California Supreme Court explored the duty owed to a buyer in *Connor v. Great Western Savings & Loan Association*.²⁰ In *Connor*, the defendant savings and loan, which financed development of a tract and which knew that the developer was doing a poor job of construction, owed a duty to the buyers of the homes in that tract to exercise reasonable care to prevent the construction and sale of seriously defective homes. Although in regard to its primary holding of liability this case has been limited by amendments to the Civil Code,²¹ it is still important to note the discussion of the obligation to look out for the interests of the home buyer. In that connection, the lender

"failed of its obligation to the buyers, more so because it was well aware that the usual buyer of a home is ill equipped with experience or financial means to discern such structural defects. Moreover, a home is not only a major investment for the usual buyer, but also the

¹⁶Haskell, *The Case For An Implied Warranty of Quality In Sales of Real Property*, 53 Geo. L. J. 633 (1965) (hereinafter "Haskell").

¹⁷55 Cal.2d 573 (1961).

¹⁸Formerly Civ. Code §§ 1734-36.

¹⁹55 Cal.2d 573, 581-582 (1961).

²⁰69 Cal.2d 850 (1968).

²¹Civ. Code § 3434.

only shelter he has. Hence, it becomes doubly important to protect him against structural defects that could prove beyond his capacity to remedy."²²

The Supreme Court thus made it abundantly clear that in the future it will strive to protect the home buyer who is ill-equipped to conduct the kind of inspection of the premises necessary to protect his interests.

The application of warranty doctrines to the sale of homes was further expanded in the case of *Kriegler v. Eichler Homes Inc.*²³ where the plaintiff owner sued the defendant developer for damages to property sustained as a result of the failure of a radiant heating system. Defendant, although conceding that "the doctrine of strict liability in tort applied to physical harm to property," argued that "the doctrine cannot be applied to homes or builders." The Court disagreed, stating that:

"In terms of today's society, there are no meaningful distinctions between Eichler's mass production and sale of homes and the mass production and the sale of automobiles and that the pertinent overriding policy considerations are the same When a vendee buys a development house from an advertised model . . . he clearly relies on the skill of the developer and on its implied representation that the house will be erected in a reasonably workmanlike

manner and will be reasonably fit for habitation If there is improper construction, such as a defective heating system, or a defective ceiling, stairway and the like, the well being of the vendee and others is seriously endangered and serious injury is foreseeable. The public interest dictates that if such injury does result from the defective construction, its cost should be borne by the responsible developer who created the danger and who is in the better economic position to bear the loss rather than by the injured party who justifiably relied on the developer's skill and implied representation."²⁴

Since the plaintiff was not the original owner of the property but was the second owner, *Kriegler* is significant not only for its application of personal property type warranties, but its application to a resale home.

The principal issue facing the courts in the application of warranties to the sale of housing lies in the question whether they should be applied to resales as well as the sale of new housing. Commentators have noted that there would appear to be little reason to distinguish from the standpoint of the buyers.

"To conclude that there are no implicit assumptions as to quality when the breadwinner earning 13,500 dollars invests 30,000 dollars

²²69 Cal.2d 850, 867 (1968) (Citations omitted).

²³69 Cal.App.2d 224 (1969).

²⁴*Id.* at 227-228.

in a house is absurd. Any distinction between the purchase of the new house and the purchase of the used house with respect to assumptions as to quality is wholly unrealistic; the only difference is the degree of expectation."²⁵

Although the California Supreme Court has not directly applied warranty concepts in the sale of existing property, it has applied them to the leasing of existing property and in so doing strongly suggests that they may follow the same approach in the sale of real property as well. In *Green v. Superior Court*²⁶ a landlord sought to eject tenants in an unlawful detainer action for failure to pay rent. Defendants argued that the condition of the apartments was such as to be uninhabitable, noting that there were over eighty Housing Code violations which included the collapse and non-repair of the bathroom ceiling; the continued presence of rats, mice and cockroaches on the premises; the lack of any heat in four of the apartment's rooms; plumbing blockages; exposed and faulty wiring; and an illegally installed and dangerous stove. The defendant tenants argued that the landlord had an obligation to provide habitable premises and that his failure to so provide relieved them of their obligation to pay rent. In holding in favor of the tenants, the Court noted that "at common law the real estate lease developed in the field of real property law not contract law."²⁷

Under property law concepts, the lease was considered a conveyance or sale of the premises for a term of years subject to the ancient doctrine of caveat emptor. Thus, under traditional common law rules, the landlord owed no duty to place the leased premises in a habitable condition and had no obligation to repair the premises. The Court went on, however, to note that

"in recent years, however, a growing number of Courts have begun to reexamine these 'settled' common law rules in light of contemporary conditions, and after thorough analysis, all of these Courts have discarded the traditional doctrine as incompatible with contemporary social conditions and modern legal theories . . . The typical city dweller who frequently leases an apartment several stories above the actual plot of land on which an apartment building rests, cannot realistically be viewed as acquiring an interest in land; rather, he has contracted for a place to live. . . . When American city dwellers both rich and poor seek 'shelter' today, they seek a well known package of goods and services — a package which includes not merely walls and ceilings but adequate heat, light and ventilation, serviceable plumbing facilities, secure windows and doors, proper sanitation and proper maintenance."²⁸

These arguments could just as easily be applied to the sale as the leasing of real property.

²⁵Haskell at 651.

²⁶10 Cal.3d 616 (1974).

²⁷*Id.* at 622.

²⁸*Id.* at 623.

Conclusion

In a growing era of consumerism, it is clear that the courts have determined that the buyer should be afforded as much protection as possible in his purchase of a home and that those who supply him with that home, including the real estate broker, have an ever increasing duty to that buyer to protect him in his purchase. This includes

the duty to disclose defects and perhaps, as Commercial Code doctrines are expanded, to take affirmative steps to insure that premises are suitable for their use, *i.e.*, human habitation. Although the doctrine of warranty and habitability has not been applied to the sale of existing property, the language of current decisions would not make such an extension surprising.

