White Paper

Disclosure Issues

The Real Estate Broker's Duty of Disclosure
and the
Concomitant Liability for Nondisclosure

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The Real Estate Broker's Duty of Disclosure and the Concomitant Liability for Nondisclosure

Two words aptly describe modern American society: consumer-oriented and litigious. Neither has a pleasant ring to the ears of real estate brokers; seventy-six percent of all cases against brokers are brought by disgruntled purchasers. In this era of consumer protectionism, brokers must be especially mindful of the duties owed not only to their clients, but also to the purchasing public. The purpose of this article is to survey the case law on the broker's duty of disclosure, briefly discussing the broker's duties to his or her principal, examining the doctrine of caveat emptor, the course of the broker's duty to disclose, the broker's duty to conduct a reasonable inspection, the purchaser's duty to inspect, conditions the courts have held to be subject to disclosure, and causes of action frequently asserted against brokers.

I. THE BROKER'S DUTIES TO HIS OR HER PRINCIPAL: THE LISTING BROKER AND THE SELLER & THE BUYER AND THE BUYER'S AGENT

The relationship between a broker and his or her principal is a fiduciary relationship, one of trust and loyalty. All of the broker's loyalties run to his or her principal; the broker must always work to the best interests of the principal even if the broker's own interests are sacrificed in the process. The broker must make full disclosures to the principal on every matter in the transaction. This is true whether the broker is the seller's agent or the buyer's agent.

Ohio holds an individual with a real estate license to a higher standard of competency and fairness than a lay member of the public. Richard T. Kiko Agency, Inc. v. Ohio Dept. of Commerce, Div. of Real Estate, 48 Ohio St. 3d 74, 76 (1990). The Ohio legislature has specifically stated that a real estate agent acts as a fiduciary to his or her client (principal) in an agency or subagency relationship. A fiduciary relationship is based on trust and loyalty. This relationship requires the broker to "exercise fidelity and good faith toward his principal in all matters that fall within the sphere of his employment;" to "execute his commission with skill, care and diligence;" and to use his best efforts to promote the principal's best interests. Salem v. DeWitt-Jenkins Realty Co., 1952 Ohio App. LEXIS 876 (Summit Cty. May 21, 1952); OHIO REV. CODE ANN. § 4735.62 (2002). This is true even when promoting the principal's interests does not necessarily promote the broker's interests.

This duty necessarily requires the broker to make full disclosure to the principal of all facts within his or her knowledge that are or may be material to all matters in connection with the transaction. Myer v. Preferred Credit, Inc., 2001 Ohio 4190, at ¶¶22-23 (Ohio, Harrison Cty. C.P. 2001). For example, if the listing broker discovers that a prospective buyer plans to use the land to build a carry out or drive-thru, the broker needs to convey this information to the seller, his or her principal. Or, if the listing broker acquires knowledge regarding the prospective buyer's credit history, this, too, must be disclosed to the seller.

The same standard is applied to buyers and the growing number of buyers' brokers. Buyers' brokers are fiduciaries of the buyer. All their loyalties run to the buyer. If, for example, the buyer's agent learns that the seller will sell for $80,000 as opposed to $100,000, he or she must communicate this to the buyer, even if the lower priced sale would result in a lower commission for the buyer's broker.

The broker must make full disclosure to his or her principal, whether buyer or seller, regarding any matter relating to the transaction.

For a broker to satisfy his or her fiduciary duties of loyalty, good faith, and full disclosure, the broker cannot act for persons who have interests adverse to those of his or her principal. Id. at ¶28. This includes the broker's self-interest. Thus, it has been held that a broker is prohibited from either (a) representing both parties ("dual representation") or (b) splitting fees/commissions with the adverse party's broker ("self-dealing"), unless these facts are fully disclosed to the principal and the principal consents prior to the transaction. Id. at ¶¶28, 34. Failure by the broker to obtain the principal's fully-informed consent can open up the broker to liability for breach of fiduciary duty. In these suits, brokers can be liable for damages irrespective of actual damage to the principal. Id. at ¶38.

Illustration:

Mr. Green lives in Ohio and has listed his home for sale with Mr. Day's real estate agency. Mr. Black is a prospective buyer. He has contracted with Mr. Johnson, who is exclusively a buyer's broker. Mr. Day learns Mr. Black is a developer who has already acquired all of the other homes on the block and has plans to turn the area into a condominium community. Mr. Day must convey this information to Mr. Green, his principal, because it is relevant to the transaction. It could cause Mr. Green to raise his price substantially or even choose not to sell. Similarly, Mr. Johnson learns Mr. Green is currently experiencing financial problems. Mr. Johnson must communicate this information to Mr. Black because it is relevant to the transaction. It could affect the amount Mr. Black will offer for Mr. Green's property.

II. CAVEAT EMPTOR – "BUYER BEWARE"

> **Caveat Emptor is a Latin phrase meaning "buyer beware." Under the doctrine of caveat emptor, the seller is under no duty of disclosure to the buyer. The risk of defect in the property falls squarely on the purchaser. Few states today still adhere to a strict application of caveat emptor. Ohio only applies the doctrine in circumstances where the defect is open to observation or discoverable upon a reasonable inspection, the purchaser has an unimpeded opportunity to inspect the premises, and the seller has not engaged in fraud.**

In analyzing the duty of disclosure, one should first look back to the common law doctrine of caveat emptor. Caveat emptor is a Latin phrase which means "buyer beware." The origins of the doctrine can be traced back to feudal England. Prior to the enactment of the Statute of Uses in 1536, land was not freely transferable as it is today, but rather was nearly entirely held by the monarch or members of the "landed gentry," and occupied by tenants who worked and lived on the land for the benefit of the landowner. When the landowner died, his property generally passed to his oldest son. Since land was generally transferred either as a gift from the crown as payment for some duty performed, or as an inheritance, and was worked by tenants who lived on the land and built their own dwellings thereon, no one asked whether there was a problem with water in the basement or if the foundation was solid. It simply was not a concern.

After the enactment of the Statute of Uses, landowners were free to transfer their property rights. Subsequently, a buyer's primary concern was whether the person purporting to sell the land actually had a good title to sell, not the physical condition of the property. The land was still primarily being used for the production of rents for the benefit of the landowner; the tenants who lived on and worked the land were still responsible for erecting and maintaining their own dwellings. Thus, again, no one inquired of the physical condition of the property.

As the use of the land began to change, purchasers became more concerned with the condition of the property itself and not just the title. The seller had no duty, however, to make any disclosures to the buyer. The purchaser was presumed to have inspected the property personally and would not be protected from his or her own ignorance of the condition of the property being purchased. This notion persisted and permeated the common law, where the general rule became that the buyer took the property at his or her own risk. The seller had no duty of disclosure to the purchaser; the responsibility was upon the buyer to know what he or she was purchasing, hence, "buyer beware." This afforded sellers much protection from purchasers' claims that the seller did not disclose the true condition of the property; the seller was generally under no duty to disclose anything to the buyer.

Today, however, most states have rejected the strict application of caveat emptor in real estate transactions, making it more of the exception than the rule. Ohio's position on the doctrine of caveat emptor in real estate transactions is stated in Layman v. Binns, 519 N.E. 2d 642 (Ohio 1988). In Layman the purchasers of a home (the Laymans) brought a cause of action for fraudulent concealment against the sellers (the Binnses), alleging the sellers had concealed a structural defect in the house. Apparently, during the construction of the home, the foundation gave way and caused a bow in one of the basement walls. Steel beams were then put into place to support the wall. When the Binnses decided to sell the house, they informed their agent about the wall and the corrective steel beams. The Laymans viewed the home with an agent and saw the beams, however, as they testified, they believed the beams were just part of the structure.

The purchase contract which was eventually signed contained language to the effect that (1) the contract was the entire agreement between the parties, (2) no representations were made by either party except those contained therein, and (3) the purchasers were relying on their own inspection of the house regarding its condition.

Approximately four years later, the Laymans decided to sell the house. At this time the defective wall was brought to their attention by another agent. The estimated cost to repair the wall was between $30,000 and $50,000. The Laymans subsequently filed suit against the Binnses for fraudulent concealment.

The Ohio Supreme Court decided the case on the basis of the doctrine of caveat emptor, that had been articulated by the Court over thirty years earlier in Traverse v. Long, 135 N.E. 2d 256 (1956). There the Court held that:

> The principle of caveat emptor applies to sales of real estate relative to conditions open to observation. Where those conditions are discoverable and the purchaser has the opportunity for investigation and determination without concealment or

> hindrance by the vendor, the purchaser has no just cause for complaint even though there are misstatements and misrepresentations by the vendor not so reprehensible in nature as to constitute fraud.

Id. at 259.

Summarizing the rule, the Court held in Layman that the following conditions must be present in order to trigger the application of the rule of caveat emptor: "(1) the defect must be open to observation or discoverable upon reasonable inspection, (2) the purchaser must have an unimpeded opportunity to examine the property and (3) the vendor may not engage in fraud."

Applying the rule to the facts, the Court held that the defect the Laymans complained of was open to observation and discoverable. Although there was conflicting evidence as to how slight or obvious was the bulge in the wall, and though the purchasers testified that they were not aware the steel beams were an indication of a defect, the Court determined that the condition was discoverable upon a reasonable investigation. "The purchasers had a duty to inspect and inquire about the premises in a prudent, diligent manner." Layman, 519 N.E. 2d at 644. Because Mr. Layman had an unhindered opportunity to examine the walls, he should have inspected the wall more carefully and asked about the beams. Id.

The Court also addressed the issue of whether the sellers committed fraud upon the purchasers. The Laymans claimed the Binnses' failure to disclose the existence of the bow in the wall amounted to fraudulent concealment. The court disagreed. To maintain an action for fraud, the purchaser must demonstrate that the seller failed to disclose material facts where the seller was under a duty to disclose the information. A seller, however, only has a duty to disclose information regarding latent material defects - those not readily discoverable or available upon a reasonable investigation by the purchaser. Id. Therefore, since the Court concluded that the defect was not latent, but open to observation and discoverable, the seller was under no obligation to disclose any information, and the Laymans' cause of action failed under the rule of caveat emptor. Id. at 645.

More recently, in Bell v. Perkins, the doctrine of caveat emptor prevented the buyer from rescinding her land installment contract after she discovered that the basement had flooding problems. 124 Ohio App. 3d 539, 542 (Preble Cty. 1997). The flooding did not qualify as a latent defect because the buyer could not show that she did not notice any water damage in the basement during inspection. In fact, the record showed that the buyer was indeed aware of many problems in the basement, including rotting sills, rusting furnace vents, leaks in the walls, crumbling masonry, dry-rotted floor joists, and a damp floor. Id. at 542. The court denied recovery, concluding that a prudent person would have made further inquiry or hired an expert to appraise the situation. Id.

Similarly, in Zanko v. Kapcar, the doctrine of caveat emptor prevented the buyer from recovering damages because the defects in the wood floor were open to observation or discoverable upon reasonable inspection. 2002 Ohio 2329, at ¶26 (Summit Cty. May 15, 2002). The buyer could have rolled back the rugs to observe the floorboards and could have examined the underneath of the floor from the basement crawl space. Id. Additionally, the buyer failed to reschedule an appointment to inspect the property after the sellers cancelled the first one, and she was unable to demonstrate that the sellers impeded in any way her opportunity to inspect the house. Id. at ¶27.

Note however that the doctrine of caveat emptor may not protect a seller from liability if the seller concealed or fraudulently misrepresented the defects. Czarnecki v. Basta, 112 Ohio App. 3d 418, 422-23 (Cuyahoga Cty. 1996). In Czarnecki, the buyers were awarded $30,000 toward the cost of the repairs when seller failed to make the buyer aware of extensive water damage throughout the house and affirmatively denied that the roof leaked. The seller intentionally did not tour the buyer through damaged portions of the house and went so far as to hide up to forty air fresheners in the second floor of the house to mask the odor associated with the water damage.

These same caveat emptor rules apply to the cooperating broker who is working with the buyer. For example, in Black v. Cosentino, the buyers sued, in addition to the seller, the real estate agent who had represented them in the sale of their home and assisted them with the purchase of seller's home as a subagent of the listing broker. The buyers claimed misrepresentation and concealment in the purchase of a home. 117 Ohio App. 3d 40, 42 (Lorain Cty. 1996). The buyers alleged that the cooperating agent and sellers concealed water problems, which resulted in basement and foundation damage, as well as the results of an FHA inspection and the reasons for denial of financing. The buyers' claim was denied under the doctrine of caveat emptor because the disclosure form had indicated past water leakage in the basement. Id. at 45. This disclosure provided notice of the possibility of problems, and buyers had the opportunity to arrange for an expert inspection. Id. In addition, the conditions evidencing dampness reported by the buyers after they moved in were open, observable, and readily apparent upon inspection. Id. The agent was not liable for fraud because the buyer could not prove that the agent knew or should have known about the condition of the house; the buyers admitted that the agent did not make any representations concerning the property's condition. Id. at 46.

The doctrine of caveat emptor also precluded the buyers' claim against the seller with respect to the FHA inspection. Buyers argued that had they known that the FHA report showed items that needed repair, they never would have purchased a home with so many defects. Id. at 46. All of the FHA areas of concern, however, were open and observable and involved minor repairs. Id. Additionally, the buyers admitted that they were aware of many of the same problems that the FHA found. Again, buyers could not provide evidence that the agent had misrepresented the condition of the property.

Illustration:

Mr. Smith is the executor of an estate that owns real estate in Ohio. He listed the house with Mr. Brown's real estate agency. No property disclosure form was required because the property was in an estate. Mr. Smith tells Mr. Brown that his roof leaks and that water stains are visible in the ceiling. Mr. Jones is a prospective buyer. When he comes to the open house, the water stains are clearly visible but Mr. Jones makes no inquiry as to their cause. He buys the house and subsequently discovers the leaking roof. He sues Mr. Smith and Mr. Brown for not disclosing the condition of the roof. Mr. Jones loses because he had an unimpeded opportunity to inspect the house, the defect was observable or discoverable upon a reasonable inspection, and neither Mr. Smith nor Mr. Brown engaged in fraud.

III. SOURCE OF THE DUTY TO DISCLOSE

A. Common Law

The broker's duty to disclose is derived from contract and tort common law notions that in a transaction where one party lacks the faculties to ascertain the truth, or where important facts are solely within the knowledge of one party, that party possessing superior knowledge must deal honestly, fairly, and non-fraudulently with the other party.

The doctrine of caveat emptor started to wane as courts began to realize that although the buyer may have an opportunity to inspect the property prior to purchase, the buyer was not in the best position to uncover defects. Rather, the seller would necessarily be better informed of the condition of the property. In step with the blossoming wave of consumerism, courts began to rethink the relationship between buyer and seller, giving heed to notions of fairness and economic efficiency. Because the landowner was in the best position to learn of defects not open to observation or discoverable upon a reasonable investigation, fairness dictated that the landowner inform prospective buyers of these conditions. The landowner could no longer use his or her superior knowledge to the detriment of the purchaser. Contractual relationships were engrafted with the requirement of fair dealing. Similarly, in tort law, equality of knowledge between the parties was important. The courts saw more economic efficiency in requiring disclosure regarding defects from the party best able to have knowledge of defects - the seller. Thus, the duty to disclose arose out of the inequality of knowledge between the buyer and seller, regarding defects that are not observable or discoverable by the purchaser upon a reasonable inspection.

B. State Statutory Law – Residential Property Disclosure Forms

Sellers, and by extension brokers, now have a statutory duty to disclose material defects of the property that are actually known. All sellers must in good faith provide buyers with a comprehensive disclosure form regarding these physical conditions. A violation of the statute may allow a buyer to rescind the purchase agreement.

The seller of residential real estate is required to prepare a comprehensive disclosure form on the physical condition of the property. OHIO REV. CODE ANN. § 5302.30 (2002). The seller must disclose in writing certain material defects actually known without regard to observability or discoverability. Residential real estate is defined to include any real estate improved with a building or other structure that has one to four dwelling units. There are a few minor exceptions in the statute, i.e. property in an estate, but generally the requirement applies to all residential real estate improved with one to four dwelling units.

The seller must disclose material matters relating to the physical condition of the property, including the water supply source, the nature of the sewer system, and conditions of the roof, foundation, walls, and floors. OHIO REV. CODE ANN. § 5302.30(D). A "catch-all" provision requires the seller to disclose any material defects in the property that are within seller's actual knowledge. Id. The seller does not have a duty to inspect his or her property or otherwise acquire additional

knowledge of the defects of the property. Good v. McElhaney, 1998 Ohio App. LEXIS 4763 (Athens Cty. Sept. 30, 1998).

The disclosures made by a seller on this form must be made in good faith, which the law defines as "honesty in fact." The buyer is still encouraged, however, to obtain his or her own professional inspection. OHIO REV. CODE ANN. § 5302.30(D). The statute does not provide a penalty for a seller who fails to disclose known defects, but it provides equitable relief, allowing a buyer to seek rescission of the purchase agreement before the title transfer.

Some Ohio courts state that this law modifies the common law doctrine of caveat emptor because it requires homeowners to disclose all known latent defects as well as patent defects. Belluardo v. Blankenship, 1998 Ohio App. LEXIS 2409, at *11 (Cuyahoga Cty. June 4, 1998) (caveat emptor now applies only to patent conditions not enumerated by the statutory requirements). These courts believe that it would be inconsistent to require sellers to complete the form honestly and at the same time allow them to omit obvious defects from the form. Hanson v. Rieser, 1999 Ohio App. LEXIS 5256, *20 (Franklin Cty. Nov. 9, 1999).

Other courts state that buyers remain responsible for discovering defects that are patent. Riggins v. Bechtold, 2002 Ohio 3291 (Hamilton Cty. June 28, 2002). In Riggins, the sellers gave the buyers two property disclosure forms that stated that the house had settlement cracks and a crack in the breakfast room wall. Id. at ¶2. The buyers contracted to buy the 70-year-old home, had the home inspected, bought the home, lived in it for six months, and then noticed several other areas of the home that allowed water seepage. The buyers sued the sellers for fraudulent failure to disclose the defects. Id. at ¶5. The court ruled in favor of the sellers because inspectors had characterized the holes that leaked in the house as "obvious," and the buyer had an unimpeded opportunity to inspect those portions of the home before the closing. Id. The sellers were not liable because they had not failed to disclose any known latent defects. Id.

IV. PURCHASER'S DUTY TO INSPECT

The purchaser has a duty to conduct a reasonably diligent inspection and inquiry of the property he or she intends to purchase. However, this duty may terminate where the seller affirmatively responds to the buyer's question regarding a condition of the property.

The seller and his or her agent have a duty to disclose defects not observable or discoverable upon a reasonable investigation. Therefore, a duty remains upon the buyer to conduct a reasonably diligent inspection and inquiry of the property he or she intends to purchase to find the discoverable defects. See Layman, 519 N.E. 2nd at 644. The buyer cannot hold his or her agent liable for defects that the buyer failed to adequately inspect. In Kossutich v.Krann, for instance, the buyer's agent was not liable for statements that later proved inaccurate. 1990 Ohio App. LEXIS 3449, *7 (Cuyahoga Cty. Aug. 16, 1990). The buyer failed to establish that his agent replied falsely when asked about a stained corner of the basement where leakage later developed. The buyer did not convince the court that the agent had prior knowledge of the condition of the basement such that she would have known that her statement about the stain was inaccurate. Id. at *7. The agent was relieved of liability despite the fact that she did not conduct independent research to verify the accuracy of her

statement to the buyer. Id. The court rejected the buyer's argument that a real estate salesperson is an expert at detecting basement leaks and that the agent, therefore should have known the spot signified a leakage problem. Id. at *8.

The standard by which the purchaser's conduct should be measured is that of "ordinarily prudent persons of their station and circumstances." Traverse v. Long, 135 N.E. 2d 256, 259 (Ohio 1956). The average purchaser will be held to a lower standard than a builder, plumber, electrician or real estate professional. As a general rule the purchaser may not rely on representations of the seller or the seller's agents regarding matters where the true facts are equally available to both parties, such as matters of public record. The purchaser's duty to investigate may terminate, however, if the purchaser directly asks the seller or the seller's agent a question regarding a condition of the property and receives an affirmative answer to the question. For example, in Zanko v. Kapcar, the sellers fraudulently represented to buyers that they had completely redone the electronic wiring and that it was up to code. 2002 Ohio 2329, at ¶31 (Summit Cty. May 15, 2002). There was no evidence that the buyer should have had any reason to question the truth of that representation, and therefore she was justified in relying on it despite the fact that she did not have a professional inspection of the house.

Similarly, in Brewer v. Brothers, the sellers expressly misrepresented the quality of the electrical system they had personally installed. 82 Ohio App. 3d 148, 149-52 (Warren Cty. 1992). The buyer relied on the representations in choosing not to have an electrical inspection conducted. Id. Even without the direct misrepresentation, the doctrine of caveat emptor would not have protected the seller from liability because these defects in the system were not open to observation and could not have been discovered by the average person. Id. at 153.

Additionally, if the seller subsequently becomes aware of material facts not known to the buyer, the seller must communicate this information to the buyer or risk being liable for fraud. Similarly, if a seller or agent makes a statement that is true when made but conditions change, rendering the prior statement false, the buyer must be informed of the change in conditions.

For example, a broker represented to prospective buyers that a house was "solid" and "sound." The broker subsequently learned the house had termite infestation but did not communicate this information to the buyer. The buyer bought the home, moved in, and almost immediately discovered evidence of the termites. The purchaser sued and prevailed against the broker under a theory of fraud. The Court held that the broker's "non-disclosure, coupled with the hidden nature of the impairment, entitled [the purchaser] to rely upon [the broker's] prior representation with regard to the overall soundness of the property, and imposed a duty upon [the broker] to disclose to [the purchaser] the existence of the termite infestation." Miles v. McSwegin, 388 N.E. 2d 1367, 1370 (Ohio 1979). Once the seller or broker makes a representation, he or she is under an obligation to give the buyer all subsequently acquired information on the subject so as to not render the original statement misleading.

In Foust v. Valleybrook Realty Co., 446 N.E. 2d 1122 (Ohio Ct. App. 1981), an Ohio court of appeals affirmed a judgement for plaintiff-purchasers who had been misled to believe that tap-in to a new sanitary sewer system for the home was optional when it was really mandatory. The broker told the purchasers that while the home had a septic system in place, tap-in to a sanitary sewer line was available if they chose to tap in. However, the broker lived in the area himself and was aware of a

tentative assessment on his own property for tap-in to the system. He also told the purchasers the cost to tap-in would be around $500, but the purchasers spent nearly $5,000 in charges, fees and interest thereon. Although it was at least conceivable that the purchasers could have independently investigated and discovered whether the tap-in was indeed optional or mandatory, the court nonetheless entered judgement for the purchasers on their cause of action for fraudulent misrepresentation. Defendants argued there could be no fraud because purchasers had no right to rely on Defendants' oral representation and should have uncovered the truth through a reasonably prudent investigation. Foust, 446 N.E. 2d at 1125. The court rejected the broker's argument for a number of reasons. First, while it is true Ohio law requires a purchaser who is put on notice as to any doubt of the truth of a representation to investigate before relying on the statement, there was apparently nothing done or said to give the purchasers any doubt as to the validity of the representation. In addition, the court considered this a material fact which was not visible and, therefore, subject to disclosure by the broker. Foust, 446 N.E. 2d at 1125. Finally, and perhaps most importantly for brokers, aside from the general duty of disclosure a broker owes to the purchaser regarding material facts not visible or discoverable upon reasonable inspection, the trial court and court of appeals found the underlying circumstances of the transaction significant: the purchasers were unfamiliar with the area, were from out-of-town, and were leaving the area every weekend apparently to go back home. Under these circumstances, the courts found the purchasers "had a right to rely on the representation of [the broker] and were not under a duty to inquire of others after receiving answers to their questions. Id. This would indicate that facts and circumstances will be a factor in a case, such as this, where it is questionable whether this is something one would normally discover in a prudent, diligent investigation. So, brokers beware! Although a duty does remain on purchasers to do a reasonably prudent inspection of the premises, the burden is falling more heavily than ever on brokers to make sure that purchasers are not buying defective properties.

Illustration:

Mr. Smith lives in Ohio and has listed his home for sale with Mr. Brown's real estate agency. Mr. Smith's home is located very near a marshy creek. Every spring he has a problem with high water, so he installed two sump pumps in his basement. The pumps are in plain view. Mr. Jones, a prospective buyer, attends Mr. Smith's open house. He sees the two pumps but does not inquire as to their purpose. Mr. Jones buys the house. The subsequent spring rain is unusually heavy. Mr. Jones' basement sustains some water damage despite the two sump pumps, which could not keep up with the water. Mr. Jones sues Mr. Smith and Mr. Brown for failure to disclose the water problem. Mr. Jones loses because had he conducted a reasonable inspection and inquiry, he would have uncovered the existence of the problem.

V. THE BROKER'S DUTY TO INSPECT

The listing broker has an affirmative duty to conduct a reasonably diligent inspection of the seller's property to uncover defects and make those defects known to the buyer. The listing broker may not rely on representations of the seller where he or she has reason to believe the representation is incorrect. The real estate agent is held to a higher standard than the non-licensee.

The buyer is not the only party to a real estate transaction with a duty to investigate and inspect the premises. According to the Code of Ethics of the National Association of REALTORS®, the broker is obligated to discover adverse factors reasonably apparent to someone with expertise in the real estate licensing authority. Code of Ethics, Article 2. Like the buyer, the broker is only held to the standard of knowledge of others so situated, i.e., other brokers. The broker is not held to the standard of a contractor or electrician, or other professional, but rather to find conditions which other prudent, diligent brokers would find during an inspection. The broker can best fulfill this obligation by knowing all that he or she can, positive and negative, about the property.

A relatively new statute in Ohio specifically provides that a real estate licensee is not required to discover latent defects in property, or to advise on matters outside the scope of knowledge required for real estate licensees, or to verify the accuracy or completeness of statements made by the seller, unless the licensee has reason to believe that the statements may be inaccurate or incomplete. This statute has not yet been tested in court but it does seem to give licensees protection when a defect, determined to be latent, is not discovered and disclosed.

Once the broker discovers or should have discovered adverse conditions, either through personal inspection or in reliance upon the seller's representations, the broker's duty to disclose to the buyer commences. A broker must disclose all material facts about the physical condition of the property of which the broker has actual knowledge and which the buyer would not discover by a reasonably diligent inspection. OHIO REV. CODE ANN. § 4735.67(A) (2002). The buyer's agent is obligated to disclose to the buyer facts known which affect the value of the property. Kossutich v. Krann, 1990 Ohio App. LEXIS 3449 (Cuyahoga Cty. Aug. 16, 1990). This duty includes disclosure of any material defects in the property, environmental contamination, and information that any other law requires to be disclosed. A broker is assumed to be acting with "actual knowledge" if he or she acts with reckless disregard for the truth.

Additionally, a broker has a duty to advise a buyer if the broker is aware that the seller's representations are inaccurate. OHIO REV. CODE ANN. § 4735.67(B) and (E) (2002). However, a broker is not liable to the buyer for false information that the seller provided to the broker and which the broker then provided to the buyer in the real estate transaction, unless the broker had actual knowledge that the information was false, or acted with reckless disregard for the truth. OHIO REV. CODE ANN. § 4735.68(A) (2002). In those cases which the broker has some reason to doubt the seller, the broker must further investigate.

In Duman v. Campbell, the buyers sued the sellers and the agent for fraudulent misrepresentation. 2002 Ohio 2253, ¶3 (Cuyahoga Cty. May 9, 2002). The agent informed the buyers that the sellers had never experienced any water problems in the basement. This representation was consistent with the statements made by the sellers on the property disclosure form. The buyers presented evidence that, before they viewed the home, the agent told another prospective buyer who inquired about the dampness under the basement carpet and presence of mildew that the basement had water problems. Id. at ¶35.

The court determined that the agent would be liable if she had knowledge of the potential falsity of sellers' disclosure; the knowledge reasonably should have given her cause to question it; and she intentionally or with reckless disregard for the truth communicated to the buyers the sellers' disclosure of a dry basement to buyers. Id. See also Allison v. Cook, 139 Ohio App. 3d 473, 485

(Warren Cty. 2000) (agent is liable if the agent gave false information to the buyer either knowingly or in reckless disregard of the truth, or if the agent conveyed false information on her own initiative).

It is important to note that the caveat emptor defense will never protect from liability a real estate agent who fails to disclose to his or her clients facts known by the agent that are material to the transaction. Parahoo v. Mancini, 1998 Ohio App. LEXIS 1630, *34 (Franklin Cty. Apr. 14, 1998) (refusing to relieve real estate agents from liability based on a caveat emptor defense). Caveat emptor protects certain parties (sellers and sellers' agents) from claims based upon nondisclosure of readily discernable defects when there is no special relationship giving rise to a duty to disclose. Id. at *32. However, a fiduciary relationship exists between a real estate agent and his or her client that gives rise to the duty to disclose, and therefore caveat emptor will not allow an agent to escape his or her disclosure duty. Id. at *34.

One way real estate agents sometimes learn of a defect in property is from a property inspection report provided in connection with a real estate transaction that does not close. For example, a buyer may enter a contract to purchase property which is conditioned upon a property inspection. The property inspection discloses problems with the property that allows the buyer to back out of the purchase pursuant to the terms of the contract. The real estate agent sees the property inspection report which discloses the problems with the property. The real estate agent then continues to market the property to other potential purchasers. In this scenario, the Ohio real estate licensing authority has held that the real estate agent must disclose to potential purchasers the information in the property inspection report even if the real estate agent does not believe that the information is true and accurate and even if a subsequent inspection report has been obtained which disputes the validity and accuracy of the first report. The licensing authority has held that, in this case, the results of both reports must be presented to the potential purchaser so that the purchaser can then evaluate the accuracy of the information.

Illustration:

Mr. Smith lives in Ohio and has listed his home for sale with Mr. Brown's real estate agency. Mr. Brown noticed, when he inspected Mr. Smith's house, that when he turns on light switches, he can sometimes see sparks. He asks Mr. Smith if there is anything wrong with the electrical wiring in the house. Mr. Smith says, "No." Mr. Brown investigates the wiring no further. Mr. Jones is a prospective buyer. When Mr. Jones arrives at Mr. Smith's open house at 6:00 p.m., all of the lights are already on in the home. Mr. Jones decides to buy the house. A few weeks after he moves in, Mr. Jones calls Mr. Brown and asks if there is anything wrong with the electrical system in his new house. Mr. Brown says "No." Three days later Mr. Jones suffers a serious physical injury due to electric shock, subsequently learning the house is improperly wired. He sues Mr. Brown and Mr. Smith for failure to disclose the faulty wiring. Mr. Jones wins because (a) Mr. Brown was not justified in relying on Mr. Smith's representation that there was nothing wrong with the wiring when he had reason to doubt Mr. Smith, and (b) a reasonably diligent inspection by Mr. Brown would have uncovered the defect.

VI. MOST CLAIMS AGAINST REAL ESTATE BROKERS INCLUDE CLAIMS OF FRAUD FOR FAILURE TO DISCLOSE DEFECTS IN PROPERTY.

A real estate broker can be sued for breach of contract and breach of fiduciary duties when the broker fails to satisfy his or her high duties of absolute loyalty and full disclosure to his or her client. Moreover, the broker can also be sued by the party to the transaction that the broker does not represent. These causes of action always include claims of fraud. A fraud claim does not require a contractual relationship or a fiduciary relationship. Indeed, most claims against real estate brokers for the failure to disclose material defects in property are brought by buyers against agents for sellers.

Because a broker's duty is less than specific as to what must be disclosed, it is not surprising that brokers are most frequently sued on grounds of fraud, such as fraudulent concealment, non-disclosure, misrepresentation, and also for negligent misrepresentation. In order for a cause of action based on fraud to proceed, the following elements must be present: (1) "actual or implied representations or concealment of a matter of fact which relates to the present or past, and which is material to the transaction;" (2) which are "made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be inferred;" (3) "with the intent of misleading another into relying upon it," (4) "and reliance upon it by the other person with a right to so rely;" (5) and the other person suffers injury by such reliance. Klott, 322 N.E. 2d 690, 692 (Ohio Ct. App. 1974). Thus, fraud claims can be brought by either party to the transaction because there is no requirement of a contractual or fiduciary relationship.

Fraud claims can be either "active" or "passive," sometimes also referred to as "affirmative" or "constructive." Active or affirmative fraud includes claims of fraudulent misrepresentation and fraudulent concealment, both of which are based on some affirmative act or statement on the part of the broker. Passive or constructive fraud claims consist of fraudulent non-disclosure—that is, the failure to say something or do something when the court implies a duty to speak or act. The remedies for both kinds of fraud are the same, but as described below, the ability to disclaim liability may turn on this distinction.

It is worth noting that fraud of a broker's agent can be imputed to the broker as long as it was committed within the scope of the agent's employment. In determining liability, the proper question to ask is whether the agent was acting within the scope of his or her authority (i.e. conducting ordinary real estate duties) when the agent committed the fraud, not whether the broker had authorized the fraud. In fact, if the agent was acting within the scope of authority, the broker can be liable even when wholly ignorant of the fraud. See Myer v. Preferred Credit, Inc., 2001 Ohio 4190, at ¶13 (Ohio, Harrison Cty. C.P. 2001); Wardley Better Homes & Gardens v. Cannon, 61 P.3d 1009 (Utah 2002).

A. Fraudulent Misrepresentation

A broker will be liable for fraudulent misrepresentation if the broker makes a knowingly false statement regarding a material fact to the buyer, or if when the broker makes the statement not knowing whether it is true or false, he or she makes it under circumstances implying knowledge on his or her part. This is also true for an incorrect opinion given under circumstances implying knowledge because of the higher standard to which the broker is held. Fraudulent misrepresentation is a form of "active fraud."

A broker will be liable for fraudulent misrepresentation where: (1) the broker makes a knowingly false representation regarding a material fact, or makes the statement with utter disregard for whether it is true or false; (2) the broker intends for the buyer to rely on the statement; (3) the buyer has a right to rely on the statement and does rely on it; and (4) the buyer suffers harm because he or she relied on the statement. Often a buyer claims that he or she was fraudulently induced to purchase property because of a false statement on the part of the broker upon which the buyer relied. If the false statement had not been made, the buyer claims he or she would not have purchased property. The buyer, therefore, asks the court to set aside the sale or, in the alternative, to award damages, such as the cost of remedying the falsehood, e.g. the cost of fixing the leaky roof or waterproofing the basement. Courts sometimes refer to these claims as claims of fraudulent inducement. The key to fraudulent inducement is a justified reliance on the part of the buyer. If the buyer was justified in relying on the broker's false statement and was induced to purchase the property, suffering some harm as a result, the buyer will have a valid cause of action against the broker.

In Sanfillipo v. Rarden, 493 N.E. 2d 991 (Ohio Ct. App. 1985), an Ohio court of appeals applied elements of fraud to the following fact pattern. The plaintiff-purchaser, Mr. Sanfillipo, wanted to purchase some property on which to construct a building. He inquired of broker June Frame, sales agent for the company with which the property was listed, whether there was access to gas and water utility services on the undeveloped property. Evidence in the record indicated Frame had orally advised Sanfillipo this was available. Evidence also indicated that Frame had not independently verified the truth of her representation regarding the matter and that she became specifically aware of the lack of utility availability after she made her original representation to Sanfillipo. Frame never corrected the statement she had made earlier. Sanfillipo, 493 N.E. 2d at 993-94.

Sanfillipo did visually inspect the premises, but did not specifically look for signs of utility availability because Frame had already told him it was available. Id. After he bought the property he learned that no utility service was available.

Sanfillipo filed suit for damages, and the court considered whether the doctrine of caveat emptor would bar recovery. While recognizing the duty of the purchaser to inspect the premises, the court also noted it had previously held that a purchaser would not be automatically denied relief for failing to examine public records in advance of his acquisition of property. Niehaus v. Haven Park West Inc., 440 N.E. 2d 584 (Ohio Ct. App. 1981). It then noted the Sixth Appellate District's holding in Foust "that any duty of inspection may be held to terminate at the point when representations have been made with respect to a material fact in direct response to a purchaser's inquiry."

Sanfillipo, 493 N.E. 2d at 995. The court found summary judgment against the plaintiffs to be inappropriate here where there was conflicting evidence as to whether Sanfillipo asked about utilities and was answered by Frame, and whether the absence of utility service was apparent to the ordinarily prudent individual conducting a reasonable investigation.

In Noth v. Wynn, 571 N.E. 2d 446 (Ohio Ct. App. 1988), the court of appeals affirmed the lower court's granting of summary judgment against the purchasers, the Noths, on their claim of fraudulent inducement against the seller and broker. The Noths claimed that the sellers, the Wynns, had not given them accurate information about how much of the lake the Noths bought when they purchased the Wynns' home. They also claimed the Wynns concealed the property ownership rights in the lake by not telling the Noths that a third party had the power, at its option, to drain the lake.

The court held that the Noths' actions for fraudulent inducement could not proceed because they had no right to rely on the oral representation of the Wynns or their agent regarding the property where the true facts were equally available to both parties. Noth, 571 N.E. 2d at 449. In this case, the restriction on ownership and true boundaries would have been discovered if the Noths had simply looked at the public records. The Noths did not even have a title search performed. The court concluded that "[w]here any adversities regarding title to property are of public record and therefore easily discoverable, the purchaser of the property is not entitled to rely upon the alleged misrepresentations of the seller or the seller's agent." Id.

The Noth and Sanfillipo cases may, at first glance, seem to conflict. However, it was not clear in Sanfillipo that an ordinary check of public records would have revealed the availability of utilities. If checking the public records would not yield the desired information, this would justify Mr. Sanfillipo's reliance on Ms. Frame's statement. Also, in Sanfillipo the broker was aware Mr. Sanfillipo would need utility access in order to exercise his intended use, and evidence suggested she allowed her original affirmative statement to remain uncorrected even after she knew it was no longer true. On the other hand, the Noths simply did not conduct a diligent inspection of the property. Since the restrictions on ownership and boundaries were easily discoverable, their reliance on statements by the Wynns or their agent was not justified. None of the considerations in Sanfillipo were applicable to Noth, and the court's opinion was a reflection of that fact.
Many other Ohio courts, when deciding claims of fraudulent misrepresentation, have focused on the issue of whether a buyer's reliance was justifiable under the circumstances. In Parahoo v. Mancini, for example, buyers who failed to investigate could not complain of fraud with respect to the size of their land when an accurate description of the property they purchased was brought to their attention during the transaction and could have been determined from the public records. 1998 Ohio App. LEXIS 1630, **23-24 (Franklin Cty. Apr. 14, 1998). The buyers claimed that their broker and the sellers made false representations by failing to disclose that they had sold most of the backyard to the state. Id. at *18. However, the conveyance was actually disclosed to the buyers during closing through the deed, title policy, and mortgage documents. Id. at *24. The documents excluded the state purchase from the conveyance and specifically described the excluded amount. Id.

In addition, the fraud claim could not succeed because the defect was readily discoverable by the buyers. Id. The deed conveying the backyard to the state was recorded three weeks before the closing and specifically described the land. The buyers could have reviewed the public records to see that the sellers had conveyed the backyard to the state of Ohio and the amount of the

conveyance. Id.

In Barna v. Paris, buyer alleged misrepresentations by the seller and agent regarding the septic tank and zoning classification. The sellers and their agent were relieved of liability for fraud under the doctrine of caveat emptor because they did not make any representations as to the septic tank system, and the accurate zoning information was available through public records. 2000 Ohio App. LEXIS 4555, at *17 (Lake Cty. Sept. 29, 2000). While the agent did incorrectly identify the zoning, she did not do so with either the intent to defraud or with wanton or reckless disregard of the truth. Id. at **16-17.

In addition, the buyer could not justifiably rely on the agent's representation because the zoning records were equally available to all of the parties for review. Id. at *17. The buyers were put on notice of a potential defect with the septic system through the property disclosure form and because they hired their own professionals to inspect the system. Id. at *11. Additionally, no evidence was presented that the seller or agent made affirmative representations that contradicted the property disclosure form. Id. at *12.

In Buchanan v. Geneva Chervenic Realty, buyer sued the seller and the seller's agent for fraudulent misrepresentation of several physical conditions, including damage from pets. 115 Ohio App. 3d 250, 257-58 (Summit Cty. 1996). The court found that the agent did make several inaccurate and misleading statements with regard to the home being pet-free. The court acknowledged that an agent has a duty not to assert as fact matters to which they have no knowledge. The court determined that this agent's deceptive statements constituted one element of fraudulent misrepresentation.

The court found, however, that the buyer could not prove that her reliance on the agent's erroneous statements was justified. The buyer became aware during the inspection that animals had formerly lived on the premises. Id. at 258. She requested the correction of other problems before finalizing the agreement, but she did not further inquire about the animals or request accommodations with regard to the former presence of pets. Id. Despite the agent's misrepresentations, the buyer had enough information to be on sufficient notice of possible problems resulting from pets in the home. Id. at 259.

In another Ohio case, a broker was held liable for fraudulent misrepresentation for his failure to disclose the existence of an easement over the property which had taken effect before the transaction but not recorded until afterward. In Gilbey v. Cooper, 310 N.E. 2d 268 (Ohio, Columbiana Cty. C.P. 1973), the Gilbeys asked the Coopers and their agent Caple about the location of the property lines. Both the Coopers and Caple had knowledge that the state had taken a temporary and permanent easement across the property, but Caple represented to the Gilbeys, in the Coopers' presence, that the new bypass would not touch their land, making no reference to the easement. Since the easement had not been recorded as of the date of the purchase agreement, and no evidence of the easement was visible to the purchaser conducting a diligent inspection, the court found both the sellers and their broker violated their absolute duty to disclose the defect and were liable to the Gilbeys for fraudulent misrepresentation for their nondisclosure of a latent material fact. This case vividly illustrates a situation where the buyer was absolutely justified in relying on the broker's statement. Generally, easements are a matter of public record, but this one had not yet been recorded. Thus, even the buyer's diligent investigation would not have uncovered the defect.

When a seller or broker has engaged in fraudulent misrepresentation, liability cannot be avoided simply by including a disclaimer in the contract. For example, in Schlecht v. Helton, the court found that the seller could not escape liability for water problems in the basement because he had fraudulently misrepresented the basement's condition. 1997 Ohio App. LEXIS 114, *8 (Cuyahoga Cty. Jan. 16, 1997). The seller failed to acknowledge water problems on the property disclosure form and falsely answered direct questions about the basement condition. Id. at *9. The court found that the "as is" clause in the purchase agreement could not bar liability on a fraudulent misrepresentation claim because the evidence showed that the statements were made fraudulently. Id.

Illustration:

Mr. Smith lives in Ohio and has listed his property for sale with Mr. Brown's real estate agency. Mr. Jones is a prospective buyer. During an inspection of the property, Mr. Jones asks Mr. Brown if the property would have access to water, electricity, and cable TV, all of which he would need in his business. Mr. Brown says these services are available; however, he is really uncertain whether these services are actually available. Mr. Jones buys the property and discovers the services are unavailable. He sues Mr. Brown and Mr. Smith on the grounds of fraudulent inducement and wins because Mr. Brown made a representation without regard to its truth on which Mr. Jones relied and had a right to rely, and suffered harm thereby. Mr. Brown should NOT have provided information unless he knew it was TRUE.

Brokers are also frequently accused of fraudulent misrepresentation even though they have the best of intentions and have no actual knowledge that they are misleading the buyer. In Pumphrey v. Quillen, 135 N.E. 2d 328 (Ohio 1956), the Supreme Court of Ohio held that in an action for fraudulent misrepresentation, the plaintiff need not prove the defendant made a statement knowing it was false if he can show the defendant made it without knowing whether it was true or false under circumstances implying knowledge on the defendant's part. Id. at syllabus paragraphs 1 and 2. Again, there must be some evidence the buyer relied on the misrepresentation. Here, the purchasers brought a suit for fraudulent misrepresentation against the seller and broker. Apparently the broker represented that the walls of the home in question were of tile construction when they were actually made of a different material and simply coated with a substance called Perma-Stone. Though the evidence suggested even experts were not aware the walls were not tile, see Pumphrey, 135 N.E. 2d at 332 (Taft, J. dissenting), the court held that since the broker made the statement without knowing it to be true, having no sufficient basis of information to justify his representation, he was "as culpable as if false . . . " and liable for fraudulent misrepresentation. Id. at 331. His statement was made not as an opinion, but as a statement of fact, without a sufficient factual basis to support it, therefore he was liable.

Illustration:

Mr. Smith lives in Ohio and has listed his house for sale with Mr. Brown's real estate agency. Mr. Jones is a prospective buyer. During an inspection of the house, he asks if the hardwood floors are oak. Although he is not positive, but thinks they look like oak, Mr. Brown says yes. Mr. Jones buys the house and subsequently learns the floors are not oak. He sues Mr. Brown and Mr. Smith on the

ground of fraudulent misrepresentation and wins because Mr. Brown made an affirmative statement regarding a material fact, uncertain whether it was true of false, and without sufficient facts to support his statement. He should not have given an answer if he was uncertain.

B. Fraudulent Concealment - Hiding the True Condition of the Property

A broker will be guilty of fraudulent concealment when the broker takes affirmative steps to prevent the buyer from uncovering material defects in the property. Fraudulent concealment is considered "active fraud."

Because fraudulent concealment is similar to fraudulent misrepresentation, the legal principles are the same. The difference is that fraudulent concealment usually includes a claim that the real estate broker conspired with the seller to hide a defect in property. In this situation, the broker would not only represent that the basement is dry, but the broker would instruct the seller to paint over water marks or patch cracks in the basement wall so that the buyer will not discover the true condition of the property. Even if no misstatement is made concerning the dryness of the basement, the broker will be liable for fraud.

For example, in Shear v. Fleck, the seller was found to have actively concealed latent problems with water in the basement, so the buyer was entitled to recover for damages despite the "as is" clause in the purchase agreement. Shear v. Fleck, 2001 Ohio App. LEXIS 4063, at **18-19. The sellers deliberately masked the physical flaws caused by the water; contracted for minimal repairs in order to secure a "lifetime warranty;" characterized the problem as a "one-time nature;" and misrepresented the duration of the problem on the disclosure form. Id. at **16-17.

Likewise, in Jacobs v. Recevskis, the seller allegedly fraudulently concealed water and sewage leaks. The evidence revealed that, while they lived in the home, the sellers had experienced leaks in the roof, problems with the well, and problems with the septic system. Jacobs v. Recevskis, 105 Ohio App. 3d 1, at *6 (Clark Cty. June 14, 1995). But the seller told neither the buyer nor the agents about the problems because he felt that he had corrected the problems. Id. The court determined that the corrective steps taken by seller only concealed and disguised the problems and prevented the buyer's inspection from discovering the leaks. Id. at *7. The case was set for trial to resolve whether buyer's actions were taken with the requisite intent to mislead and deceive the buyers or for the purpose of repairing and remedying the existing problems. Id.

In cases of fraudulent concealment, the buyer is often awarded punitive damages, in addition to the costs of repairs, because the court determines that the real estate broker's conduct is so unjustified as to constitute willful and malicious misconduct.

Illustration:

Mr. Smith lives in Ohio and has listed his home for sale with Mr. Brown's real estate agency. In the process, Mr. Smith pointed out some cracks in the basement walls to Mr. Brown and asked him how they could fix them and thereby make the home more attractive to buyers. Mr. Brown suggested some cosmetic mudding and a fresh coat of paint. Mr. Jones is a prospective buyer who attends Mr. Smith's open house. Mr. Jones buys the house. Two years later, he realizes there is a distinct bow in

his basement wall. He hires a professional contractor and is told the wall has had cosmetic repairs, but will need major structural work. Mr. Jones sues Mr. Brown and Mr. Smith and wins because they actively prevented him from discovering a material defect in the property.

C. Fraudulent Nondisclosure - Silence When There is a Duty to Speak

Fraudulent nondisclosure is "passive fraud" whereby the broker and/or seller commits fraud upon the purchaser by a failure to make a disclosure when under a duty to disclose. It is fraud by omission rather than committing an affirmative act. The facts and circumstances of each case will determine whether nondisclosure of a fact rises to the level of fraudulent nondisclosure.

Fraudulent nondisclosure is a cause of action sometimes asserted against brokers and sellers for the failure to disclose when under a duty to do so. They simply do not say anything when they are supposed to speak. For this reason, fraudulent nondisclosure is different from the causes of action already described, which require some commission of an act in order for the broker to be liable. Fraudulent nondisclosure arises when an omission occurs. The elements necessary to successfully maintain an action for fraudulent nondisclsoure are: (1) an actual concealment (2) of a material fact (3) with knowledge of the fact concealed (4) with intent to mislead another into relying upon such conduct (5) followed by actual reliance thereon by such other person having the right to so rely (6) with injury resulting to such person because of such reliance. Id. at 510. Implicit in these elements is the requirement that the non-disclosing person have a duty to disclose. Thus, a fraudulent nondisclosure claim against the sellers was dismissed in Arbor Village Condo. Ass'n v. Arbor Village, Ltd. because the seller did not have a duty to disclose past repairs to the faulty hot water system where the buyers bought the condominiums "as is" and did not hire inspectors or appraisers. 95 Ohio App. 3d 499, 511 (Franklin Cty. June 9, 1994).

Crum v. McCoy, 322 N.E. 2d 161 (Ohio, Franklin Cty. Muni. Ct. 1974), is an example of a successful claim of passive or constructive fraud. In Crum the McCoys listed their home for sale with Mr. Goodman of Westerville Realty and informed him at that time of a problem with the home's water system. Mr. McCoy told Mr. Goodman that he wanted prospective buyers to be told up front about the water problem. Goodman listed the problem on his house listing form and his broker's information card. When he prepared a listing for the Multiple Listing Service, however, he did not note the water problem because as he testified, there was not enough room on the form. Id. Mr. Crum called Goodman to arrange a showing, but neither Goodman nor his agents revealed the inadequacy of the water supply system to Crum at any time. The Crums thereafter bought the house, discovered the problem, and subsequently brought suit against the McCoys and the broker.

The court found that Mr. Crum had conducted a prudent, diligent investigation. Nothing in his inspection caused him to have any doubts about the condition of the water system. Although he did not notice that the washing machine was not hooked up, he did see clothes piled up and around it, which would indicate to the ordinary man that the appliance was being used. Crum, 322 N.E. 2d at 164-65. Instead, the court found both the broker and the seller had failed to disclose the defect. "A real estate broker with knowledge of a serious latent defect in property which has been listed with him has an obligation to use diligence to see that a buyer is informed of the defect, even though the buyer is the customer of a cooperating broker who gets his information concerning the property from a multiple listing service." Id. at 165. Goodman was under a duty to make sure prospective

buyers were made aware of the water supply problem. As a principal, the McCoys were liable for the acts of their agent broker since he had implied authority to act in the manner in which he did. The broker was liable to the sellers for the damages caused by his nondisclosure, however, because it constituted a breach of his fiduciary duty to his principal. Crum 322 N.E. 2d at 165.

Similarly, in Even v. Krawitz, the seller was found liable for fraudulent nondisclosure when the buyers, who relied on the property disclosure form, discovered substantial water leakage soon after they moved in. 1997 Ohio App. LEXIS 1754, at *9 (Cuyahoga Cty. May 1, 1997). The buyer proved fraudulent nondisclosure by showing that the condition that caused the damage existed while sellers owned the home; the water seepage was discovered soon after buyer's moved in; sealing had been put in place by the sellers to conceal the cause of the damage during inspection; and the property disclosure form contained no information about the water leak and damage. Id. at **10-11.

Fraudulent nondisclosure can also create liability when a seller does not reveal to a buyer sources of peril of which the buyer knows and which are not discoverable by the buyer. Klott v. Associates Real Estate, 41 Ohio App. 2d 118, 121 (Franklin Cty. 1974). In Klott, however, the buyers could not succeed on such a claim because the fact that the water supply on the property was provided by a well instead of a community system was neither purposefully hidden from the buyer nor incapable of being observed. Therefore, the seller did not have a duty to bring this to the buyer's attention. The buyers claimed that they would not have purchased the property if they knew about the malfunctioning water well. Id. at 119-120. The court determined that while concealment of a dangerous and serious condition of the property, such as a contaminated well, might be actionable, in this case no misrepresentations were made and the defective operation of the well did not put the buyer in peril. Id. at 123. Additionally, there was no reason why the buyer could not have sought out information from the vendor concerning the source of the water and the condition of the equipment. Id.

Nondisclosure is the equivalent of fraudulent concealment when the duty to speak arises in order to place the other party on equal footing. Mancini v. Gorick, 41 Ohio App. 3d 373, 374 (Summit Cty. 1987). In Mancini, the buyer sued the seller, who was the original architect and general contractor for the house, for failure to disclose structural defects in the roof. Although the buyers never took advantage of the inspection provision in the purchase agreement, the court determined that the seller engaged in fraudulent concealment sufficient to overcome the "as is" clause in the agreement. Id. at 374. The nondisclosure by the sellers was the equivalent of fraudulent concealment because the buyer had placed confidence in the seller as he had personally designed and built the house. Id. at 375. The seller was aware that buyer relied on his professional expertise in deciding not to have the house inspected. Id. at 374-75.

Illustration:

Mr. Smith lives in Ohio and has listed his house for sale with Mr. Brown's real estate agency. Mr. Smith has a serious termite problem and tells this to Mr. Brown. Mr. Jones is a prospective buyer who attends Mr. Smith's open house. While they converse about the house, no question is asked and no information is given regarding termites. Mr. Jones buys the house. A year later he discovers the termite problem. He sues Mr. Brown and Mr. Smith on a theory of fraudulent nondisclosure and

wins. Termites are a latent material defect, and as such, should have been disclosed. Mr. Brown and Mr. Smith were under a duty to disclose and failed to do so. They were therefore liable for fraudulent nondisclosure.

D. Negligent Misrepresentation

Negligent misrepresentation occurs where a broker fails to exercise reasonable care to discover defects the broker should be able to find, and then makes representations regarding the conditions for which the broker did not use reasonable care to investigate. A broker will be liable under a theory of negligent misrepresentation without a showing that the broker knew the statement was false or had utter disregard for whether it was true or false. Rather, the focus is on whether the broker exercised the care and diligence of the ordinary broker to discover defects in the property. The broker will generally not be held liable under negligent misrepresentation, however, for statements regarding matters of public record.

A final theory of brokers' liability to buyers is that of negligent misrepresentation. It is different from fraud in that it does not require proof of a knowing misrepresentation. It can be the product of an honest mistake. There is some suggestion in Ohio case law that juries will apply this theory when they are reluctant to find that the broker acted with utter disregard of the rights of the buyer, but nevertheless they feel that the buyer has been wronged.

Under the Illinois interpretation of this theory, a cause of action will only lie where a person seeks information from another who is possessed of special skills, the individual trusts the other to exercise due care, and the other party knew or ought to have known that reliance was being placed on his skill and judgement. O'Brien v. Noble, 435 N.E. 2d 554, 556 (Ill. App. Ct. 1982). In O'Brien, the plaintiffs sued the broker under negligent misrepresentation for failing to advise them of a developmental restriction in the zoning ordinance. The appellate court held that no liability existed because no representation was made regarding zoning, and furthermore, zoning matters are of public record and equally accessible by all. The court concluded that "liability will be found when the defendant misrepresents facts of which he possesses almost exclusive knowledge and the truth or falsity of which are not readily ascertainable by the plaintiff." O'Brien, 435 N.E. 2d at 557. Since zoning ordinances were a matter of law, and "all men are presumed to know the law," the plaintiffs reliance upon the broker was not justified and the cause of action failed.

Illinois permits a common law claim for negligent misrepresentation against an agent as long as the misrepresentation is a false statement of material fact. Randels v. Best Real Estate, Inc., 243 Ill. App. 3d 801, 808 (Ill. App. Ct. 1993). In Randels, the buyers did not know about a village ordinance that required the hookup of the municipal sewer system at their expense. Denying the negligent misrepresentation claim against the agent, the court found that the agent's omission about the ordinance, which was a matter of public knowledge equally available to buyers, was not one of material fact because the buyer could have discovered the omission through ordinary prudence. Id. This was particularly true given that the buyer was a licensed real estate agent who received a commission for the sale of the property and had received information from the city about a sewer assessment.

In Kansas, a claim of negligent misrepresentation was initially allowed by statute. In Johnson v. Geer Real Estate Co., 720 P.2d 660 (Kan. Ct. App. 1986), the broker was unaware of the fact that the home was served by a septic system as opposed to the public sewer system. Neither was the seller aware of this fact. The court held the broker and real estate company liable to the purchaser for negligent misrepresentation for their failure to discover and tell the purchaser that the house was served by a septic system. The seller was not found liable. The court found a difference in the standards of knowledge to which the seller and broker would be held. The standard for the seller was lower; no evidence was found to indicate the seller was aware or should have been aware of the existence of the septic system.

On the other hand, the court noted the existence of several factors which "to the eye of an experienced realtor, would indicate that the property was not served by the public sewer system." Johnson, 720 P.2d 660, 664-65 (Kan. Ct. App. 1986). The court found the broker's failure to discover the factors and investigate further were sufficient grounds for establishing the broker's negligence. Under Kansas law, K.S. A. 58 - 3602(a)(3 1), a real estate licensee had a duty to disclose that which he knew or should have known. Id. at 665. The court concluded the language of the statute clearly permitted imposition of liability for ordinary negligence. This was true, despite the sellers being found not liable, due to the real estate broker's expertise in these sorts of matters. Johnson, 720 P.2d at 666.

After Johnson, however, the Kansas legislature amended the statute to limit recovery to when the broker engages in fraud or makes any substantial misrepresentation. Brunett v. Albrecht, 248 Kan. 634, 641-42 (Kan. 1991). Thus, the Act may no longer be the basis for a private cause of action for negligent or fraudulent misrepresentation, although the court did note that those actions could be brought pursuant to other statues or at common law. Id. at 642-43.

In fact, the Kansas Supreme Court recently recognized a common law cause of action for negligent misrepresentation against real estate agents for statements inducing a buyer to purchase property. Mahler v. Keenan Real Estate, 255 Kan. 593, 606 (Kan. 1994). In Mahler, the buyers relied on the seller's agent's statement that the water being discharged from the pipe was from the shower, sink and dishwasher, and that the home had no water problems of which he was aware. Id. at 606. In imposing liability, the court focused on whether the agent failed to exercise reasonable care or competence in obtaining or communicating the information to the buyers. Id. The court found that the agent had no source for his statement other than his own assumption about the sources of the water from the pipe. Id. It was most problematic that the agent transformed his general opinion into specific information and presented it to the buyers as fact. Id.

In contrast, an Ohio court has found that buyers could not succeed on a negligent misrepresentation cause of action against the sellers' agent. Parahoo v. Mancini, 1998 Ohio App. LEXIS 1630 (Franklin Cty. Apr. 14, 1998). In Parahoo, the buyers failed to find out that the sellers had conveyed part of the land to the state. Id. at *5. The court found that under the doctrine of caveat emptor, reliance on intentional or negligent misrepresentations as to property size was unreasonable as matter of law when accurate descriptions were readily available. Id. at *27. This included misrepresentations made by sellers' agents. The buyers did not present evidence of affirmative misrepresentations by the agents. Id. In addition, the correct description of the property was available in public records and was specifically provided to buyers at the closing. Id.

Illustration:

Mr. Smith has listed a parcel of property, located in Ohio, for sale with Mr. Brown's real estate agency. The property is zoned residential. Mr. Jones is a prospective purchaser. He views the property with Mr. Brown and asks whether the land may be put to commercial use. Mr. Brown says "Yes." Mr. Jones buys the land but cannot get a permit to build a commercial building on his property. He sues Mr. Brown and Mr. Smith on the grounds of negligent misrepresentation. Mr. Jones loses because zoning is a matter of public record easily accessible to all. Thus, while Mr. Brown may not have used reasonable care in discovering the property's zoning, Mr. Jones cannot rely on statements regarding matters of public record.

VII. EXCULPATORY LANGUAGE

An "as is" clause will act as a bar to a broker's liability when sued under the theory of fraudulent nondisclosure (passive fraud). Fraudulent nondisclosure is an "act of omission," or not acting when one is under a duty to act. An "as is" clause eliminates a broker's or seller's duty to disclose material latent defects, thus, the broker or seller is no longer under a duty to "act."

An "as is" clause, however, will <u>not</u> prevent a broker from being liable on theories of fraudulent concealment, fraudulent inducement, or fraudulent misrepresentation, which are acts of "active fraud" requiring the commission of an act (i.e., concealment or making a misstatement). Thus, while the "as is" clause eliminates the duty to disclose latent defects, it does not authorize the commission of acts to defraud the purchaser and, therefore, will not limit a broker's liability for such conduct.

Other types of exculpatory language will only be effective in Ohio where damages are a result of negligence. Therefore, exculpatory language, including an "as is" clause, will only limit the broker's liability where the broker did exercise some degree of care. If the broker did not exercise any care at all or engaged in willful or wanton misconduct, exculpatory language will not act as a limitation on liability.

Brokers often try to include language in the contract which limits their liability. For example, the contract in <u>Sanfillipo v. Rarden</u> contained the following language:

> "Purchaser is relying solely upon his own examination of the real estate, the owner's certifications herein, and inspections herein required, if any, for its physical condition and character, and not upon any representations by the real estate agents involved, except for those made by said agents directly to the purchaser in writing." 493 N.E. 2d 991, 996 (Ohio Ct. App. 1985).

The court held that while this sort of language is not uncommon, it is only effective in Ohio where the damages complained of are caused by the broker's negligence. "[A] limitation of liability has no effect when there has been a failure to exercise any care whatsoever, . . . or where there has been willful or wanton misconduct . . . ." Id. In case of fraudulent inducement, the limitation will have no effect if the representations did induce reliance, or if the representations were made under circumstances evidencing actual fraud. Id.

Other language often used by both sellers and brokers to limit or escape liability is the "as is" clause. The Ohio court of appeals for Summit County dealt with the effect of an "as is" clause on liability in the case of Kaye v. Buehrle, 457 N.E. 2d 373 (Ohio Ct. App. 1983). The Kayes were in the market to buy a new home. A broker recommended they look at the Buehrles' home. The Kayes agreed to pay the full asking price of $129,000. While the Buehrles and the broker were aware the basement would leak during a heavy rain, this information was never disclosed to the Kayes.

The day after the Kayes moved into their new home, it rained very heavily and the basement flooded. Several months thereafter, one of the basement walls buckled in under the pressure of water built up in the ground around the house. The Kayes repaired the damage, then filed suit against the Buerhles and the broker for the nondisclosure. Kaye, 457 N.E. 2d at 374, 375.

The defendants disclaimed any liability due to the "as is" language in the purchase agreement. The contract stated that the sellers did not warrant the property, that the buyer examined the property and was taking it in as "as is" condition, and that the buyer had two weeks from the date of the agreement to have professionals come in and inspect the property. If major defects were found, the sellers could cancel the agreement or correct the defects at their option. Id. at 375. The agreement also stated that the buyer's failure to have professionals come in within two weeks was a waiver and indication he was taking the property as it was. Id.

The court examined the three fraud claims individually. The court concluded the claim for fraudulent nondisclosure was properly disposed of by the trial court. The "as is" language in the contract placed the risk of the existence of defects upon the buyers. "[W]hen a buyer contractually agrees to accept property 'as is,' the seller is relieved of any duty to disclose." Id. at 376. The existence of the "as is" clause successfully places the risk of defect upon the purchaser and relieves the seller of any duty of disclosure. The existence of an "as is" clause, however, is not a bar to claims of fraudulent concealment, fraudulent inducement, or fraudulent misrepresentation. In these cases, the fraud complained of "is 'positive' fraud, i.e., fraud of commission rather than omission." Id. Therefore, where active fraud is charged, an "as is" clause will not preclude recovery. Despite this fact, the Kayes' claims for fraudulent concealment and fraudulent misrepresentation still failed. There was no evidence of an intent to conceal defects or to prevent the Kayes from acquiring material information. The fraudulent misrepresentation claim failed for lack of reliance. The evidence showed that no representations were made prior to the sale, so nothing was said on which to rely at the time of the purchase. Therefore, the court of appeals affirmed the judgment of the lower court in favor of the defendants. See also, Donnelly v. Taylor, 122 Ohio Misc. 2d 24 (Medina Cty. C.P. 2002) (holding that sellers were not liable to buyers for existence of bats in their home, even though sellers were aware of the bats, because house was bought “as is,” and buyers could not show that the sellers took any steps to actively conceal the bats’ existence).

An "as is" clause can effectively preclude recovery by buyers, either because the court finds that (1) the buyers had no justifiable reliance or (2) the parties had agreed on a shift of the risk as to the existence of any additional defects. For example, in Berger-Vespa v. Rondack Bldg. Inspectors, Inc., 740 N.Y.S.2d 504 (N.Y. App. Div. 2002), a New York court found that the disclaimers contained within the purchase agreement as well as the dual agency disclosure form further supported the conclusion that the buyers were not justified in relying on any alleged negligent misrepresentations by the sellers and broker regarding the structural soundness of the house. Id. at 507. The purchase agreement stated that the property was being sold "as is" without warranty to its condition, while the disclosure form stated that the broker was not an advisor as to, among other things, the structural condition of the property. Id. at 505.

In Tipton v. Nuzum, an "as is" clause prevented the buyers from succeeding in a suit against the seller and the seller's agent for fraudulent and/or negligent concealment of known defects in the foundation of the house. 84 Ohio App. 3d 33, 36 (Summit Cty. 1992). While inspecting the home prior to purchase, the buyers were aware that a sump pump had been installed in the basement and that the house was built below a hill. Id. at 38. After they moved in, the buyers noticed an accumulation of water on the basement floor. The seller told them that he did not mention water problems in the basement because he had taken corrective measures, such as installing a sump pump and pouring new concrete, and believed that the water problem had been resolved. Id. at 36.

The court found that the "as is" provision in the purchase agreement placed the risk as to the existence of any defects upon the buyer. Id. at 39. The contract stated that, subject to inspection, the property was to be accepted in its then "as is" condition. Therefore, the sellers had no duty to disclose any knowledge of past water problems with the basement. Id. Once alerted to the possibility of a defect in the property, the buyer had a duty to inquire further of the owner, or seek advice of someone with sufficient knowledge to appraise the defect. Id. at 38. The court noted that the "as is" clause would not bar a claim for positive fraud, such as fraudulent concealment or misrepresentation, however, the buyers presented no evidence that the seller made any attempt to intentionally conceal known defects. Id. at 39.

Note, though, that an "as is" clause will not protect a seller from liability when other provisions of the purchase agreement specifically state that the "as is" clause does not apply to them. Moore v. Daw, 2000 Ohio App. LEXIS 6146, at *19 (Muskingum Cty. Dec. 22, 2000). In Moore, the "as-is" provision did not shield the seller from breach of contract liability when the seller failed to fulfill its responsibilities in securing a termite report as specified in the purchase agreement. Id.

A "present physical condition" clause is substantially the same as an "as is" clause. Masten v. Brenick, 2001 Ohio 2500, at *15 (Hocking Cty. Mar. 6, 2001). If a buyer agrees to accept the property "as is," the seller is relieved of any duty to disclose that the property was in a defective condition. Id. The "as is" clause places the risk upon the buyer as to the existence of the defects and relieves the seller of the duty of passive disclosure. Id. In Masten, the buyer purchased the property in its "present physical condition," so the wet basement could not be a "latent defect," and caveat emptor precluded the buyer's recovery because he was unable to prove fraud by seller. Id. at *1.

Illustration:

Mr. Smith lives in Ohio and has listed his house for sale with Mr. Brown's real estate agency. Mr. Smith's house has a problem with water in the basement during heavy rains and some structural damage as well, evidenced by some very small cracks in the basement walls. After a stretch of hot, dry weather, Mr. Smith has an open house. Mr. Jones attends and inspects the house. He notices a small crack in the basement wall and asks its cause. Mr. Brown says it is from some settling the house experienced a few years ago and tells Mr. Jones it is normal. Neither Mr. Brown nor Mr. Smith informs Mr. Jones of the water problem or the actual structural damage. Mr. Jones decides to buy the house. An "as is" clause is in the contract, indicating Mr. Jones has inspected the house and takes the property "as is." The sale goes through. The following spring, after a heavy rain, Mr. Jones discovers water in his basement. Thereafter, he hires a general contractor to remodel his basement because of the damage done to the old furnishings and improvements. The contractor then informs Mr. Jones of the structural damage as well. Mr. Jones sues Mr. Brown and Mr. Smith for fraudulent misrepresentation of the structural damage and fraudulent nondisclosure of the water problem. Because of the "as is" clause, Mr. Jones loses on the claim for fraudulent nondisclosure of the water damage because the "as is" clause eliminated the duty to disclose latent material defects. However, Mr. Jones wins on his claim for fraudulent misrepresentation of the structural damage, however, because an "as is" clause will not prevent liability in a case of active fraud, such as Mr. Brown's statement that the cracks were normal when, in fact, he knew of the damage.

VIII. MATERIALITY

> **A condition is material if it is something that would influence a buyer's decision whether or not to purchase the property, or if it affects the value or desirability of the property. Often what is "material" is decided after the purchase, by a judge, during a suit brought by a dissatisfied buyer who claims that if the buyer had known about the condition, he or she would not have bought the property.**
>
> **A "latent" material defect is a material condition which is not observable or readily discoverable upon a reasonable inspection.**

As the case law demonstrates, the seller has a general duty to disclose to the purchaser any information the seller has regarding latent material conditions of the property. The sorts of things people think of most often are the existence of termites, a leaky roof, or a wet basement—things the purchaser may not be able to uncover during a reasonable inspection of the property. These are latent defects, those not necessarily visible, as opposed to patent defects, which are open to observation. Other types of latent defects a broker would likely be expected to be aware of and disclose would be the presence of appliances to be sold with the house that are not in working order, asbestos, or high levels of radon. Because a broker is generally held to a higher standard of knowledge than a purchaser, the broker will need to conduct a thorough inspection of the home and inquire about these types of defects.

The above mentioned conditions are obviously material to the average buyer—they would certainly influence him to act or refrain from acting in a particular manner. In addition to these, there are other types of conditions which could affect a buyer's behavior. They are not as obvious as those

described by the latent/patent distinction, but they could very well be considered material, and moreover, lead to liability for nondisclosure.

A. Neighborhood Conditions

> **"Neighborhood conditions" refers to such things as quality of the schools; proximity to a landfill or toxic or hazardous waste sites; zoning; building codes; availability of bus service; or proximity to a group home. While it is still unclear whether these are conditions which must be disclosed, if the seller or broker is specifically asked about any of these, and knows the answer, the seller or broker should honestly respond to the questions.**

One such category of material conditions could be termed "neighborhood conditions." For example, would it be material to the buyer that the land upon which the houses in the neighborhood are built was formerly used as a landfill? Would that affect his or her decision-making process regarding whether or not to purchase the home? Should the broker disclose this information? The answers are hardly easy or clear. As a fiduciary to the seller, the broker does not want to do anything that reduces the likelihood of obtaining the best offer for the seller's property. The seller may not want the broker to tell prospective buyers about the former use of the land.

On the other hand, is this the sort of condition the average buyer would discover through a reasonable inspection? Is it the sort of thing a buyer would normally think to ask about? While perhaps not, might it nonetheless affect the property's desirability or value to the buyer? Whether or not the seller or broker should disclose this information will turn on the specific facts of each transaction. If the buyer specifically asks whether there is a landfill nearby or if the land upon which the house is built used to be a landfill, neither the broker nor seller should make a misrepresentation to the purchaser. **If the broker or seller knows the answer, the broker or seller should go ahead and disclose the information**. The risk of having to prove to a court that the information was not material or was not misrepresented far outweighs the possibility that the information will have a negative impact on the buyer.

For example, in Market Street Group v. McComb, the buyer was entitled to rescind the contract when the seller misrepresented the number of student tenants in the apartments. The court found that this misrepresentation concerned a material issue on which the buyer relied when deciding to enter the contract. 1998 Ohio App. LEXIS 1151, at *8 (Greene Cty. Mar. 27, 1998). The seller knew that the student occupancy issue was important to the buyer and that any information on the issue would affect his purchasing decision. Id. at *9. The buyer was not required to inform the seller that the sale was contingent upon a precise number of student tenants. Id. at *10. It was enough that the buyer conveyed to the seller or his agent that the student-occupancy issue was important to the buyer. Id. For rescission, the buyer needed to prove that the representation was material and substantial; that it affected the identity, value, or character of the subject of the contract; that it was false; that he had a right to rely on it; and he was induced by it to make the contract. Id. at **5-6.

In Chapman v. Hosek, 475 N.E. 2d 593 (I11. Ct. App. 1985), the purchaser sought to rescind the purchase agreement on the grounds that the seller and brokers had fraudulently concealed and

fraudulently misrepresented the fact that the home she purchased was in a flood hazard area, and subject to damage and inaccessibility after heavy rains. The purchaser claimed this was accomplished in part by the broker's affirmative indication in his listing that no flood insurance was necessary. Chapman argued she relied on the listing and made no further inquiries on the matter. Id. at 595-97.

The court held that a material fact was one that, "had the other party been aware of it, he would have acted differently." Id. at 598. Furthermore, "concealment of an existing material fact is actionable where employed as a device to mislead." Id. In this case, the particular facts suggested the condition of the neighborhood, in as much as it was in a flood hazard area, was a material fact.

The brokers claimed Chapman had no right to rely on their listing regarding flood insurance because information was available to the public that would have told Chapman her house was in a flood hazard area. They characterized her reliance as relying on their representation of the law, and argued she could not justifiably rely on representation of law since the truth was readily discoverable through public records. Id. at 598. The court disagreed. The public records referred to were of commission maps and reports, "not tantamount to a public law, nor ... the type of information an average prospective buyer would research if given no indication whatsoever that flooding was a problem." Id. at 599. Thus, since flooding was not something one would expect the average purchaser to investigate, especially when told flood insurance was unnecessary, Chapman was justified in relying upon the broker's representation.

It appears that the broker in Chapman was also negligent. The facts that the area was located in a flood hazard area and that a mortgagee would require flood hazard insurance are things one would expect a broker, held to a higher standard of knowledge, to know.

Zoning issues also present a question of materiality to brokers. What if a broker knew that the buyer wanted to use the property in a way which the broker knew would not conform to the zoning ordinance in effect for that area? Does the broker have a duty to disclose to the buyer that the buyer's intended use of the property would not be allowed?

Generally, the answer would be that the broker has no duty to disclose this information. Whether a use is permitted by zoning ordinances is a matter of law, and "as a general rule, one is not entitled to rely upon a representation of law since both parties are presumed to be equally capable of knowing and interpreting the law." City of Aurora v. Green, 467 N.E. 2d 610, 613 (Ill. Ct. App. 1984). So even if the broker made a representation as to how the property was zoned, the purchaser would have no right to rely on the statement. In City of Aurora, the purchasers relied on the misrepresentations of the sellers and their agent that the parcel of land was in a zone where it could be used for a five-unit apartment building. The court held that since the zoning maps and records were open to public examination, and that the zoning administrator would give the purchasers the information they needed upon request, the purchasers had no right to rely on the representation of the sellers. Had they done a reasonable investigation they would have been put on notice that their intended use was not permitted in that zone. Therefore, the purchasers' claim was denied. See also Stichauf v. Cermak Rd. Realty, 236 Ill. App. 3d 557 (Ill. App. Ct. 1992) (denying a similar claim by buyer against sellers and real estate agents because the zoning ordinance involved was a matter of public record, not information in the exclusive knowledge of the sellers and agents, and thus a cursory review of the zoning ordinance would have put buyer on notice that his property was in

violation and could not be resold). Id. at 568.

Likewise, in Van Horn v. Peoples Banking Co., 64 Ohio App. 3d 745 (1990), where the purchaser could have determined the actual acreage of the parcel he bought by means of a simple title check, he was not permitted to rely upon the seller's representations of the parcel's size. This was especially true since the seller had conveyed a quitclaim deed to the purchaser which should have warned the buyer to investigate any representation made by the seller. Id. at 748. See also Starrett v. Bryan, 1994 Ohio App. LEXIS 2351, at *4 (Cuyahoga Cty. June 2, 1994) (rejecting buyers' action for fraudulent inducement based on failure of the seller or his agent to disclose either the correct boundaries of the property, or a tax lien on the title, was not appropriate because a buyer had no right to rely on the oral representations of the agent given that the boundaries and restrictions were public record and equally available to all parties). Id.

While zoning issues may generally be said to be issues of law, compliance with a building code has been considered a question of fact. In Kinsey v. Scott, 463 N.E. 2d 1359 (Ill. Ct. App. 1984), a building was not built in conformity with the building code, but the builder-seller represented to the buyer that it was in compliance. Since the lack of conformity was not something the average purchaser could discover upon reasonable inspection and was a matter of fact and not law, the purchaser was justified in relying upon the seller's representation. The seller made a false representation; there was nothing to warn the purchaser as to the falsity of the statement; the purchaser relied on the statement and suffered injury because of it. Thus, the seller was found liable to the purchaser for fraudulent misrepresentation. Id. at 1365-66.

Similarly, in Curran v. Heslop, 252 P.2d 378 (Cal. Ct. App. 1953), the defendant did not reveal violations of the building code which were not apparent to the purchaser. Since they were not apparent, the court found a duty on the part of the sellers to disclose the violations to the buyer. The non-disclosure was concealment of material fact. Id. at 381. The court also stated that "an independent investigation or examination of property does not preclude reliance on representations where the falsity of the statement is not apparent from an inspection, or the person making the representation has a superior knowledge ...." Id. The facts were sufficient to uphold the lower court's rescission of the contract.

Failure to disclose the fact that property is subject to an order to comply with the local building code also is concealment of material fact. For example, in Katz v. Dept. of Real Estate, a purchase agreement was rescinded because the seller, a real estate broker, failed to disclose that the residence was subject to an order to comply with the municipal building code. 96 Cal. App. 3d 895, 898 (Cal. Ct. App. 1979). The court found that the broker had a duty to disclose the order because this was a fact materially affecting the value and desirability of the property. Id. at 900. The broker, however, had purchased the residence subject to the order and then sold the property to the buyer "as is" without notifying buyer of the order. Id. at 898. Administrative action was taken against the broker, which resulted in the revocation of his license. Id. at 899. In addition, the court imposed this disclosure duty on the broker even though he had no actual knowledge that the buyer was unaware of the order. The broker's silence was unacceptable given that knowledge of the order was not necessarily within buyer's diligent reach as its existence was not visibly apparent. Id. at 900.

B. Stigmatized Property: Murder, Suicide, Ghosts and Goblins

"Stigmatized" or "psychologically impacted" property is property which has been the site of a murder or suicide, or is reputed to be inhabited by ghosts or poltergeists. In the few cases decided on the subject, courts have not ruled out the possibility that these things are material conditions requiring disclosure. Therefore, if a broker is ever confronted with such a problem, the broker should inform prospective buyers of the conditions at some point during the negotiations—not necessarily at the first viewing, but certainly once it is established that the purchasers are serious about the property.

Another category of conditions which may be material fact to a prospective purchaser comes under the heading of stigmatized or psychologically impacted property. Would you want to know if the home you were considering buying had recently been the scene of a gruesome murder? What if the murder occurred five years ago? Ten years? Thirty years? Is this a material fact which affects the desirability or value of the property? The answer is "Maybe."

One court that considered the question decided that if the purchaser could prove the value of the house was less than she paid for it because the home was the site of a gruesome murder, she would be entitled to damages. In Reed v. King, 193 Cal. Rptr. 130 (Cal. Ct. App. 1983), Reed purchased a house from King which had ten years earlier been the site of a multiple murder.

Neither King nor his agents informed Reed of this fact. After the sale, Reed was told about the incident by her neighbor. Id. at 130. Reed filed suit against King and his agents for fraudulent concealment, claiming the house was only worth $65,000 because of its history, and thus, because King concealed its history, Reed paid $11,000 more than the house was worth. She sought rescission and damages.

The critical question in the case was whether the stigma of the house was material such that the seller was placed under a duty to disclose the fact to the purchaser. Id. at 131. "Whether information is of sufficient materiality to affect the value or desirability of the property . . . depends on the facts of the particular case." Id. at 132.

The court was forced to weigh the consequences of allowing such an "irrational" basis for rescission of contracts and the potential for instability in contractual relations against the fact that murder is unsettling and not something which the average buyer would necessarily uncover or inquire about during a reasonable inspection. The court concluded that since this case came as a review of summary judgment against the purchaser, simply allowing the case to proceed would not be an endorsement of the fact's materiality. Instead, the claim was allowed to proceed in order to permit Reed to try to prove her claim that the murder did have a significant effect on market value. If she could do so, she would be entitled to a judgment in her favor regarding materiality and the duty to disclose. The court said that "[if] information known or accessible only to the seller has a signigicant and measurable effect on market value and, . . . the seller is aware of this effect, we see no principled basis for making the duty to disclose turn upon the character of the information." Id. at 133. Thus, Reed has paved the way for future cases of this nature to result in liability on the seller for nondisclosure where the purchaser can competently show the stigma's effect on the value of the property.

Even in states where the doctrine of caveat emptor is rigorously applied, a seller has a duty to disclose the existence of poltergeists to avoid rescission of the purchase agreement. Stambovsky v. Ackley, 169 A.D. 2d 254, 256 (N.Y. App. Div. 1991). In Stambovsky, after the sale was complete, the buyer learned the house had a reputation for being possessed by poltergeists. The court determined that "haunting" was not a condition that was expected to be ascertained by a buyer upon reasonable inspection of the premises. Id. at 257. The seller had deliberately reported the presence of poltergeists in both the national and local press, but because the plaintiff was not a resident of the local village, he could neither be familiar with the folklore of that area nor readily learn that the home was haunted. Id. at 256. The impact of the reputation the seller had created for the house went directly to the "very essence of the bargain" between the parties, greatly impairing the value of the property and its resale potential. Id. at 256. While caveat emptor precluded an award of damages, it did not prevent the equitable remedy of rescission. Id. at 258. Therefore, nondisclosure provided the basis for rescission where a condition that had been created by the seller materially impaired the value of the contract and was peculiarly within the knowledge of the seller, or unlikely to be discovered by a prudent purchaser exercising due care with respect to the transaction. Id. at 259.

Ohio recently acknowledged a cause of action for residential property tainted by stigmatizing events that have occurred on or near the premises. A seller now has a duty to disclose the psychological defect that the property is unsafe for habitation due to the serious crimes that have occurred in or near the residence. Van Camp v. Bradford, 63 Ohio Misc. 2d 245 (Butler Cty. July 29, 1993). In Van Camp, the buyer had inquired before closing about the bars on the basement windows. The seller stated that they were a result of a break-in sixteen years prior but failed to mention the numerous rapes that had occurred recently in the house and surrounding neighborhood. Id. at 250. After purchasing the home, the buyer discovered the criminal history of the home and the area and filed suit against the sellers and agents.

The court determined that caveat emptor would not apply and treated the stigma associated with the residence the same as a latent property defect. Id. at 252-53. Even the most prudent purchaser could not be expected to check police records to ascertain the relative safety of a neighborhood or a particular residence. Id. at 253. To succeed on a psychological defect claim, the buyer must prove fraudulent inducement. Id. at 254. The court will also review subjective considerations, such as whether the seller is aware that the buyer is likely to attach importance to a subject. Id. at 255. The misrepresentation will be found to be material, regardless of its significance to a reasonable person, if it would be subjectively material to the buyer. Id. In Van Camp, the seller knew that the buyer was a single mother with a teenage daughter. Id. at 259.

In addition, the court determined that Ohio law requires a seller or agent to provide a good faith response to an inquiry, even one regarding a potential psychological impairment. Id. at 257. The agents were released from liability, however, because the inquiry was directed solely to the seller. Id. at 259. The agents had no affirmative duty to speak up and disclose their knowledge of the crimes simply because they were in the room at the time the inquiry was made. The agents would have been liable had they similarly misrepresented or failed to disclose a material fact upon an inquiry directed to them. Id. at 260.

If a broker must confront such a problem with stigmatized property, the broker should inform prospective buyers of the conditions at some point, though not necessarily on the first showing. For

instance, one Columbus area agent handled a listing of a stigmatized property by not informing potential buyers of the stigma until they came back for a second showing. In this way he did not scare everyone off, but gave the information only to those who showed a serious interest in the home. In his view, it was a negative characteristic of the home which, if disclosed up front, would not come back to "haunt" him after a transaction took place. See Columbus Monthly, April 1992, p.70. While disclosure may affect the sale price of the property, this is much more acceptable than being sued for nondisclosure once the transaction has been completed.

The whole idea of stigmatized property is a rather novel concept. As the Reed case shows, materiality may be molded to fit the circumstances. The general impression it creates is that materiality is a buyer's concept - if it affects or would have affected the buyer's conduct in the transaction, then in hindsight it is material. Equity and fair dealing are of paramount importance in this area. If your behavior offends the court's sense of equity, you can plan on a finding of materiality, and losing your case.

IX. CONCLUSION

As they say, "the winds of change are blowing." The doctrine of caveat emptor, practically insulating sellers and brokers from liability in the past, has been and continues to be eroded by a wave of consumerism in this country. Even where the doctrine is still rigorously applied, inroads are being made to reflect the attitude that purchasers cannot be expected to discover everything about the property they intend to purchase, and where material information is known or available only to sellers and their agents, equity will prevail over a strict application of "buyer beware". The market is being equalized, and in the process more and more responsibility is being placed upon brokers to make certain that purchasers of property are treated fairly and that their interests are protected.

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