

PROPERTY CONDITION DISCLOSURE STATEMENTS

Warren Chornoby¹

You have found your dream house. A beautiful Victorian home with a scenic view overlooking a picturesque river. You eagerly complete an agreement of purchase and sale. The problem - the seller neglected to mention one small point - the house is haunted. Can you sue the vendor, the agent, or perhaps both? If this example seems ridiculous remember the adage truth is stranger than fiction:

In Stambovsky v. Ackley, 572 N.Y.S. 2d 672 (1991), the buyer convinced the state Supreme Court Appellate Division that the seller's failure to disclose that she had asserted more than once that the house was infested by poltergeists impaired the value of the property enough to warrant rescission.

The Stambovsky court found no duty on the part of the real estate broker to disclose the ghostly goings on, but cases involving non-disclosure of more common and substantial defects have thoroughly spooked real estate professionals...²

The Halifax-Dartmouth Real Estate Board recently introduced a Property Condition Disclosure Statement for use by members of the Nova Scotia Real Estate Association. This form is currently intended to be a voluntary document, which members are encouraged to use when they list a property. By introducing this form, Nova Scotia has joined the growing trend in which home sellers make known to realtors and buyers the general condition of their property and certain types of defects. This type of disclosure is mandatory in numerous U.S. states where residential

¹ Warren Chornoby is an Articled Clerk at the law firm Stewart McKelvey Stirling Scales.

² Lawton, James D. "Seller Beware", *ABA Journal*, August 1992 p. 90.

property condition disclosure legislation has been passed,² and in Canada, British Columbia has for several years required a property purchase disclosure statement to be filled out and signed by all owners and to accompany each residential listing submitted to the Multiple Listing Service (MLS).

This paper will briefly examine the legal background in which these forms have developed, and then examine the disclosure statement to determine what benefits, if any, these types of forms provide.

Defects - The Common Law Approach³

The traditional common law approach with respect to hidden defects of quality in the purchase of a home or property was caveat emptor - "let the buyer beware"⁴. As a result of this doctrine, vendors were largely shielded from any liability that may have arisen from defects in the property's

² For example: Alaska, California, Kentucky, Ohio, and Wisconsin are among a growing list of U.S. states with mandatory disclosure legislation. Generally this legislation is limited to residential transactions and may include certain exceptions for transactions such as court ordered sales and foreclosures. It should be noted that in California the disclosure form was 32 pages long in 1993.

³ The following excerpt is based extensively on an article in Chapter 6 of the materials prepared for a Continuing Legal Education Seminar on October 9, 1992 prepared by J. Ronald Creighton of Patterson Kitz, Truro, Nova Scotia.

⁴ This maximum essentially summarizes the rule that a purchaser is responsible for examining, judging and testing before making a purchase. As Dickson J., in *Fraser-Reid v. Droumtsekas* (1979), 9 R.P.R. 121 (S.C.C.) at p. 129 points out this approach was based upon "the laissez-faire attitudes of the 18th and 19th centuries and a notion that a purchaser must fend for himself, seeking protection by express warranty or by independent examination of the premises. If he fails to do either, he is without remedy, either at law or in equity, in the absence of fraud or fundamental difference between that which was bargained for and that obtained."

physical condition. Furthermore, a vendor was under no real obligation to potential purchasers to disclose all they knew about the condition of the property. When real estate agents and brokers began to assist vendors with residential sales they too were shielded by the principle of caveat emptor. In addition, because of the agency relationship between vendors and real estate brokers which required agents to protect the interests of their principal, the broker was further protected from any liability that may have arisen because of lack of disclosure.

The marketplace, however, has over time become more concerned with consumer protection. Correspondingly, home buyers have begun to expect more information about the property they intend to purchase. The current trend is towards greater protection for the purchaser of real property. For purchasers of new homes, legislatures have responded and provided mechanisms for new home warranties. Furthermore, purchasers of homes under construction are protected by implied obligations of workmanship and fitness for habitation that survive the closing.

Although the caveat emptor philosophy continues to significantly influence the law applicable to the purchase and sale of used housing, the law has developed a variety of mechanisms to provide relief to many purchasers of used housing. The type of relief available often depends upon the type of defect in the residential property.

There are essentially four types of defects:

- (a) patent defects;
- (b) latent defects of which neither the purchaser nor vendor was aware;
- (c) latent defects which the vendor actively misrepresents or takes steps to hide;
- (d) latent defects which the vendor does not disclose and the purchaser does not inquire about.

Patent defects are readily discoverable upon an ordinary inspection by a purchaser. A purchaser assumes the risk of patent defects. The vendor is under no duty to draw attention to patent defects which can readily be observed by the purchaser if he pays ordinary attention during inspection. If the purchaser fails to observe patent defects on inspection, the rule of caveat emptor applies. If a vendor renders an otherwise patent defect undiscoverable, however, the purchaser may obtain relief.

The action of a vendor resulting in concealment of a defect, does not necessarily have to be made with fraudulent intent. A court may order rescission when the vendor merely had hoped to raise the value of the premises. Any act of concealment by a vendor of defects which would otherwise be patent is treated as fraudulent and the contract is voidable by the purchaser if he has been deceived by it. Any conduct calculated to mislead a purchaser or lull his suspicions with regard to a defect known to the vendor has the same effect.

A latent defect is not discernible upon an adequate inspection of the property using ordinary and

reasonable care. Most problems arise with regard to latent defects. These may include such things as moth or termite infested houses, serious structural faults such as foundation cracks, an inadequate water supply or sewage disposal system, a hidden underground culvert, defective siding, etc. When neither party in a real estate transaction is aware of the latent defect, the courts will not provide the purchaser with relief. For example, a problem with the foundation which was not ascertainable without excavation or removing the basement walls might be classified as a latent defect for which the purchaser would not be able to obtain damages.

Fraud, misrepresentation or concealment on the part of the vendor will relieve the purchaser from the full impact of the caveat emptor doctrine. If the latent defects are actively concealed by the vendor, the rule of caveat emptor does not apply, and the purchaser can, ask for rescission of contract and/or compensation for damages resulting therefrom.

In *King and Bowser v. Kesebi* (1985) 68 N.S.R. (2d) 175 (N.S.S.C.T.D.), the vendor sold a house in which the siding was prematurely deteriorated. The vendor knew of the defect because he previously had received a settlement from the manufacturer. The purchasers noticed some of the defective siding but relied on the vendor's representation that the siding was alright. The purchaser understood that the vendor was a carpenter knowledgeable in these matters. The court awarded damages for fraudulent misrepresentation. In the case of misleading statements which are made or steps that are taken to lull the purchaser's concerns, courts have little difficulty in assisting the purchaser.

A vendor is not obliged to disclose all known facts affecting the value of a property which may be material to the purchaser's judgment. However, there may be a duty on the vendor to disclose latent defects which render the premises dangerous in themselves, or where the circumstances are such as to disclose the likelihood of such danger, or which would render the property useless to the purchaser for a purpose for which, to the vendor's knowledge, the purchaser wishes to acquire it, or where a work order or notice has been served in respect of the property which fundamentally affects the value of the property. There is no fiduciary relationship between the vendor and purchaser in the negotiation of an Agreement of Purchase and Sale.

In *Bresson and Bresson v. Ward et al.* (1987), 79 N.S.R. (2d) 156 (N.S.C.Ct.), the purchasers of a house encountered water problems upon taking possession and sued the vendor's claiming the vendors fraudulently misrepresented the quantity of water, made representations that induced the purchasers to contract, or negligently misrepresented the quantity of water. In dismissing the action, at p. 167 the court states:

Nothing in the agreement represented the well being free from defects or other additional qualities of water. Again, I find that the defendant...only represented the defendant's experiences and did not give an absolute representation that there was nothing wrong. In my opinion the defendants did not intend that the plaintiffs would rely on the representations. They gave the plaintiffs complete run of the property and an ample opportunity to satisfy themselves of the situation.

Similarly, in *Chisling and Hatcher v. Frame* (1990), 98 N.S.R. (2d) 417 (N.S.C.Ct.), the vendor of a house appealed a small claims decision which awarded damages for innocent

misrepresentation. The purchaser had originally sued the vendor for the cost of repairing cracks in the foundation. The purchasers had asked the vendor whether she had a water problem. The vendor had replied that to the best of her knowledge she had no water problem. The vendor was not aware that the purchasers wanted to finish the basement with a rec room and bedroom. Her representations were made in good faith and based upon her belief and experience. The court found that the adjudicator had erred in awarding damages for innocent misrepresentation.

In summary, the rule of caveat emptor will protect vendors where the defect was either patent or unknown to either party. If the vendor actively conceals a problem or misrepresents the qualities of his property in some material way, the courts will act to protect the purchaser from the full impact of the caveat emptor doctrine. This protection will come sometimes in the form of rescission but more often in damages. Where the vendor does not actively mislead the purchaser, the authorities are less clear, but it appears that where there is no inducement or representation the vendor may remain silent unless the defect goes to the property's safety or suitability for human habitation.

As previously mentioned, the doctrine of caveat emptor has, in addition to providing protection to vendors, generally provided protection to real estate agents. Real estate agents have also been protected because their agency relationship is with the vendor and not the purchaser.

Nevertheless, the real estate agent has increasingly become the defendant in litigation, and the courts have slowly imposed certain standards of conduct. Several cases will help illustrate this

point.

In *Lambert v. Gillis* (1993), 122 N.S.R. (2d) 296 (N.S.S.C.), the court states, at p. 298:

The duty of a vendor's agent to a prospective purchaser is one of honesty and integrity as a professional and not a duty arising from contract.

A prospective purchaser is entitled to rely upon representations made by the vendor's agent who must maintain a level of professionalism that does not countenance the misleading of a prospective purchaser by misrepresentation or omission on matters that are material to the entry by the prospective purchaser into the agreement of purchase and sale and acquisition of the property.

This general duty of care does not excuse the purchaser from her obligation of inquiry and satisfaction as to what is being purchased unless such a misleading or omission is established warranting the prospective purchaser's reliance on the agent to an extent that nullifies the purchaser's own obligation on a particular aspect of the purchase.

In *Jakubke v. Sussex Group - SRC Realty Corp.* (1993), 31 R.P.R. (2d) 193 (B.C.S.C.), the vendor added a new west wing to his house before selling it. As a result of a municipal inspection, a stop-work order was issued, and the vendor amended his plans to comply with the municipal requirements. After the final inspection, the vendor proceeded to complete the bedroom and bathroom without a permit. The unlawful status of the renovations were never disclosed to the purchasers. The real estate agents were aware that the wing likely did not comply with the current building code. They thought the wing was old or original construction and that the municipality would not attempt to enforce the current code if the original work had been completed to code requirements. In showing the home, the agents described it as having a bedroom and bathroom in the west wing. The court found that the fact that the work had been done by the vendor without a

permit and in contravention of the municipality's directives was a latent defect, whose non-disclosure by the vendor constituted a fraudulent misrepresentation. The court also found that although there was no express representation by the agents that the bedroom and bathroom could be lawfully used, that was how the rooms were described, marketed and displayed. The fraudulent misrepresentation was, therefore, passed on to the purchasers by the agents. At p. 206, the court reviews the duty of care of a realtor to a purchaser:⁵

In some circumstances, a real estate agent is entitled to rely on representations of fact made by the vendor...In Foster, Real Estate Agency Law (1984), the duty to exercise care and skill is described in the following terms (at p. 243):

"It is now well established that real estate brokers who elect to provide information and advice to the third parties with whom they may have dealings must exercise reasonable care and skill in the performance of their undertaking in ensuring the completeness and accuracy of such information and advice."...

"That the misinformation conveyed by a broker to a third party originates with the broker's principal, or with the listing broker in a multiple listing situation, will not necessarily relieve the broker from personal liability to the third party. A broker must at least check the completeness and accuracy, both of all information which is usual or customary for brokers to verify, and of all other information as to the completeness and accuracy of which he is in doubt. However, authority exists to support the contention that the obligation of, at least, a listing broker is somewhat broader in that he must ascertain and verify all pertinent facts concerning the property placed in his hands for disposal."

In the present case, there were circumstances which ought to have caused the realtors to doubt the completeness and accuracy of the representations. The court acknowledges at p. 207, that:

⁵ Citing Lysk J. in *Sedgemore v. Block Bros. Realty Ltd.* (1985), 39 R.P.R. 38, where he quotes with approval W.F. Foster, *Real Estate Agency Law* (Toronto: Carswell, 1984), at p. 49.

great care must be taken not to impose standards on these realtors that are more properly those to be imposed upon architects, builders, engineers or solicitors. I do not think, at least on the evidence before me, that there is a duty on a realtor to ensure that a building complies in every respect to the building codes either present or past. A consideration of the duty and standard of care of realtors must also be viewed in light of what might be a conflicting duty to their principals.

However, the court does find that the realtors did not meet their duty and standard of care. They were aware extensive renovations had occurred. It was apparent to them that the west wing work was not in compliance with the building code. An inquiry as to the status of the bedroom and bathroom would have revealed the true state of affairs.

In *Fletcher v. Hand* (1994), 40 R.P.R. (2d) 52 (Alberta Q.B.), the purchasers bought a farm property on the basis of a representation with respect to the farm well's capacity. The vendor was the originator and only source of misrepresentation that was made fraudulently or recklessly. The real estate agents were found to be in breach of their duties to the purchasers. The information representing the capacity of the well was a material fact that the listing agent was required to verify so that the purchasers would know to what extent they could rely on the information. The listing agent's failure to ascertain the accuracy of the representations constituted a failure to meet the standard of care normally required of a listing agent. In addition, the selling agent was also under a duty to make inquiries and to validate any material representations. The selling agent could not simply rely on the listing agent to discharge the duty of providing complete and accurate information. The companies were also vicariously liable for their agent's negligence.

Like the vendor, clearly there are occasions when the real estate broker may be found liable for defects in the physical condition of the property. In the United States, it is estimated that approximately two-thirds of all lawsuits brought by buyers against sellers and real estate brokers involve misrepresentation claims or claims for failure to disclose defects⁶. It is likely that similar statistics would be appropriate in Canada. Due in part to the increasing claims against real estate brokers property disclosure statements were developed.

Property Condition Disclosure Statements

The Property Condition Disclosure Statement (the "disclosure statement")(attached) published by the Halifax-Dartmouth Real Estate Board for use by members of the Nova Scotia Real Estate Association focuses on disclosing property conditions with respect to ten main areas and provides for additional comments as required. There is a signature block for witnesses, vendors, and purchasers. The topic areas covered by the form are as follows:

- a. water supply;
- b. sewage disposal;
- c. electrical system;
- d. plumbing system;
- e. heating system;

⁶ Minimum Standards of Practice, National Association of Realtors Property Condition Disclosure (1991).

- f. structural;
- g. mechanical;
- h. environmental;
- i. zoning and permits; and
- j. general limitations with the property.

The statement provides the vendor with several questions with respect to each topic area. For example, "Are you aware of any problems with water quality?" The vendors are responsible for the accuracy of the answers on the disclosure statement and if uncertain are asked to reply "Do not know." Other possible responses are yes, no, and does not apply. The disclosure statement will form part of the contract of purchase and sale if so agreed in writing by the vendors and purchasers.

The statement also includes several disclaimers:

The information contained in this disclosure statement has been provided to the best of my knowledge.

The information contained in this property condition disclosure statement has been obtained from the seller of the property and is believed to be accurate, however, it may be incorrect, it is the responsibility of the purchaser to verify the accuracy of this information. The Broker, Agents and members of the Halifax/Dartmouth Real Estate Board assume no responsibility or liability for the accuracy of this information.

In addition, the disclosure statement urges purchasers to carefully examine the property and have

it inspected by an independent party or parties to verify the information.

The use of the disclosure statement in real estate transactions is intended to result in several advantages, including the following:

- a. Since most lawsuits against sellers and real estate agents are based on misrepresentation, the disclosure statement provides a written record of what disclosures the vendor made to the purchaser;
- b. The purchaser is provided with more information with respect to the condition of the property and can therefore make a more informed purchase. This may lessen the surprises that some purchasers experience after closing, and therefore help to reduce the chances of litigation occurring;
- c. The disclosure form helps encourage purchasers to obtain an independent examination of the property;
- d. The disclosure statement may help reduce the vendor's liability by providing written evidence of what the vendor disclosed;
- e. Disclosure helps provide further information to aid purchasers in their choice of

homes. Properties which appear similar can be compared based on the information derived from the form;

- f. If the forms are used the forms can in addition to helping reveal latent defects of which the vendor is aware also serve to reveal patent defects in the property which under the common law the vendor was under no obligation to disclose;
- g. The disclosure statement clearly places the responsibility of disclosure on the vendor and this may reduce the litigation commenced against real estate agents;
and
- h. As the disclosure statement will provide information on most areas in which buyer's questions arise, there may be a reduction in the number of representations which an agent must make.

While the above benefits may materialize when disclosure statements are used, there are several factors which reduce the utility of such forms, including:

- a. The disclosure statement is not mandatory and may not be used in all transactions. If, however, buyers are made aware of the existence of these forms and real estate agents encourage their use or help draft agreements of purchase and sale which are

conditional on the completion of a disclosure statement, the impact of this problem can be reduced;

- b. The requirement to update information on the forms is not mandatory, but instead is dependant on a request from the purchaser. This may result in changes in the property occurring between the signing of the statement and closing not being disclosed;
- c. The disclosure statement does not actually change the common law discussed earlier and as a result does not actually provide the buyer with any additional remedies. The form only serves as an information mechanism not as a collateral warranty. Caveat emptor is still relevant because of the disclaimers; and
- d. Obviously the disclosure statement does not replace professional inspections. The vendor is generally not an expert, and the form only pertains to information within the vendor's actual knowledge. If the vendor acted in good faith, they are not likely to be found liable for any error, inaccuracy or omission. For example, in *John Levy Holdings Inc. v. Cameron & Johnstone Ltd* (1992), 26 R.P.R. (2d) 130 the Ontario Court of Justice (General Division) considered the meaning of a similar phrase "to the best of my knowledge and belief". In this case, the vendor had covenanted that to the best of its knowledge and belief the soil did not contain

contaminated waste materials. The court held that the use of the words in a covenant, representation or warranty served to qualify the ensuing statement and to limit the absolute truth of the statement. The covenant as a result did not eliminate the doctrine of caveat emptor.

It is important to note that the disclosure statement will not relieve real estate agents from liability as a result of negligent or fraudulent conduct. In fact, the disclosure form may actually create a possible negligence claim against an agent if the agent does not inform the buyer and/ or vendor about the forms. It could be argued that an agent, who did not provide information on disclosure statements, is negligent because a reasonable professional would inform purchasers/vendors about the use of the disclosure statement. Furthermore, the agent will clearly be liable if they know of some material defect and do not inform the buyer, and the disclosure statement does not reduce an agent's obligation to ensure the completeness and accuracy of such information.

In short, the disclosure statement is simply an information tool which helps to provide a written record of certain aspects of a real estate transaction. It does not, however, alter the common law, instead it simply provides a starting point for resolving issues pertaining to disclosure. The disclosure statement is a useful aid to purchasers, but it is not a substitute for a professional inspection. Without clearly defined enforcement provisions and mandatory usage, the purchaser is not actually provided with any significant new remedies, and while the agent may not be required to make as many representations to the purchaser, the agent may still face liability under

the growing responsibilities courts are willing to impose⁷. The disclosure form may reduce litigation because purchasers are more aware of what they are purchasing, but the law has not changed and once litigation commences the game is the same. Therefore, agents should not blindly assume that the disclosure statement will protect them from liability, their professional obligations have not been reduced, and as a minimum they must still check out the premises. While disclosure statements will help record what representations were made by the vendor, the agent can not simply hide behind the fact the representations were made by the vendor. Furthermore, an agent should ensure that when the disclosure statements are used that both the vendor and purchaser are aware of the impact of these forms.

Finally, in closing a recent Canadian example indicates that the disclosure statement may in fact lull purchasers into a false sense of security and that the legal implications of disclosure statements are yet to be decided by Canadian courts. The purchasers bought a 27 year old home for \$314,000. Unfortunately, as soon as they moved in they discovered "improperly installed light switches, an ant infestation, faulty appliances and a workshop that had been added to the house without a building permit or inspection. They now estimate it could take \$60,000 to \$80,000 to correct all the problems."⁸ They did not have a home inspection and had relied on the disclosure

⁷ It should be noted that courts in California (see *Easton v. Strassburger*, 199 Cal. Rptr. 383) have found that a licensed real estate agent must conduct a reasonably competent and diligent inspection of residential property, and disclose to the buyer all facts revealed by that inspection which materially affect the value or desirability of that property. The legislature responded by passing a law detailing what type of inspections a real estate agent must conduct.

⁸ Constantieau, Bruce, *The Vancouver Sun* Aug 9, 1994.

statement to reveal any problems. The president of the Real Estate Board of Greater Vancouver , indicated that this was the first complaint he had received about disclosure statements since they became mandatory. As legal action is being considered, this may become the first Canadian case to consider the disclosure statement.