FAIR DISCLOSURE OF DEFECTS IN RESIDENTIAL PROPERTY

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When a piece of residential real estate is exchanged for consideration, a contract between the seller and purchaser is formed. This generates a bond that binds them together beyond the simple act of obtaining a piece of property. With the demise of caveat emptor, the two parties may be advancing their relationship to the point of obtaining attorneys to enforce the provisions of law that have been designed to create an increasingly honest and just society. This article will address a number of specific problems commonly faced in the fulfillment of the directives found in the Oklahoma Residential Property Condition Disclosure Act .

The Oklahoma Residential Property Condition Disclosure Act was enacted to assure purchasers of residential property of fair salesmanship on the part of the seller. This relatively new area of law has swept the country, with the majority of states having enacted some type of legislation requiring the disclosure of property conditions to purchasers. As is the case with any new legislation, some vagueness on the part of the legislature has left some of the specific details up to the courts to determine. This act is not difficult to comply with, but the courts have rightly decided that if the seller does not take the disclosure requirements seriously, it can mean trouble for his or her pocketbook.

The Residential Property Condition Disclosure Act is codified in the Oklahoma Statutes beginning at 60 O.S. § 831 (hereafter "Disclosure Act" or "Act"). The Disclosure Act basically requires represented sellers of used residential property to disclose certain defects in the property being sold before the sale price is agreed upon. In order to help facilitate the disclosure of defects, the Oklahoma Real Estate Commission provides a form that sellers are required to complete. This form lists various features that are common in the sale of a property. The form asks whether or not the listed area of the property has a defect. The seller is required to answer "yes, no, unknown, or N/A" in regards to the question regarding each specific aspect of the property. The seller has the duty to answer each inquiry of the form truthfully, to the best of the seller's "actual knowledge." If the seller fails to be completely honest when completing the disclosure form, the seller is liable to the purchaser for actual damages and attorney fees.

It should be noted that this has been a brief and simplified overview of the Disclosure Act. For a more detailed description of the Act, please refer to The Sharp Sword of Residential Property Disclosures.

I. THE DISCLOSURE STATEMENT FORM

When filling out the Disclosure Form, the seller does not have a duty to investigate each item on the list. There is no need for the seller to hire a professional property inspector. Furthermore, it would behoove the seller to not rely upon an inspector's report when filling out the Disclosure Form. The Disclosure Act requires the seller to fill out the form from the seller's knowledge, not from the knowledge of a third party. If a seller does have an inspector inspect the property, it would be useful to include the report of the inspector for the buyer, but it can not substitute for a proper Disclosure Form, and appropriate responses on the Form. If the seller relies upon the inspection to report the absence of a defect when

the seller believes that there is in fact a defect, the seller can be found in violation of the Disclosure Act. It would be better to report the defect even though the inspection did not discover it.

All that is required by the Act is for the seller to answer each question according to the seller's "actual knowledge". After the seller receives the Disclosure Form, the seller need only review the questions and consider each and every one individually. The seller has four answer choices for each question: yes, no, unknown, or n/a. Each answer not only indicates the condition of the property, but also exhibits what level of knowledge the seller has of the property. Answering "no" to a question indicates that the seller has actual knowledge of the property, and the property does not have any problems. Answering "yes" to a question indicates that the seller has actual knowledge of the property, and that it does have a problem. Answering "unknown" to a question indicates a lack of actual knowledge of a property, and places a burden upon the purchaser to investigate into the status of the property in question. Answering "n/a," of course just means that the property does not contain the questioned aspect, so the property condition inquiry is not applicable.

It must be remembered that if any part of the property has been subject to repair, the act of repair must be indicated on the Disclosure Form. Also, any time a repair or a defect is indicated, a full description is required in the "explanation" section of the Form. The description must be detailed enough for the reader to discern what the defect is, and whether or not it has been remedied. If an item has been repaired, but problems still persist, or if other problems have arisen, this should be noted, along with the repairs, on the Form.

II. WHAT CONSTITUTES A 'DEFECT'

A problem that has some sellers scratching their heads is whether or not something constitutes a defect. The Disclosure Act defines the term "defect" at 60 O.S. §832(9):

"Defect" means a condition, malfunction or problem that would have a materially adverse effect on the monetary value of the property, or that would impair the health or safety of future occupants of the property.

In Rogers v. Meiser, the court quoted directly from the language of the statute, deciding that no further explanation was necessary. But the Oklahoma Real Estate Commission decided to boil down what is a "defect." The Commission, via its Form, asks the simple question of whether or not a particular piece of equipment on the property is in its "normal working order." If the equipment is normal, like it has always been, then there is no defect; if not then there is a defect in the property. Additionally, the Form, in this writer's opinion, creates definitions of defects simply by asking the specific questions. For example, one question on the Form queries: "Do you know of any current problems with the roof?" Hereby, the Form effectively defines as a defect any "problems" with the roof.

Cases generally do not give any other definition of what a defect actually is, but they do give many examples of items they find to be defects. Courts have identified defective property to include expansive soils, water damage from pools, flooded basement, failed foundation, cracks in basement walls, broken

air conditioner, termite infestation and many other problems that people frequently run into after purchasing property.

A defective piece of property can be described as any property that is not in "normal working order." The decision to disclose information about the property comes in when it is a materially adverse defect that would have an impact upon the value of the particular piece of property. If there is a piece of property that is not in normal working order and knowledge of the defect would effect the value of the property, then it is a defect under the definition in the Oklahoma Residential Property Condition Disclosure Act.

III. ACTUAL KNOWLEDGE

Actual knowledge of the defect is a prerequisite for seller liability under the Disclosure Act, which states, "...a statement of whether the seller has actual knowledge of defects or information in relation to the following..."1 The Disclosure Act then proceeds with a list of various types of property the seller must identify and indicate whether or not the property is in proper working order on the Disclosure Form. If the seller does not know the condition of the property, the seller can indicate this lack of knowledge on the disclosure form by selecting "unknown." By selecting yes or no, the seller has indicated that the seller has possession of actual knowledge about the property in question. To what degree the seller has actual knowledge of the property remains a question for the courts.

If the seller does select "no" on the disclosure form in regards to a piece of property, and the property does indeed have a defect, it does not immediately follow that there is "actual knowledge" of the defect by the seller. Evidence of the seller's actual knowledge of the specific defect in the property is necessary for any litigation on this issue. Evidence merely tending to prove that a seller should have known about the defect will not meet this standard. Actual knowledge must be shown through actual, credible evidence. The fact that there are defects in the property after it has been purchased does not prove that the defects were present before the sale, and it does not give any indication of actual knowledge.

IV. EVIDENCE OF ACTUAL KNOWLEDGE

Obtaining evidence of actual knowledge may sound difficult, but it is possible through a little investigation and hard work. An admission by the seller is always nice, but rare, and furthermore, an admission is not required to prove actual knowledge.

In many cases, circumstantial evidence is readily available and can easily show that the seller must have known about the defect before the sale. Past actions of the seller can give indications that the seller knew about the defect before the sale of the property. Repairs made to the property, usage of the property, insurance claims made by the seller, and third party testimony can all easily show whether or not a seller had actual knowledge of a defect.

Actions designed to "conceal, misrepresent, or attenuate the defect" by the seller can be evidence of actual knowledge of a defect. For example, in Engelhart v. Kramer, the seller placed paneling over large cracks in the walls four days before placing the property on the market. The court said that this is highly

suspicious behavior and leads to the conclusion that the only reason for the action was to conceal a defect, therefore knowledge is evident.

Failed attempts to rectify the defect can be seen as evidence of actual knowledge. In Humpage v. Conti, the seller had, some years previously, applied for permits to drill a deeper well. This showed that there had been previous attempts to rectify the problem of a water supply shortage. Further testimony showed that these attempts had failed. Expert testimony indicated that the amount of water supplied to the premises by the well was far below the normal standard, and anybody living at the premises would have known there was a water shortage, unless they did not use the water at all. The court took all of this together to decide that the sellers had known of the defective well. The knowledge of the water shortage had to be disclosed, and because of their failure to do so, the sellers were liable to the buyers for the costs of making the well deep enough to produce an adequate water supply, which was very expensive.

V. MISCELLANEOUS "ACTUAL KNOWLEDGE" INFORMATION

There is not a "good faith" standard in Oklahoma for actual knowledge. Local case law does not explain how the courts interpret this, but other states have addressed this issue. South Dakota's property disclosure act contains a "good faith" clause. There must be intent or malice on the part of the seller to violate the disclosure act in South Dakota. The state will not find a seller liable for an erroneous answer on the disclosure form if the answer was made in "good faith." Unlike South Dakota and similar to the Oklahoma act, the Illinois property disclosure act does not require "good faith" on the part of the seller. The Illinois courts have decided that there is no need to prove that the seller acted with bad faith or malice. In Illinois, and in Oklahoma, all that need be shown is that the seller knew of the defect, and the seller failed to disclose the defect to the buyer according to the disclosure act's requirements.

Since the Disclosure Act requires "actual knowledge" of the defect, there is no comparative or contributory negligence to take into consideration. There is in fact no negligence-based theory of causation. The buyer does not have to worry about his or her comparative negligence. The Disclosure Act does not give a remedy for negligent failure to disclose. The buyer does not have to inspect the property to verify the disclosures. A buyer can rely upon the statements made by the seller in the disclosure form. This makes it much easier for people purchasing property from different states or over great distances. Nevertheless, it would be highly advisable for any buyer of a property to seek at least one if not two or more independent professional inspections of the property. It is recommended that the buyer should not rely solely upon the inspection that the mortgage company may or may not supply. Some of these inspections are simply "drive by's", and they may not actually even get out of their vehicle. Remember, the seller is liable only for all non-disclosed defects that the seller actually and specifically knew about before the sale of the property.

VI. DAMAGES AVAILABLE UNDER THE DISCLOSURE ACT

The Disclosure Act details the remedies available to the buyer through the judicial process. The statute allows the purchaser to recover in a civil action for the failure of the seller to provide the disclosure statement to the buyer and for the failure to disclose defects. The amount of recovery available to the

buyer is limited to the amount of actual damages incurred by the buyer. This includes the costs of repairing the defect suffered by the buyer, and any diminution in value of the home after the repairs have been completed. The Act specifically excludes exemplary damages. This should not scare off attorneys from representation, as the Act does give the prevailing party court costs and reasonable attorney fees.

VII. INDEPENDENT INSPECTOR LIABILITY

It is common for a prospective buyer of a property to retain an independent third party professional inspector. This is usually recommended by realty and mortgage companies. With the death of the doctrine of caveat emptor, the buyer has many more remedies. Unfortunately, the inspectors do not always find problems that become evident soon after the buyer takes possession of the property. If action against the seller of the property is not available or not worthwhile, there may be a cause of action against the professional inspector. Professional inspectors are mandated to have some form of liability insurance. Even though the Disclosure Act does not have any direct relation to the liability of a professional property inspector, this question often arises at the same time, so it is worth a quick review in this setting.

The inspector has a duty to perform his services competently. A professional inspector is licensed by the state. A licensed professional has to maintain a professional standard. When the report says that no evidence of a defect has been noticed, there should not be a defect. If a defect is discovered in an area that was inspected, and should have been apparent to a professional, the inspector's liability should come into question. A new inspector should be retained and questioned about the defect, and whether or not it should have been included in the original inspection report. If it is obvious that a proper inspection should have made note of the defect, the negligent inspector may be held liable.

Reported cases of inspector negligence is somewhat rare in Oklahoma. In the case of Brown v. State Farm, the court found that an inspector was liable to a third party. The inspector had conducted an investigation for the insurance company, who then denied the claimant's insurance claim based upon the inspector's report. It turns out that the inspector was negligent in his investigation, and since it was foreseeable that the claimant would be reliant upon the report, the inspector therefore owed a duty of care to the claimant. An inspector does not always have to be right, but the inspector does need to perform his job competently.

The Oklahoma courts have also tackled this topic in the case of Cleveland v. Dyn-A-Mite Pest Control. In this case, the purchasers of the house were supplied a termite inspection report from the sellers. The report indicated that there was not any evidence of infestation at the time of the inspection. The court found for the plaintiffs, holding Dyn-A-Mite Pest Control liable for the damages caused by the infestation. It turns out that Dyn-A-Mite Pest Control had previously and repeatedly treated the home for termite infestations. The infestation problems that Dyn-A-Mite Pest Control knew about were not mentioned on the termite infestation report. The court noted that the inspection was contracted by the sellers of the property, but that because Dyn-A-Mite Pest Control knew potential buyers would be relying upon the report they are liable to the buyer for damages caused by the negligent report.

VIII. CONCLUSION

Full and complete honesty is what is required by the Oklahoma Residential Property Disclosure Act. When a seller is filling out the disclosure form, it is best to just be as transparent as possible concerning the problems associated with the property. While it may not entice quite as many lucrative offers from prospective buyers, it will save money in the long run. Litigation ensuing from a seller's failure to disclose can be very expensive to defend. If the seller loses, not only does the seller have to pay their own attorney's fees, but also the plaintiff's attorney fees, on top of the actual damages in the matter. If you are the seller of residential property, it is best to make sure that the buyer has been notified of all problems or defects of the property.

Shelton, Douglas J. The Sharp Sword of Residential Property Disclosures, The Oklahoma Bar Journal, Vol. 75 No. 15, p. 1391-1401, 5/15/2004

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1.Brown v. State Farm, 58 P.3d 217 (Okla. Civ. App. 2002)

Cleveland v. Dyn-A-Mite Pest Control, 57 P.3d 119 (2002); see also: Horsch v. Terminix, 865 P.2d 1044 (1993).