Hidden-But-Discoverable Defects: Resolving the Conflicts between Real Estate Buyers and Brokers

Kevin C. Culum
HIDDEN-BUT-DISCOVERABLE DEFECTS: RESOLVING THE CONFLICTS BETWEEN REAL ESTATE BUYERS AND BROKERS

Kevin C. Culum*

I. INTRODUCTION

Courts have had difficulty establishing the parameters of brokers’ duty to disclose to buyers the physical defects of residential real property. Often judicial analyses confuse this area of law by juxtaposing rigid and outdated principles, such as caveat emptor, against contemporary policy objectives, such as informing consumers. The confusion often results in internally inconsistent decisions, thwarting the desired policy goals. This comment proposes to discard current judicial analyses in favor of an analysis based on the reasonable expectations of both buyers and brokers. The proposed analysis combines tort causes of action for broker misrepresentations with a broker’s duty to inspect property for hidden-but-discoverable defects.

* I would like to thank Zane K. Sullivan, Attorney at Law, Missoula, Montana, and Professor Robert G. Natelson, School of Law, University of Montana, for their advice and comments without which I could not have completed this comment. Any omissions or errors, however, are strictly my own.

1. This comment uses the term “broker” to connote both real estate brokers and agents. The Montana Code Annotated defines the term “broker” as follows:

“Broker” includes an individual who for another or for a fee, commission, or other valuable consideration or who with the intent or expectation of receiving the same negotiates or attempts to negotiate the listing, sale, purchase, rental, exchange, or lease of real estate or of the improvements thereon or collects rents or attempts to collect rents or advertises or holds himself out as engaged in any of the foregoing activities. The term “broker” also includes an individual employed by or on behalf of the owner or lessor of real estate to conduct the sale, leasing, subleasing, or other disposition thereof at a salary or for a fee, commission, or any other consideration. The term “broker” also includes an individual who engages in the business of charging an advance fee or contracting for collection of a fee in connection with a contract by which he undertakes primarily to promote the sale, lease, or other disposition of real estate in this state through its listing in a publication issued primarily for this purpose or for referral of information concerning real estate to brokers, or both, and any person who aids, attempts, or offers to aid, for a fee, any person in locating or obtaining any real estate for purchase or lease.


Published by The Scholarly Forum @ Montana Law, 1989
Consumerism has motivated reforms in this area of law. This comment, therefore, focuses solely on residential real property and does not address problems involved in detecting and disclosing defects in commercial property. The comment begins by outlining policy objectives pursued by courts today. This comment then traces the misrepresentation theories which courts have used to encourage broker disclosure and the theories' effectiveness in achieving those policy objectives. The comment then proposes a judicial or legislative imposition of a broker's duty to inspect that would succeed in aiding buyers without excessively increasing the burden placed on brokers, and an analysis that courts should use when determining a broker's liability for failing to detect or disclose defects. Finally, the comment concludes by outlining the logistical considerations Montana must address before courts may effectively implement the proposed analysis.

II. BACKGROUND

A. Historical Development of Broker Liability

During the latter half of the nineteenth century with the federal government's freeing of large tracts of land from the public domain, the brokerage business developed meteorically, and with it legal controversies. Unfortunately, the development of common-law responses to these controversies did not keep pace with the growth of the brokerage business. Therefore, courts disposed of these controversies by using established legal principles, particularly caveat emptor and agency theory.

Although these principles continue to pervade brokerage law, they fail to reflect market realities and society's view of the broker. Most people contact a real estate broker as a matter of course when deciding to purchase property, and most buyers believe the broker represents them in a real estate transaction. Regrettably, brokers derive little incentive from the market to perform obligations for the buyer's benefit such as providing material information. To fulfill buyers' and brokers' reasonable expectations, Montana should adopt a legal framework founded in policy to analyze broker torts.

3. Id. at 2.
4. See, e.g., McLennan v. Inv. Exch. Co., 170 Mo. App. 389, 394, 156 S.W. 730, 732 (1913) (interpreting broker's duties by analogy to caveat emptor and agency principles); Estes v. Crosby, 171 Wis. 73, 79, 175 N.W. 933, 935 (1920) (actions of agent gave rise to broker liability).
5. See Dugan v. Jones, 615 P.2d 1239, 1248 (Utah 1980) (broker has an absolute duty of loyalty to the principal/seller).
Developing a sound legal framework requires understanding the conflicting expectations of the buyer and the broker in a real estate transaction. Given that buyers believe brokers represent them, buyers expect that brokers will obtain and disclose all available material facts. Buyers premise these expectations on brokers’ presumed integrity and knowledge of real estate. Buyers therefore rely on brokers to advise them on the merits of the property’s physical characteristics. Conversely, brokers are chiefly concerned with realizing a profit and regard any imposition on them of a legal obligation to buyers as a threat to their profit margin. A realistic policy, though, can recognize broker obligations to buyers and still minimize the costs resulting from the obligations. Brokers should not expect to continue to enjoy their historical immunity from buyers’ causes of actions, but they do have a right to expect to know precisely what conduct the law demands of them. Once brokers understand their legal obligations to buyers, brokers can minimize their liability, and thereby reduce their costs.

Several policy considerations compel the law to fulfill both parties’ expectations by imposing obligations to the buyer from the broker. First, clarifying the broker’s obligations to the buyer will not only fulfill the broker’s expectations, but will also increase the professionalism of the industry. Imposing consistent professional standards will help eliminate brokers from the industry who now profit from the law’s current vagueness by satisfying the law’s bare minimum. Second, by granting the broker a license, a state essentially grants the broker a profitable franchise. States therefore have a duty to “regulate [the broker] and, thus, protect the public against abuses which can occur within the real estate business.” Third, of the two parties, the broker is better able to obtain material information concerning the property. Thus, equity demands placing this responsibility on the broker. Fourth, because the placing of this responsibility on brokers would increase buyers’ available information, it


8. Ninety-five percent of buyers rely on brokers to some degree, specifically because of brokers’ “knowledge of the housing market.” NATIONAL FAMILY OPINION, INC., BUYER QUESTIONNAIRE 16 (Dec. 1979 to Jan. 1980) [hereinafter QUESTIONNAIRE], reprinted in FTC REPORT, supra note 6.

9. As one survey showed, over two-thirds of buyers relied on the broker to some degree “to discover structural defects.” QUESTIONNAIRE, supra note 8, at 17.


12. See Tennant v. Lawton, 26 Wash. App. 701, 615 P.2d 1305 (1980). In this often cited case, the court stated that the policy behind identifying a duty from a broker to a buyer is that the broker “is a professional who is in a unique position to verify critical information given him.” Id. at 708, 615 P.2d at 1309.
would necessarily raise the level of the real estate market's efficiency. Finally, because brokers derive profit from real estate transactions, it is only just that the brokerage industry internalize and bear the cost when brokers fail to meet their professional standard.

For the preceding policy reasons, courts and legislatures should demand that brokers disclose to buyers "facts materially affecting the value or desirability of the property that are known to [them] or which through reasonable diligence should be known to [them]."\(^6\) Policy compels, therefore, two separate broker obligations; first, the duty to disclose to the buyer all available information, and second, the affirmative duty to obtain information for the buyer. Currently, a majority of jurisdictions concentrate solely on the first, and base their analyses on misrepresentation torts.\(^6\) A limited number of jurisdictions, however, do extend the broker's obligations to the buyer to the affirmative duty to obtain information.\(^17\)

C. The State of the Law in Montana

Montana belongs to the majority of jurisdictions which recognize misrepresentation torts in a buyer-broker transaction. In *McCarty v. Lincoln Green, Inc.*,\(^18\) the Montana Supreme Court adopted negligent misrepresentation as a cause of action for a buyer against a broker.\(^19\) In *McCarty*, the buyer relied on the broker's inaccurate representations concerning the property's acreage.\(^20\) Since *McCarty*, the Montana Supreme Court has not again addressed broker liability for a negligent misrepresentation.\(^21\) However, in the recent case of *Wagner v. Cutler*,\(^22\) the court imposed liability on a seller for negligently misrepresenting the con-


17. Easton, 152 Cal. App. 3d at 100, 199 Cal. Rptr. at 388. See generally Amato, 98 N.M. at 233, 647 P.2d at 435 (broker must have general knowledge of building code and use it to obtain information for the buyer); Bevins v. Ballard, 655 P.2d 757, 763 (Alaska 1982) (broker can fulfill duty by investigating seller's statements); Menzel v. Morse, 362 N.W.2d 465, 479 (Iowa 1985) (Wolle, J., dissenting).


20. Id. at ___, 620 P.2d at 1224.


dition of a home. The Montana Supreme Court has not expressly adopted innocent misrepresentation torts in buyer-broker transactions. Finally, neither the Montana Supreme Court nor the Montana legislature has required the broker to augment a buyer’s information.

III. Buyers’ Theories of Recovery

Courts and legislatures now attempt to satisfy the objective of full and truthful disclosure of brokers’ statements through misrepresentation torts. These theories reflect traditional tort causes of action, and include intentional misrepresentation, negligent misrepresentation, and innocent misrepresentation. Silhouetting misrepresentation theories against a backdrop of the buyers’ and brokers’ expectations illustrates the failure of these theories to encompass the practical needs of buyers and brokers.

A. Intentional Misrepresentation

Intentional misrepresentation torts historically provided buyers their first theory of recovery against brokers for brokers’ affirmative misrepresentations designed to induce buyers to purchase residential real property. Brokers commit fraud when they fail to disclose material facts of which they have actual knowledge and on which the buyer justifiably relied. Eventually, courts recognized that intentional omissions may constitute fraud when the broker “is under a legal duty to speak.”

23. Id. at __, 757 P.2d at 783.
24. But see Parkhill v. Fuselier, ___ Mont. ___, 632 P.2d 1132 (1981). In Parkhill, the plaintiffs/buyers alleged innocent misrepresentation. In affirming the trial court’s holding, the Montana Supreme Court focused on the negligence of the agents of the defendants/sellers, and therefore left the issue of innocent misrepresentation unresolved. Id. at __, 632 P.2d at 1135.
25. But see Evans v. Teakettle Realty, ___ Mont. ___, 736 P.2d 472 (1987). In Evans, the trial court offered a duty to inspect instruction. However, neither party appealed the instruction which read as follows:

The duty of a real estate agent, representing the seller, to disclose facts, includes the affirmative duty to conduct a reasonably competent and diligent inspection of the residential property listed for sale and to disclose to prospective purchasers all facts materially affecting the value or desirability of the property that such an investigation would reveal. Id. at __, 736 P.2d at 475 (Sheehy, J., dissenting).

26. See Estes, 171 Wis. at 80, 175 N.W. at 935-36. In the early twentieth century, several buyers successfully sued brokers for their fraudulent statements about the actual purchase price. See, e.g., Hokanson v. Oatman, 165 Mich. 512, 517, 131 N.W. 111, 113 (1911) (buyer entitled to rely on broker representations). In time, courts applied fraud theory to misrepresentations concerning physical defects in housing. See, e.g., Wolford v. Freeman, 150 Neb. 537, 544, 35 N.W.2d 98, 102 (1948) (broker stated that cracks in walls and foundation resulted from simple “settling”).

27. Courts define a material fact as “one to which a reasonable person would attach importance in determining his choice of action in the transaction in question.” See, e.g., Lynn v. Taylor, 7 Kan. 2d 369, ___, 642 P.2d 131, 134-35 (1982).

29. Lynn, 7 Kan. 2d at ___, 642 P.2d at 134 (broker failed to disclose to buyer the
B. Negligent Misrepresentation

After prohibiting brokers from committing an intentional misrepresentation, courts broadened the scope of the broker's duty to provide the buyer with information by adopting negligent misrepresentation theory.\(^\text{30}\) Negligent misrepresentation imposes on brokers a duty to exercise reasonable care in "obtaining and communicating information which the [buyer] is justified in expecting . . . ."\(^\text{31}\) Beyond conveying such material information, the broker need not answer further questions propounded by the buyer.\(^\text{32}\) Although owing no duty to answer these questions, brokers may choose to offer an answer to the question. When they do, brokers assume a duty to respond accurately, and a misrepresentation will give rise to negligent misrepresentation liability.\(^\text{33}\) Negligent misrepresentation provides an incentive for brokers to be honest when inducing buyers to purchase property.

Should the Montana Supreme Court consider expanding the negligent misrepresentation tort, it should examine the dramatic range in application of the tort from jurisdiction to jurisdiction.\(^\text{34}\) For example, some courts require the buyer to demonstrate the broker's actual knowledge of the defect, blurring the distinction between fraud and negligent misrepresentation.\(^\text{35}\) Conversely, certain jurisdictions exact a high duty of care results of an adverse termite report).

\(^{30}\) The \textit{Amato} court quoted the \textit{Restatement (Second) of Torts} § 552(1) (1977) as follows:

One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise \textit{reasonable care or competence in obtaining or communicating the information}.

\textit{Amato,} 98 N.M. at 232, 647 P.2d at 434 (emphasis added by court).

Montana adopted the tort of negligent misrepresentation as a cause of action for buyers against brokers in \textit{McCarty,} ___ Mont. at ___, 620 P.2d at 1224. For a more detailed discussion, see supra notes 18-23 and accompanying text.


\(^{32}\) Courts have criticized the actual knowledge standard for negligent misrepresentation because it discourages the broker from offering to the buyer information not specifically requested. As one court stated, "If a broker were required to disclose only known defects . . . he would be shielded by his ignorance of that which he holds himself out to know." \textit{Easton}, 152 Cal. App. 3d at 100, 199 Cal. Rptr. at 388. Another critic noted that negligent misrepresentation theory allows "brokers to misrepresent material aspects of the property in question with impunity unless the buyer" can show actual or constructive knowledge. \textit{Hoffman v. Connall,} 108 Wash. 2d 69, 82, 736 P.2d 242, 248 (1987) (Dore, J., dissenting).

\(^{33}\) \textit{Fennell Realty Co. v. Martin,} 529 So.2d 1003, 1005 (Ala. 1988) (exception to Alabama's general rule of \textit{caveat emptor}).

\(^{34}\) The \textit{Wagner} decision indicates Montana may lean toward a broader interpretation of negligent misrepresentation when faced with the issue again. \textit{Wagner,} ___ Mont. ___, 757 P.2d 779.

\(^{35}\) \textit{See Hammond v. Matthes,} 109 Mich. App. 352, 311 N.W.2d 357 (1981). The \textit{Hammond} court held that "the [buyer] must show the additional element that the agent made the questionable representation knowing it to be false or made it recklessly without knowl-
that actually imputes knowledge to brokers. These examples demonstrate the broad spectrum of applications from which Montana may develop further the tort of negligent misrepresentation.

C. Innocent Misrepresentation

Some jurisdictions impose liability on brokers for innocently conveying false information which materially affects the buyer's decision to purchase the residential real property. In these cases, brokers innocently passed on to buyers the false representations the sellers had made to the brokers. Courts apply this tort by focusing on two aspects of the buyer-broker transaction. First, courts hold brokers liable for the misrepresentation because they implied personal knowledge of the statements' veracity. This pretense of knowledge effectively replaces the knowing or negligence element of the other misrepresentation analyses. Second, courts justify holding brokers liable for these innocent misrepresentations by choosing between the two equally innocent parties, buyer and broker.

edge of its truth . . . ." Id. at 359, 311 N.W.2d at 361. See also Provost v. Miller, 144 Vt. 67, 473 A.2d 1162 (1984). In Provost, the court relieved the broker from liability by stating, "An agent is not liable because of misrepresentations of the principal or of another agent unless [the broker] knows or should know of them." Id. at 69, 473 A.2d at 1163 (quoting RESTATEMENT (SECOND) OF AGENCY § 348 comment b (1958)) (emphasis supplied).

36. Amato, 98 N.M. at 233, 647 P.2d at 434 (broker is assumed to know the building code).


38. In Bevins, the court quoted the RESTATEMENT (SECOND) OF TORTS § 552C(1) as follows:

One who, in a sale, rental or exchange transaction with another, makes a misrepresentation of a material fact for the purpose of inducing the other to act or to refrain from acting in reliance upon it, is subject to liability to the other for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation, even though it is not made fraudulently or negligently.

Bevins, 655 P.2d at 762.

In Wisconsin, the courts recognize an action for buyers against brokers in strict responsibility for misrepresentation. This tort resembles the more common tort of innocent misrepresentation, and its elements are as follows:

(1) that the [broker] made a representation of fact; (2) that such representation of fact was untrue; (3) that the [broker] made the representation as a fact based on his own personal knowledge, or in circumstances in which he necessarily ought to have known the truth or untruth of the statement; (4) that the [broker] had an economic interest in the transaction; and (5) that the [buyer] believed such representation to be true and relied on it.

Reda v. Sincaban, 145 Wis. 2d 266, —, 426 N.W.2d 100, 102 (1988) (emphasis supplied).

39. Bevins, 655 P.2d at 763. 40. Id. at 762.

41. Id. at 763. See also Gauerke, 112 Wis. 2d at 282, 332 N.W.2d at 809. The Gauerke court stated, "Public opinion calls for placing the loss on the innocent [broker] rather than on the innocent [buyer]" when the broker has an "economic interest in the transaction" from which the broker expects to gain. Id.
This second aspect connotes a strict liability standard.\textsuperscript{42} Courts, however, have not yet focused solely on strict liability when imposing liability on brokers for innocent misrepresentation, explaining that brokers had the alternative of "disclaiming" knowledge rather than making a misrepresentation.\textsuperscript{43}

If Montana courts extend the tort of innocent misrepresentation to broker statements, Montana must adopt both prongs of the analysis. Business decisions of brokers often hinge on the risk of exposure to liability, the cost of verifying information, and the potential for increased sales based on information inducing buyers to buy the property. Extension of the scope of brokers' liability to strict liability may actually reduce the amount of information available to buyers. Under strict liability, the risk of exposure may outweigh the other two factors, motivating brokers to "disclaim" any knowledge about the property and to refrain from making any representation concerning it.

Even though jurisdictions applying innocent misrepresentation continue to focus on both prongs of the analysis, including the brokers' pretense of knowledge, courts nonetheless fail to encourage brokers to provide buyers with available and accurate information. Courts offer brokers two alternatives to avoid liability, disclaiming knowledge or "investigating" sellers' statements.\textsuperscript{44} The first alternative in such jurisdictions, brokers disclaiming knowledge, certainly does not fulfill the objective of increasing the buyer's information.\textsuperscript{45} These courts enumerate only one other alternative for brokers, to "investigate" sellers' representations or to require sellers to "certify" their statements.\textsuperscript{46} However, this alternative amounts to no more than obtaining a warranty from the seller.

\textbf{D. Misrepresentation Theory Analysis}

Misrepresentation torts standing alone do not satisfy the objective of increasing buyers' available information because misrepresentation theories do not demand from brokers the affirmative duty to acquire accurate information for the buyer.\textsuperscript{47} Arguably, innocent misrepresentation theory may encourage brokers to "investigate" sellers' statements, but it does not compel such an investigation.\textsuperscript{48} Because misrepresentation theories promote veracity in broker representations, however, a comprehensive analysis of broker-buyer transactions in Montana must necessarily include intentional and negligent misrepresentation tort causes of action.

\textsuperscript{42} Hoffman, 108 Wash. 2d at 73-74, 736 P.2d at 244 (rejecting innocent misrepresentation); Bevins, 655 P.2d at 764 (Connor, J., dissenting).

\textsuperscript{43} Bevins, 655 P.2d at 763.

\textsuperscript{44} Id.

\textsuperscript{45} Id.

\textsuperscript{46} Id. Arguably, this investigation could conflict with brokers' absolute duty of loyalty to a seller/principal. See Dugan, 615 P.2d at 1248 (Utah).

\textsuperscript{47} Each theory bases liability solely on a material misrepresentation, rather than on breaching a duty to acquire information.

\textsuperscript{48} See, e.g., Bevins, 655 P.2d at 763.
IV. DUTY TO INSPECT

A. The Judicial Version

In the landmark decision of *Easton v. Strassburger*, a California appellate court extended a broker's duties to include inspecting property for defects that the broker should discover through "reasonable diligence." The *Easton* court stated that certain soil problems on the property should have alerted the broker that he needed to inspect the property for hidden defects. Because the broker failed to detect and disclose these soil problems, the court imposed liability on the broker. The *Easton* court defined the soil problems as hidden from the buyer, but discoverable by the broker, thus defining an essentially hidden-but-discoverable defect.

Both buyers and brokers, the *Easton* court presupposed, have a duty to inspect the property involved in a transaction. The buyer, however, lacks the expertise to detect and discover hidden-but-discoverable defects. The broker, who has "superior knowledge, skills and experience," on the other hand, should be able to detect and discover such defects. Although the *Easton* court established for brokers the duty to make a "reasonably competent and diligent inspection," the court exempted brokers from disclosing "manifest" defects. The court reasoned that if a buyer fails to detect these "manifest defects" upon an inspection of the property, then the buyer's own failure would be the sole "proximate cause of any injury [the buyer] suffered." The *Easton* court could have completed a sound analysis by expressly stating that because brokers are unable to detect latent defects, brokers should not bear the risk of liability for those defects.

B. Legislative Solutions

Recently the California legislature codified the *Easton* rule by requir-
ing all brokers to inspect residential real property, and answered many of the unresolved questions of the *Easton v. Strassburger* decision.\(^{58}\) The legislature, therefore, provided specific precepts founded on policy which the common law had lacked in buyer-broker disclosure controversies.\(^{59}\) The California statute limits the broker's duty to a *visual* inspection of the property,\(^{60}\) and the inspection includes only those "areas that are reasonably and normally" accessible "to such an inspection."\(^{61}\) For example, a broker's duty includes inspecting the walls, floors, and roof, but does not include an inspection of the water main. Further, California's statute incorporates a "reasonably prudent" real estate broker standard, requiring brokers to use the knowledge obtained through "education, experience, and examination" when inspecting property.\(^{62}\) By defining the duty, the legislature not only put brokers on notice of their obligation to buyers, but also specified the obligation. In return for this exacting obligation, the legislature acknowledged brokers' professional status, a recognition inherent in the *Easton* decision.

Although California's statute furthers the availability of information to buyers, it also permits confusion by interchanging the words "investigate" and "inspect."\(^{63}\) By equating the words, the statute arguably broadens the scope of the duty to inspect from assuring that buyers benefit from brokers' special expertise to acts such as investigating the public record. Legislation compelling a broker to inspect property should limit its scope to a *visual* inspection of the property itself, and should not include in the duty to inspect those acts which exceed the broker's unique ability to benefit a buyer.\(^{64}\) Brokers do not solely possess the knowledge

---

58. **CAL. CIV. CODE** § 2079-2079.5 (West Supp. 1989). **CALIFORNIA CIVIL CODE** Section 2079 (West Supp. 1989) provides:

> It is the duty of a real estate broker . . . to a prospective purchaser of residential real property comprising one to four dwelling units . . . to conduct a *reasonably competent and diligent visual inspection* of the property offered for sale and to disclose to that prospective purchaser all facts materially affecting the value or desirability of the property that such an *investigation* would reveal, if that broker has a written contract with the seller to find or obtain a buyer or is a broker who acts in cooperation with such a broker to find and obtain a buyer.

(Emphasis supplied).

The California legislature expressly intended to codify *Easton v. Strassburger* and to "resolve and make precise" the scope of the duty to inspect. 1985 **CAL. STAT.** 223 § 4.

59. In *Smith v. Rickard*, 205 Cal. App. 3d 1354, 254 Cal. Rptr. 633 (1988), for example, the court relied on legislative intent to conclude that the statute does not require a broker representing a party to a commercial transaction to perform an inspection. *Id.* at __, 254 Cal. Rptr. at 636. *Smith* relied on the statement in *Easton* expressing "no opinion [on] whether a broker's obligation to conduct an inspection for defects for benefit of the buyer applies to the sale of commercial real estate" as the intent of the legislature which codified *Easton*. *Id.* (quoting *Easton*, 152 Cal. App. 3d 90, 102, 199 Cal. Rptr. 383, 390 n.8).

60. **CAL. CIV. CODE** § 2079 (West Supp. 1989).
64. *See Gauerke*, 112 Wis. 2d at 281, 332 N.W.2d at 806 (liability for misrepresentation of property's acreage); *Hoffman*, 108 Wash. 2d at 70-71, 736 P.2d at 242-43 (broker not
to detect defects in the public record or to project the property's commercial capability. Rather, professions such as title insurers, surveyors, and economists offer buyers the requisite expertise in these areas. Moreover, buyers must assume certain of the economic risks involved in the purchase of property because they receive the benefit of any economic boon that may occur.

If Montana chooses to enact a statutory duty to inspect, the Montana legislature should restrict broker liability solely to hidden-but-discoverable defects. Moreover, Montana courts should limit brokers' liability to defects patent upon a broker's expert inspection and preserve the hidden-but-discoverable distinction. Historically, common law had defined patent defects as "apparent" or "obvious" upon a visual inspection, and latent defects as "not visible" upon a visual inspection. Because latent defects by definition cannot be detected even by the brokers' expert eyes, such defects are not hidden-but-discoverable defects, and should exceed the scope of the duty to inspect.

V. A PROPOSED BROKER DUTY TO INSPECT FOR MONTANA

Satisfying both the buyer's expectation of more accurate information about residential real property and the broker's expectation of a defined course of conduct warrants that Montana be the first state to follow California's lead and expressly adopt, judicially or legislatively, a broker's liability for discrepancy in the property's boundary.


66. See infra notes 85-87 and accompanying text for a discussion of the definition of a hidden-but-discoverable defect.

67. The California statute explicitly states, for example, that:
Nothing in this article relieves a buyer or prospective buyer of the duty to exercise reasonable care to protect himself or herself, including those facts which are known to or within the diligent attention and observation of the buyer or prospective buyer.

68. A patent defect is defined as: "In sales of personal property, one which is plainly visible or which can be discovered by such an inspection as would be made in the exercise of ordinary care and prudence." BLACK'S LAW DICTIONARY 1013 (5th ed. 1979).

69. A latent defect is defined as: "One which could not be discovered by reasonable and customary inspection; one not apparent on face of goods, product, document, etc." BLACK'S LAW DICTIONARY 794 (5th ed. 1979).

70. By refusing to impose liability on the broker for such latent defects, Montana can adhere to the sound analysis first described in Easton. Several courts impose liability on brokers for latent defects because these courts fail to analyze what kinds of defects brokers should detect. Further, courts should analyze what defects buyers should detect. This analysis would explain how certain defects can be apparent or patent to brokers, and yet be latent or not visible to buyers. See Munjal v. Baird & Warner, Inc., 138 Ill. App. 3d 172, 182, 485 N.E.2d 855, 864, (1985) (describing the defect as a latent defect which the broker had an obligation to detect and disclose); Ernestine v. Baker, 515 So.2d 826, 827-28 (La. 1987) (imposing liability on broker for a latent defect which the broker had discovered).
duty to inspect the property he or she sells. Coupling a duty to inspect with the already adopted misrepresentation torts will provide Montana the two legs of analysis necessary to resolve the conflict between brokers’ and buyers’ expectations in a real estate transaction. Montana’s duty to inspect, moreover, must conform to brokers’ professional standards and must specify visual inspections of the property.

A. Brokers’ Professional Standards

When courts speak of “broker expertise,” they acknowledge that brokers have risen to an advantageous position in the real estate market. Unlike buyers, brokers are involved in countless real estate transactions a year, and therefore conduct numerous inspections of property every year. Buyers rely on brokers precisely because of this experience and training. Buyers perceive that the licensing requirements of brokers and their constant involvement with residential real property must breed in them “expertise.” Indeed, it is this expertise which buyers solicit when contacting a real estate broker.

Brokers also view their unique professional standards as the source of society’s need for them. When an occupation finally attains the stature of a profession, the profession regulates itself by reprimanding individuals who fail to satisfy the professional standard of care, by submitting to governmental licensing requirements, and by expanding the professional knowledge within the profession. Imposing a duty to inspect will appropriately encourage these elements of professionalism which buyers and brokers themselves already recognize.

Proving a breach of the duty to inspect will necessitate proof of the breach of brokers’ professional standards. The Easton decision and the California statute, for example, both state that a broker’s inspection must be “reasonably competent and diligent,” connoting a flexible standard of professional competence and expertise. Self-regulation, moreover, as-


72. In Menzel the court quoted the RESTATEMENT (SECOND) OF TORTS § 299A as follows:

Unless he represents that he has greater or less skill or knowledge, one who undertakes to render services in the practice of a profession or trade is required to exercise the skill and knowledge normally possessed by members of that profession or trade in good standing in similar communities.

Menzel, 362 N.W.2d at 471 (Iowa).

The Menzel court also elaborated extensively on the merits of brokers’ professional standard. Id.

73. CAL. CIV. CODE § 2929 (West Supp. 1989); Easton, 152 Cal. App. 3d at 99, 199 Cal.
sumes that only fellow professionals can recognize a colleague’s failure to meet the professional standard. Therefore, buyers who seek damages from brokers for breach of the duty to inspect will require expert testimony from other brokers to satisfy their burden of proof. Such expert testimony would show whether, given applicable professional standards, the broker should have detected the complained-of defect in the inspection. The stringency of brokers’ professional duty will depend mainly on brokers themselves, but the Montana courts and legislature can demand as a minimum the duty to inspect the property visually. To fulfill this duty, brokers should inspect those “areas reasonably and normally” accessible upon inspection, and detect and disclose hidden-but-discoverable defects in a report filed with the listing agreement. Because the scope of the duty to inspect extends only to detecting and disclosing hidden-but-discoverable defects, it relieves brokers of the obligation to detect latent defects and to disclose “manifest defects.”

When imposing the duty to inspect, Montana should consider the array of professional standards developed in other jurisdictions. Such standards mandate, for example, that odors or noises give rise to a further duty of inquiry. Montana could certainly require brokers to inspect residential real property with “a general knowledge of the building code.” If brokers have a working knowledge of the building code, they will more likely recognize violations suggesting a hidden-but-discoverable defect. In evaluating additional standards, the Montana courts and legislature should also examine the current licensing requirements for brokers for adequacy, particularly the education and experience requirements. Moreover, any statutory adoption of broker standards should be sufficiently flexible to permit the judiciary to recognize advances made in the profession and to fashion the duty accordingly.

B. Definitions

Consistent imposition of the duty to inspect will require distinguishing between manifest, hidden-but-discoverable, and latent defects. Defects which buyers should recognize upon a visual inspection are manifest defects; defects which brokers should recognize upon visual inspection are hidden-but-discoverable, and those defects which neither broker nor

Rptr. at 388.
74. CAL. CIV. CODE § 2079.3 (West Supp. 1989).
75. See infra Section VI for a discussion of the inspection report.
76. Ernestine, 515 So.2d at 826-27 (La.) (broker liable for odors emitted from property after receiving notice from a prospective purchaser).
77. Amato, 98 N.M. at 233, 647 P.2d at 435. In practice, this requirement may exceed the California standard because building defects may not normally be visible upon inspection.
79. Easton, 152 Cal. App. 3d at 103, 199 Cal. Rptr. at 391.
80. Id., at 99, 199 Cal. Rptr. at 388.
buyer can recognize upon a visual inspection are latent.

1. Manifest Defects

In Easton v. Strassburger, the court noted that certain defects are "apparent" or "manifest" on a buyer's inspection, relieving the broker from liability for failure to disclose such defects. Unfortunately, the Easton court did not elaborate on these manifest defects. Recently, though, the Montana Supreme Court provided guidance in Wagner v. Cutler. In that case, the court listed several "noticeable defects" the buyer should have detected when inspecting the property. Because the buyer failed to detect these defects, the buyer had no recourse against the broker for those defects. Such defects included an "unfinished basement, unfinished steps leading to the basement, light fixtures which were not in their sockets, cracks in the patio pavement, and incomplete heating ducts." In Wagner, the Montana Supreme Court sent a clear message to buyers to inspect residential real property for "obvious" flaws that all people, regardless of expertise, must recognize as a defect.

2. Hidden-But-Discoverable Defects

Because brokers have professional expertise in inspecting residential real property, brokers can detect upon their inspection defects which buyers cannot. These hidden-but-discoverable defects fall into three basic categories: (1) foundation problems, including termite damage and warping and cracking of floors; (2) general structural problems, including warped doorways, out of plumb walls, and possible asbestos contamination; and (3) indications of major problems including leaking pipes suggesting plumbing problems, wall damage or roof damage indicating flood problems, apparent soil problems such as those in Easton v. Strassburger, and any detectable problems with water or heating capacity.

81. Id. at 103, 199 Cal. Rptr. at 391.
82. Wagner, ___ Mont. at ___, 757 P.2d at 783.
83. Id. at ___, 757 P.2d at 781.
84. Id. at ___, 757 P.2d at 783.
85. See Easton, 152 Cal. App. 3d at 96, 199 Cal. Rptr. at 385 (cracked walls and warped doorways); Godfrey 128 Cal. App. 3d at 165, 180 Cal. Rptr. at 100 (termite damage and dry rot); Prichard v. Reitz, 178 Cal. App. 3d 465, 467, 223 Cal. Rptr. 734, 735 (foundation problems); Lynn, 7 Kan. 2d at ___, 642 P.2d at 134 (termite damage).
86. See Bevins, 655 P.2d at 759 (Alaska) (insufficient well water); Menzel, 362 N.W.2d at 468 (Iowa) (walls "out of plumb," improper floor support and ventilation, and obvious violations of building codes); Cory v. Carone, 527 So.2d 495, 496 (La. 1988) (noticeable crack in bathroom floor did not indicate crack in the foundation); Amato, 98 N.M. at 232, 647 P.2d at 434 (property condemned); Dawson, 733 P.2d at 409 (Okla.) (cracks in the driveway, and a separation between the frame of the garage door and the bricks); Pacific Northwest, 51 Wash. App. at 698, 754 P.2d at 1265 (landfill prevented commercial development).
87. See Blackmon v. First Real Estate Corp., 529 So.2d 955, 956 (Ala. 1988) (sewage problems); Fennell Realty, 529 So.2d at 1004 (Ala.) (heating and air conditioning system); Ernestine, 515 So.2d at 827 (La.) (leaking roof); Munjal, 138 Ill. App. 3d at 174, 485 N.E.2d at 858 (flooding problems); Neff, 89 N.M. at 147, 548 P.2d at 109 (heating and cooling sys-
3. Latent Defects

Finally, some defects remain undetectable or "latent" regardless of who inspects the property. To encourage detection of hidden-but-discoverable defects, courts and legislatures must exclude these latent defects from the brokers' duty to inspect and disclose. Brokers should not bear liability for latent defects. Latent defects may include sewer or water pipes breaking without warning, a furnace exploding without previously exhibiting a noticeable defect, or toxic seepage imperceptible during the broker's inspection. Regardless of how the law treats these physical types of defects, the law should not demand from brokers the duty to inspect the public record for "defects" such as inaccurate acreage figures.

C. Proposed Analysis

Legislative or judicial adoption of the broker's duty to inspect requires a new, three-step analysis of broker liability. The analysis focuses first on the buyer's responsibility to inspect the residential real property, then on the broker's duty to inspect, and finally on any alleged broker misrepresentations. Examining the buyer's responsibility to inspect the property and the buyer's conduct while performing the inspection should reveal if the alleged defect was manifest. If so, the analysis proceeds directly to the third step of the analysis, possible broker misrepresentations. However, if the defect was not manifest, then a court should turn to the second step, an analysis of the broker's inspection. In this step, a court should first review the broker's inspection report, which would clearly demonstrate whether the broker's inspection revealed the defect. In addition, the report would supply a summary of the procedures the broker used to detect defects. This step is crucial because it would encourage uniformity in broker conduct. Finally, after analyzing the buyer's and broker's inspections, a court should focus on any intentional or negligent misrepresentations that the broker may have made. Three examples of possible holdings demonstrate how a court could use this analysis to impose liability with appropriate regard for the policy considerations underlying the categories of defects.

1. Manifest Defects

If the basement is unfinished yet the buyer still chooses to purchase the home, then the buyer should have no recourse against the broker for negligently inspecting the property. However, if the broker or an agent makes any intentional or negligent misrepresentation concerning the property or the defect, the buyer should have an opportunity to recover damages under the third-step of the analysis for the misrepresentations which influenced the buyer's decision to purchase the property.

88. Easton, 152 Cal. App. 3d at 99, 199 Cal. Rptr. at 388.
2. Hidden-But-Discoverable Defects

If the broker's inspection report demonstrates that the broker discovered, for example, a foundation problem, then the court cannot impose liability on the broker for breaching the duty to inspect. However, the court must pursue the analysis, nonetheless, by turning to misrepresentation theories of recovery. The analysis should focus on whether the broker disclosed the foundation problem to the buyer. If the broker failed to disclose fully the foundation problem to the buyer, then the court should hold the broker liable for the defect under an intentional or negligent misrepresentation theory. If the broker, however, did disclose fully the discovered defect to the buyer, the court should address other alleged misrepresentations involving, for example, the extent of the defect. In the absence of such other allegations, the broker is free of liability for the defect. 89

If, on the other hand, the broker fails to demonstrate the discovery of the foundation problem, the broker may have breached the duty to inspect. The court should therefore review the broker's inspection procedures against the professional standards of care to determine if the broker breached these standards when inspecting the property. If so, the court should impose liability on the broker for breaching the inspection duty. 90 The court's analysis should also continue to the third step to determine whether the broker also made any intentional or negligent misrepresentations.

3. Latent Defects

In the final scenario, a court should acknowledge that a prudent broker could not have discovered, for example, that the water main supplying the home was about to rupture. A court should nevertheless review the broker's inspection report to ascertain whether the broker, for example, failed to recognize visible indications of the water main's condition. If such indications existed, then the defect was hidden-but-discoverable and the broker should have detected and disclosed it to the buyer. The court's analysis would not be complete without addressing any alleged intentional or negligent misrepresentations. If the broker fulfilled the professional standard of care when inspecting the property and made no intentional or negligent misrepresentations, the court should relieve the broker from liability for the latent defect.

VI. CONSIDERATIONS WHEN IMPLEMENTING THE PROPOSED ANALYSIS

A. Which Broker Should Perform the Inspection?

Because the listing broker has the first opportunity to inspect the

89. See Munjal, 138 Ill. App. 3d at 181-82, 485 N.E.2d at 863-64 (broker's disclosure of a hidden-but-discoverable defect relieved broker from liability).

90. See Easton, 152 Cal. App. 3d at 99, 199 Cal. Rptr. at 388.
premises, the listing broker should have the obligation to perform the ini-
tial inspection, and as promptly as possible. Providing the buyer with an
inspection report as soon as possible will accomplish the fundamental
policy objective of increasing information in the real estate market. After
inspecting the property, the broker should file the inspection report list-
ing all manifest defects, hidden-but-discoverable defects, and any areas
that may require further inquiry. A failure to use professional care in per-
forming the inspection should make the listing broker potentially liable to
the buyer for the breach of the duty to inspect even though the listing
broker may never have contact with the buyer.

The selling broker, on the other hand, should have the obligation to
disclose fully the information in the inspection report to the buyer. Any
failure to disclose should make the selling broker potentially liable for a
misrepresentation. Although the proposed analysis relieves the selling
broker from the duty to inspect the property, the analysis imputes
knowledge of the report’s contents to the selling broker. The analysis
thereby effectively simplifies the proof required of buyers when bringing a
misrepresentation tort.

Buyers will benefit from inspection reports only if they receive access
to the report. Therefore, brokers must provide all selling agents easy ac-

B. Performing the Inspection

It is only realistic to anticipate that many brokers will contract with
building inspectors to perform the inspections. These contracts will sup-
port a new business and may provide some of the expert testimony that
the brokers’ professional standard requires. However, courts and legisla-
tures must remain wary that the broker profession does not control the
inspection business. Licensing requirements for inspectors, prohibiting ret-
tainer agreements with brokers, and requiring brokers to disclose to buy-
ers the frequency with which the broker hires various inspectors may help
assure inspector independence.

C. Licensing Requirements

Currently, to receive a broker’s license an individual need only “have
graduated from an accredited high school or completed an equivalent ed-

91. The broker industry should adjust for this allocation of responsibility by making
listing brokers’ share of commissions commensurate with their greater responsibility.
92. A court may nonetheless impose liability on a selling broker for intentional or neg-
ligent misrepresentation if the selling broker actually detected a defect which the listing
broker failed to note in the report.
93. Of course, many buyers and brokers alike already retain building inspectors. Bro-
kers often, however, do not disclose the contents of the inspection reports to buyers, negat-
ing the benefit to buyers.
ucation” requirement, 94 “have been actively engaged as a licensed real estate salesman” for two years, 95 and complete a course of study totaling sixty hours which includes “the subjects of real estate principles, real estate law, real estate finance, and related topics.” 96 Although these qualifications may ensure that brokers fulfill their current duties, the Montana legislature should reevaluate the efficacy of these qualifications for satisfying the expanded duty. Sixty hours of classroom study may not ensure brokers will be able to detect hidden-but-discoverable defects as their clients expect.

VIII. CONCLUSION

This comment has proposed to supplant traditional broker tort analysis with a comprehensive analysis which reflects policy objectives consistent with today’s market realities. The expectations of the buyer for more accurate information conflict with the broker’s expectations to limit exposure to liability and reduce costs. The proposed analysis fulfills both parties’ expectations by increasing a broker’s duties to the buyer while simultaneously clarifying and specifying these duties. Given the policy objectives of fulfilling both broker and buyer expectations, the final framework of the proposed analysis must include for brokers both a duty to inspect and a duty to represent information accurately. The Montana Supreme Court has already recognized the representation duty of this analysis. A fair and comprehensive legal analysis, however, requires either legislative or judicial adoption of a clear and specific broker’s duty to inspect residential real property.

95. Mont. Code Ann. § 37-51-302(c) (1987). The Board of Realty Regulation may waive this experience requirement. Id.