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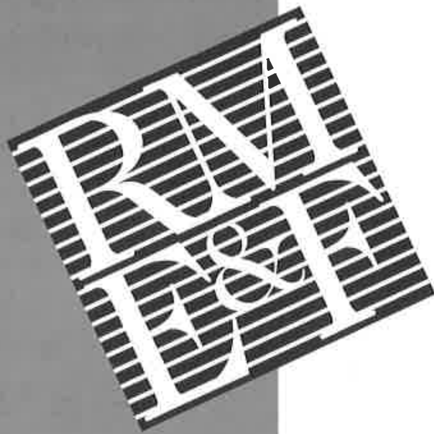

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HOME SELLERS HAVE A DUTY TO MAKE FULL DISCLOSURE

By Benjamin Weinstock and Joanne S. Agrippina

Thousands of homes are bought and sold in New York State each year, and every one of those transactions shares the overriding principle of caveat emptor - "let the buyer beware." The purchaser is charged with the responsibility of exercising due diligence to know what is being purchased. A seller's disclosure obligation is very limited. Absent active concealment or an affirmative misrepresentation by the seller, a purchaser has little or no recourse against a seller for defects later found to affect the property. *Glazer v. LoPreste,* 717 N.Y.S.2d 256 (2d Dep't 2000); *London v. Courduff,* 529 N.Y.S.2d 874 (2d Dep't 1988).

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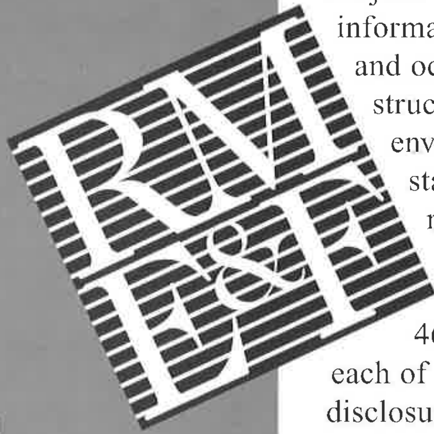
Until now that is. In a revolutionary departure from New York's seemingly staunch adherence to the longstanding rule of caveat emptor, Governor Pataki signed into law on November 13, 2001 the Property Condition Disclosure Act, *2001 N.Y. Laws 5339-A,* which will become effective on March 1, 2002. It heralds a dramatic shift of the burden of disclosure to the sellers of residential real property.

The Property Condition Disclosure Act (PCDA), will be embodied in Article 14 of the New York Real Property Law. It will require sellers of residential real property (excluding condominiums and cooperatives) containing up to 4 dwelling units to provide a disclosure statement to prospective purchasers detailing all known defects relating to the property. *Id.* at §462(2).

Sellers must complete and deliver this disclosure statement prior to a purchaser's acceptance of the contract of sale. *Id*. at §462(1). The disclosure statement consists of 48 questions to be answered by the seller based on the seller's actual knowledge, *id*. at §462(2), and covers a variety of



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subjects ranging from general information about the ownership and occupancy of the property, to structural, mechanical and environmental issues as well as statutory disclosure requirements such as federal lead-based paint and state agricultural matters. *Id.* at 462(2). Sellers must answer each of the questions in the disclosure statement with a response of "yes", "no", "unknown" or "not applicable" and a copy of the statement must be attached to the contract of sale. *Id.* at 462(2).

An earlier version of the PCDA was vetoed by Governor Pataki last year. In his memorandum to the Assembly disapproving the bill, the Governor cited several critical deficiencies in the Act.

For example, under the original bill, a seller would be responsible for including in a disclosure statement all conditions and information about which the seller had "constructive knowledge." This would require disclosure of conditions that a seller should have been aware of through due investigation, even if the seller had no actual knowledge of the condition.

Governor Pataki noted that of the 28 states that have enacted similar laws, not one included a constructive knowledge standard. The final version of New York's law omits that dubious standard.

The disclosure statement is not a warranty of any kind by the seller and should not be treated as a substitute for the purchaser's own independent inspections and tests of the property.

Actual Knowledge

Under the PCDA, sellers respond based only upon their "actual" knowledge at the time they sign the disclosure statement. *Id.* at §462(2). Going further, the PCDA expressly provides that sellers are not required to undertake or provide for any investigation or inspection of the property or any public records in connection with the giving of the disclosure statement. *Id.* at §462(3).

To the contrary, the PCDA warns prospective purchasers that the disclosure statement is not a warranty of any kind by the seller and should not be treated as a substitute for the purchaser's own independent inspections and tests of the property as well as the purchaser's own inspections of the public records pertaining to the property. *Id.* at §462(2).

Another significant objection voiced by the Governor in rejecting the original bill was that it did not provide purchasers with a meaningful remedy for a seller's failure or refusal to provide a disclosure statement. This objective appears not to have been addressed in the PCDA. Section §465(1) of the PCDA states that if a seller fails to provide a purchaser with the requisite disclosure statement, the purchaser is simply entitled to receive a $500 credit at closing. The statute does not create any further liability for a seller's non-compliance.

Surprisingly, the consequences of providing a disclosure statement could be far worse. Under the PCDA a seller who provides the disclosure statement could incur liability in two ways. First, where the statement contains a knowingly false or incomplete statement by the seller and, second, where a seller fails to provide the purchaser with a revised disclosure statement when necessary.[1] *Id.* at §465(2). A willful breach of either of these obligations results in the seller being liable for the actual damages suffered by the purchaser, in addition to any other equitable or statutory remedies. *Id.* at §465(2).

What incentive is there to provide the disclosure when the adverse consequences of completing the disclosure form so far outweigh the penalty for not completing it? Giving the seller the option to buy out of the disclosure requirement for $500 seems like a small price to pay for the avoidance of potential liability that could be many times more costly.

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While it does appear from the PCDA that sellers may simply refuse to provide a disclosure statement without any liability beyond a $500 credit, there are other consequences that practitioners should consider. For example, the PCDA neither provides for nor excludes the remedy of rescission.

Accordingly, there is a possibility under this statutory scheme that a purchaser may come forward even after the transfer of title and ask a court to rescind the sale because of the seller's failure to provide a disclosure statement. Obviously this has not yet been tested by our courts, but it is important to understand that the PCDA does not explicitly foreclose that possibility.[2]

How then can we protect our clients after March 1, 2002?

Attorneys representing a purchaser must make sure that their client knows that he or she is entitled to a disclosure and should insist that the seller provide the disclosure statement. Where a seller is unwilling to provide it, a purchaser must consider whether there may be a crucial defect with the property that the seller does not wish to reveal.

Perhaps the threat of losing a sale will be sufficient to prod a recalcitrant seller to comply. Ultimately, where a purchaser elects to proceed without the disclosure statement, attorneys should make sure to collect the $500 credit due their client at closing.

Attorneys representing a seller have a more difficult job. They must explain the disclosure statute to their client and attempt to evaluate the consequences that may arise from compliance and non-compliance. If a seller chooses to provide a disclosure statement, the attorney should suggest

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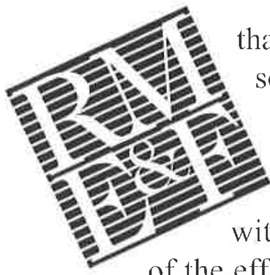

that the seller engage an engineer or consultant to assist the seller in completing it if the seller needs help.

Seller's attorneys should also consider the efficacy of a waiver clause. The PCDA does not state that its protections are non-waivable. Thus, we believe that with proper disclosure and drafting, the parties can waive all of the effects of the statute.[3]

In addition, thought should be given to drafting a clause which limits seller's damages in all cases where a disclosure statement is provided or where a revised disclosure is required but not given, except for direct and actual damages (possibly subject to a cap) suffered as a result of the seller's fraud. Taking this a step further, a seller could fix a shortened limitations period for the assertion of claims. This would help sellers establish the finality of the transaction while giving purchasers a fair chance to recover for willful misrepresentations.

The statute is only days old and already e-mail boxes are filling with messages sharing ideas and questions. One thing, however, is certain, the time has come to face this new reality. Let the lawyer beware. ■

[1] The PCDA requires the delivery of a revised disclosure statement when the seller becomes aware of new information that would render the original disclosure statement materially inaccurate. *Id.* at §464. The sellers obligation to provide a revised disclosure statement is ongoing from the time he or she delivers the initial disclosure statement to the either the time (i) title is transferred from the seller to purchaser or (ii) purchaser takes occupancy of the property, whichever is earlier. *Id.* at 464.

[2] The extraordinary remedy of rescission is a real possibility. It has been considered favorably in cases of a seller's fraud or active concealment. In one such case, *Stambovsky v. Ackley*, 572 N.Y.S.2d 672 (1st Dep't 1991) the seller created a reputation that his home was haunted. The purchaser of the property discovered after closing that his property would be difficult or impossible to resell because of this. The court held "[w]here a condition which has been created by the seller materially impairs the value of the contract and is peculiarly within the knowledge of the seller or unlikely to be discovered by a prudent purchaser exercising due care with respect to the subject transaction, non-disclosure constitutes a basis for rescission as a matter of equity." Many believe that *Stambovsky* was a precursor to the more stringent seller disclosure requirements that we are now seeing in the PCDA because it signaled the courts' willingness to depart from the doctrine of caveat emptor in a case where the facts warranted it.

[3] Compare with N.Y. Gen. Oblig. Law §7-103(3) (McKinney 2001), requiring segregation of tenants' leasehold security deposits, which expressly provides that the waiver of any provision of that section is void. If the Legislature intended to render the protections afforded by the PCDA non-waivable, the Legislature would have expressly prohibited waiver in the same manner as Gen. Oblig. Law §7-103(3).

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