



American Dream Turned Nightmare: Liability for Undisclosed Defects

The Legal Treatment of
Vaccine Injury Claims P22

Mandatory Appellate Court
eFiling Begins July 1 P45

Tipping Off with Bucks
Lawyer Mike Sneathern P30





SUMMARY

Damage caused by defects that a home's seller knew about but did not disclose can be a nasty and expensive surprise. Sellers, buyers, realtors, home inspectors, and contractors all have responsibilities to look closely and carefully at any property whose purchase they are involved with.

This article analyzes the different legal duties and potential liabilities of the various participants in residential real estate sales.

BY KEVIN D. TROST

American Dream Turned Nightmare: **Liability for Undisclosed Defects in Real Estate Sales**

When residential real estate is hot, sellers might be tempted to ignore, and buyers to overlook, problems with homes on the market. But this short-term approach to sweetening a deal can have extreme negative effects for all parties to a transaction.

Wisconsin is experiencing a hot real estate market in which demand for single-family homes is outstripping supply. Prices have increased an average of 10.3 percent statewide during the last year while the total number of listings has decreased by 36.9 percent.¹ Several conditions have coalesced to create this sellers' market. First, there is strong demand from buyers enticed by the current low mortgage rates.² Second, existing homeowners have avoided listing their homes for sale during the pandemic.³ Third, buyers are hesitant to build a new home while lumber remains at record-breaking prices.⁴

One effect of the current market is that in order to present a more attractive offer to sellers, more buyers forego due diligence and waive the home-inspection contingency. Months or years down the road, these homeowners may regret their haste after a significant undisclosed defect with the home appears. The homeowners may discover a leaky roof, a termite infestation, an unstable foundation, or any number of possible problems. Had they known about the defect before the closing, they could have demanded a financial concession from the sellers or even walked away from the purchase. Instead, the homeowners are left analyzing their potential legal recourse against those involved with the sale. In the most severe cases, homeowners may consider walking away from the home and their mortgage and declaring bankruptcy.

This article analyzes the legal duties and potential liabilities of the different players involved in residential real estate sales. Sellers, buyers, real estate agents, home inspectors, and contractors all have different duties and

responsibilities during the sale process. The sections below analyze the potential liabilities of each of these players.

Sellers' Potential Liabilities

Potential liability for the sellers of a home arises primarily from the sellers' disclosures on the real estate condition report. Under Wisconsin law, sellers of a property are required to complete a pre-printed disclosure document.⁵ On this form, sellers disclose whether they are aware of defects with various components of the structure and property.⁶ A *defect* is defined as a "condition that would have a significant adverse effect on the value of the property; that would significantly impair the health or safety of future occupants of the property; or that if not repaired, removed, or replaced would significantly shorten or adversely affect the expected normal life of the premises."⁷

The report must be made available to the buyers within 10 days after the sellers accept the buyers' offer.⁸ The sellers' disclosures on the real estate condition report are incorporated into the offer to purchase.⁹ Accordingly, sellers who are not truthful in completing the report may be subject to a claim for breach of contract.

More significantly, buyers frequently rely on the sellers' disclosures in deciding whether to proceed with purchasing the house. When sellers are untruthful in completing the real estate condition report, buyers may have a statutory claim for false advertising under Wis. Stat. section 100.18. If a jury or judge finds in the buyers' favor on this claim, the sellers can have a judgment entered against them for double damages and also for the buyers' reasonable attorney fees. Sellers may also face liability under

Wis. Stat. section 895.446 for civil theft. An unfavorable verdict under this statute could saddle sellers with triple damages as well as payment of the buyers' reasonable investigation costs, including attorney fees.¹⁰

For most claims, the sellers' liability is contingent on a factfinder determining that the sellers had knowledge of a defect and failed to disclose. Demonstrating that sellers had knowledge of a particular undisclosed defect is not easy. It is rare that sellers will admit to knowledge of a defect. In most cases, buyers must rely on circumstantial evidence of the sellers' knowledge, such as items left behind in the house or evidence of the sellers' prior work on the house. It should also be noted that the Wisconsin Statutes allow sellers to rely on the work and statements of third-party professionals.¹¹ For example, sellers who are accused of misrepresenting the condition of a roof might defeat the claim if they can show the roof was professionally inspected the previous year and given a clean bill of health.

Buyers' Potential Liabilities

Prospective purchasers of a home are not devoid of responsibility during the real estate purchase process. While they lack depth of knowledge about the home compared to the sellers, they cannot ignore obvious defects. For example, the sellers might fail to disclose any defects with the windows even though the kitchen window has a noticeable crack running down the middle of the pane of glass. The sellers likely have



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A Buyer's Nightmare: Defective Flashing Caused Extensive Water Damage, Repair, Costs

This author's expertise stems from not only professional experience but also personal experience. Nearly two years after purchasing a house, the author discovered that the roof was defectively flashed and had been leaking water into the structure of the house for decades. This discovery led to an extreme home renovation involving the removal of the roof, siding, brick, windows, drywall in numerous rooms, and structural repairs including the replacement of more than 30 feet of rotten rim joist. It also resulted in a multiyear legal action against the sellers of the house; the home inspector who appeared to miss tell-tale signs of prior attempts to address the leaking flashing; and the sellers' roofer, who reused flashing when re-roofing the house.

Fortunately, the legal claims yielded a favorable settlement a few weeks before a jury trial scheduled to last eight days. During the litigation, the parties addressed a variety of legal issues that arise in undisclosed-defect cases, including the determination that a contractual-arbitration clause had been waived, the inapplicability of the economic loss doctrine to limit noneconomic damages, and the enforcement of the transferability of a contractor's written warranty. **WL**

a persuasive defense that the buyers knew or should have been aware of the obviously defective window.¹²

The buyers' culpability may be greatly diminished if a defect is not obvious or if the buyers are first-time home buyers who lack a general depth of knowledge about real estate. After all, buyers may only visit a property two or three times before the closing. Normally, they will at least visit for a showing and during the final walk-through before the closing. They might (or might not) also attend a home inspection. Many buyers will only spend a few hours in a property before purchase. Even seasoned buyers may experience a sensory overload while touring a property as they attempt to determine whether it meets their needs. It is understandable that buyers may overlook or not understand the significance of a water mark on a room's ceiling or a slightly deformed top of a water heater. As a result, it may be difficult to hold buyers entirely responsible for observing a defect unless the defect is glaring and obvious.

Real Estate Agents' Potential Liabilities

Disgruntled buyers often cast blame

on the sellers' real estate agent and potentially their own agent for failing to identify a problem with a property. Real estate agents have a duty, codified in the Wisconsin Administrative Code, to inspect property and disclose certain facts.¹³ They are required to perform a "reasonably competent and diligent inspection" to identify observable, material adverse facts.¹⁴ An agent must disclose all material adverse facts that the agent knows and that another party does not know or cannot discover through reasonably vigilant observation.¹⁵ For real estate agents, a material adverse fact is one that is of such import that it would affect a party's decision to enter into a real estate contract or would affect the terms of the contract.¹⁶

Although these codified duties provide grounds for buyers to include agents in their claims for compensation for undisclosed defects, liability for a real estate agent can be illusory. As professionals in the real estate industry, agents should have a higher degree of expertise than buyers in spotting defects with a house. Nevertheless, agents often do not spend any more time in a property than buyers, which constrains the level of detail that they can be

expected to identify in an inspection. Like buyers, they have to rely to some extent on the sellers' representations about the property.¹⁷

More significantly, agents are released from their duty to inspect or disclose adverse property conditions if a third-party home inspection occurs.¹⁸ Following a third-party inspection, the agent's responsibility is reduced to disclosing any adverse facts known by the agent that contradict the information disclosed in the inspector's report or the sellers' real estate condition report.¹⁹

Home Inspectors' Potential Liabilities

Unlike several other states, Wisconsin licenses home inspectors and regulates their work.²⁰ Home inspectors are obligated by Wisconsin regulations to conduct a "reasonably competent and diligent home inspection" to "detect observable conditions" that are "readily accessible."²¹ Inspectors are thereafter required to prepare a written report on the inspection, including a disclosure of material adverse facts. For a home inspector, material adverse facts are property conditions that, "if not repaired, will have a significant adverse effect on the life expectancy of the identified item."²²

The Wisconsin Statutes explain the components of the property that the inspector must inspect and describe.²³ They also specify certain conditions about which the home inspector has no duty to inspect. For example, a home inspector has no legal obligation to comment on the adequacy of mechanical components.²⁴ While the inspector must comment on whether a furnace is operational, buyers might discover after the sale that the far reaches of the house are uncomfortable in the extremes of winter because the system components are inadequately sized.

Home inspectors likewise have no duty to mention the presence of pests, insects, or vermin.²⁵ Thus, an inspector who emerges from inspecting the attic might say nothing about the mouse

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tunnels observed in the insulation or piles of bat guano. Similarly, the scope of the inspector's work is limited to the physical residence itself and attached components such as a garage and deck.

a couple of key limits to a home inspector's potential liability. First, the statute of limitation on a claim against a home inspector is two years.²⁷ This two-year period runs from the date of the home

Following a third-party inspection, the agent's responsibility is reduced to disclosing any adverse facts known by the agent that contradict the information disclosed in the inspector's report or the sellers' real estate condition report.

The scope of the home inspector's duties does not extend to the health of trees or other features in the yard or to underground components such as a well or septic system.²⁶ Those must be the subject of separate inspections.

A home inspector is subject to liability for professional negligence for overlooking or inaccurately describing observable conditions. It is important to recognize

inspection, not from the date a defective condition is discovered. Accordingly, it is not uncommon for the statute of limitation to have expired on a claim against a home inspector before the buyers even discover a problem and realize they may have an actionable claim.

A second key limitation to liability is that a home inspector is only responsible to inspect and describe components

of a home that are observable and readily accessible.²⁸ Because the home inspection occurs before closing when title to the property remains vested in the sellers, the home inspector is not privileged to move the sellers' personal property. Thus, there may be personal property of the sellers that (intentionally or unintentionally) obscures or hides property defects. If the sellers' basement is filled with personal property, the home inspector might not spot a crack in the foundation or water stains running down the wall indicating a water intrusion problem. Additionally, a home inspection is not designed to be technically exhaustive, so buyers cannot rely on a home inspection to constitute a review of compliance with local building codes.²⁹

Contractors' Potential Liabilities

Sellers frequently hire contractors to undertake repairs before listing a home for sale. Some of those repairs may be performed without permits or not to industry standards. This is especially true if sellers do not provide the same level of oversight of the contractors that they would have provided if they were planning to stay in the home. Buyers that discover a defect resulting from the contractor's work after the closing may file a professional-negligence claim against the contractor or seek to enforce a contractor's warranty.

Regarding a contractor's warranty, it is not uncommon for sellers and their real estate agents to mention a contractor's warranty in marketing materials given to prospective buyers. Care should be taken to ensure that a referenced warranty is transferrable and will continue in force upon the sale of the home. Contractors' warranties are often written to be specific to the purchaser of the product or service.³⁰ Buyers may be surprised to learn after the closing that a warranty that would logically run with the home, such as a roofer's warranty, was specific to the sellers and was no longer in effect upon the sale of the

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home. Buyers may be reduced to arguing that they are third-party beneficiaries of the sellers' warranty.³¹

Conclusion

The purchase of a home can be an exciting occasion. However, it can also lead to equally negative emotions when the buyers discover undisclosed defects after the closing. Suddenly the buyers are facing unexpected repairs costing thousands or, in severe cases, hundreds of thousands of dollars. They begin to question whether the sellers who lived in the property for many years, the experienced real estate agents, or the buyers' home inspector knew or should have known about a compromised roof, a mouse-infested attic, or a water-damaged finished basement. To carefully analyze whether someone failed in their obligations, it is important to understand the duties of the people involved in the transaction.

It might be tempting for buyers in the current real estate market to waive their right to an inspection. Taking such a gamble helps the buyers present the most tantalizing offer to sellers who are likely choosing among multiple full-price (or over full-price) offers. Nevertheless, this approach is fraught with danger in the event the sellers

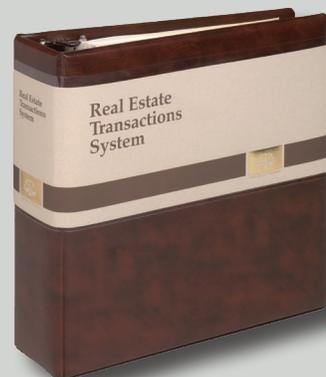
ALSO OF INTEREST



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Learn more about the obligations and duties regarding disclosure of real estate property defects with *Real Estate Transactions System* by State Bar of Wisconsin PINNACLE.

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intentionally or unintentionally fail to disclose a significant defect with the home. The potential benefits of waiving an inspection contingency are outweighed by the risk of later discovering an expensive remediation and repair nightmare.

Attorneys representing sellers should make their clients aware of their duties of disclosure and the potential legal implications of misrepresentation. Selling a home is not a *caveat emptor*

scenario. Wisconsin law provides buyers with strong statutory claims that carry with them the possibility of punitive-damages and attorney fee awards. Even when sellers successfully defend themselves against such claims, they do so at a great financial and emotional cost. It is better for sellers to risk over-disclosure on a real estate condition report and leave the closing with a clear conscience. **WL**

ENDNOTES

¹Wis. Realtors Ass'n, *March 2021 Home Sales Report*, www.wra.org/HSRMar2021/ (April 19, 2021).

²Zach Winter, *Why Are House Prices Going Up, and How Long Will It Last?* (May 4, 2021), <https://www.bankrate.com/real-estate/why-are-house-prices-going-up/>.

³*Id.*

⁴Lance Lambert, *Lumber Prices Are up 232% and "Could Spiral out of Control in the Next Few Months"*, *Fortune* (April 27, 2021).

⁵Wis. Stat. § 709.02.

⁶Wis. Stat. § 709.03.

⁷*Id.*

⁸Wis. Stat. § 709.02(1).

⁹See WB-11 Residential Offer to Purchase, lines 159-162.

¹⁰Wis. Stat. § 895.446(3).

¹¹Wis. Stat. § 709.07.

¹²See *Malzewski v. Rapkin*, 2006 WI App 183, ¶ 15, 296 Wis. 2d 98, 723 N.W.2d 156 (citing *Lambert v. Hein*, 218 Wis. 2d 712, 582 N.W.2d 84 (Ct. App. 1998)) ("A buyer aware of the 'true nature' of defects, or who has the right to discover the 'true nature' of defects that are disclosed, cannot later complain when he or she goes ahead with the purchase: (1) despite knowing about the defects, or (2) after giving up a right under the contract to discover their 'true nature.'").

¹³Wis. Admin. Code § REEB 24.07(1)(c).

¹⁴*Id.*

¹⁵Wis. Stat. § 452.133.

¹⁶Wis. Admin. Code § REEB 24.02(1), (12).

¹⁷Realtors are immune from liability if they are unaware that the sellers' representations are untrue. *Norton v. Migliaccio*, 2008 WI 44, ¶ 31, 309 Wis. 2d 132, 749 N.W.2d 544.

¹⁸Wis. Stat. § 452.23(2); Wis. Admin Code § REEB 24.07(5).

¹⁹Wis. Admin. Code § REEB 24.07(6).

²⁰Wis. Stat. §§ 440.97-.979.

²¹Wis. Admin. Code § SPS 131.31(1).

²²Wis. Stat. § 440.975(3).

²³See generally Wis. Stat. § 440.975.

²⁴Wis. Stat. § 440.975(4)(d).

²⁵Wis. Stat. § 440.975(6)(k).

²⁶Wis. Stat. § 440.975(6)(L).

²⁷Wis. Stat. § 440.977.

²⁸Wis. Stat. § 440.975(2).

²⁹*Id.*

³⁰Drafters of warranties are required to specify any limitations on scope. Wis. Admin. Code § ATCP 110.04(2).

³¹*Shilling v. Employers Mut. Cas. Co.*, 212 Wis. 2d 878, 886-87, 569 N.W.2d 776 (1997). **WL**