SELLER BEWARE: MANDATORY DISCLOSURE PROVISIONS IN IOWA PUT SELLERS OF RESIDENTIAL REAL ESTATE ON ALERT

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I. INTRODUCTION

"Let the buyer beware" was the traditional response to a home buyer who discovered after the sale that the roof leaked, the plumbing was defective, or the house was infested with termites.[1] A seller had no duty to disclose information

1. *See* Swinton v. Whitinsville Sav. Bank, 42 N.E.2d 808, 808-09 (Mass. 1942) (holding seller had no duty to voluntarily disclose termite infestation); Kuczmanski v. Gill, 302 S.E.2d 48, 50-51 (Va. 1983) (stating that seller was not liable for failing to disclose rotted floors, defective toilet and gutters, and missing storm windows); Denis Binder, *The Duty to Disclose Geologic Hazards in Real Estate Transactions*, 1 CHAP. L. REV. 13, 13 (1998) (stating that claims of failure to disclose a natural risk were historically "met by the seemingly hollow defense of caveat emptor").

unknown to the buyer.[2] Many times, buyers were left without any legal remedies against the seller.[3] However, over the past fifty years, the property doctrine of caveat emptor has virtually collapsed, giving way to the tort doctrine of duty to disclose.[4]

Iowa has moved away from caveat emptor over the last forty years.[5] Many states, including Iowa, have recently limited caveat emptor by enacting legislation that imposes an affirmative duty upon sellers of used residential property to disclose to buyers certain defects that are known to the sellers.[6] In 1994, the Iowa legislature added a provision to the Iowa Code which "furthers the trend away from caveat emptor by requiring a seller of real estate to complete a disclosure form which informs the purchaser of 'the condition and important characteristics of the property and structures located on the property . . . .'"[7] Under the new statute, liability is imposed on a transferor, broker, or salesperson who "has actual knowledge of the inaccuracy, or fails to exercise ordinary care in obtaining the information."[8]

The collapse of caveat emptor raises new issues including the breadth and depth of disclosures required, the ramifications of an omission or concealment, the extent of a seller's awareness of defects, and the obligations of a buyer to discover defects.

This Note examines these issues and the questions they raise, especially as applied to Iowa law. Part II explores the origin and causes of the demise of

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2. Binder, *supra* note 1, at 13.
3. *Id.*
4. *Id.*
5. *See, e.g.*, Arthur v. Brick, 565 N.W.2d 623, 625 (Iowa Ct. App. 1997) ("The tendency in later cases has been to enlarge the responsibility of the seller and restrict the application of caveat emptor.").
6. ALASKA STAT. §§ 34.70.010-.200 (Michie 2000); CAL. CIV. CODE §§ 1102.1-.17 (West Supp. 2001); DEL. CODE ANN. tit. 6, §§ 2570-2578 (1999); HAW. REV. STAT. §§ 508D-1 to -19 (Supp. 2000); IDAHO CODE §§ 55-2501 to -2518 (Michie 2000); 765 ILL. COMP. STAT. 77/1-/99 (West 2001); IND. CODE ANN. §§ 24-4.6-2-1 to .6-2-13 (Michie 1996); IOWA CODE §§ 558A.1-.8 (2001); KY. REV. STAT. ANN. § 324.360 (Michie 2001); MD. CODE ANN., REAL PROP. § 10-702 (1996); MICH. COMP. LAWS ANN. §§ 565.951-.966 (West Supp. 2001); MISS. CODE ANN. §§ 89-1-501 to -525 (1999); NEB. REV. STAT. ANN. § 76-2,120 (Michie 1995); N.H. REV. STAT. ANN. § 477:4-c (Supp. 2001); N.J. STAT. ANN. §§ 46:3C-1 to -12 (West Supp. 2001); N.C. GEN. STAT. §§ 47E-1 to -10 (1999); OHIO REV. CODE ANN. § 5302.30 (Anderson Supp. 2000); OKLA. STAT. ANN. tit. 60, §§ 831-839 (West Supp. 2002); OR. REV. STAT. §§ 105.465-.490 (1999); R.I. GEN. LAWS §§ 5-20.8-1 to -11 (1999); S.D. CODIFIED LAWS §§ 43-4-37 to -4-44 (Michie 1997 & Supp. 2000); TENN. CODE ANN. §§ 66-5-201 to -210 (Supp. 2000); TEX. PROP. CODE ANN. § 5.008 (Vernon 2002); VA. CODE ANN. §§ 55-517 to -525 (Michie 1995 & Supp. 2000); WASH. REV. CODE ANN. §§ 64.06.005-.900 (West Supp. 2002); WIS. STAT. ANN. §§ 709.01-.08 (Supp. 2001).
7. Arthur v. Brick, 565 N.W.2d at 625 (quoting IOWA CODE § 558A.4(1)).
8. IOWA CODE § 558A.6(1).

caveat emptor. Part III analyzes the recent statutory constraints on caveat emptor, including the Iowa Code provision concerning real estate disclosure and subsequent Iowa court interpretation. Part IV considers the implications and unanswered questions resulting from the new statutory provision. Finally, Part V contains the conclusion.

II. HISTORY OF THE CAVEAT EMPTOR DOCTRINE

A. *The Definition of Caveat Emptor*

The common law doctrine of caveat emptor means "let the buyer beware."[9] The phrase "caveat emptor" is derived from Latin.[10] It stands for the principle "that in the absence of express agreement, a seller is not liable to the buyer or others for the condition of the land existing at the time of transfer."[11]

B. *The Origin of Caveat Emptor*

Caveat emptor developed at a time when "most real estate transactions were arms-length between two similarly situated parties with comparable bargaining power."[12] Buyers and sellers were usually farmers with equal bargaining power, and they valued the land itself far more than any simple buildings it contained.[13] In that era, any improvements were noncomplex and the structural details were readily apparent to a buyer.[14] Buyers had the capability to conduct investigations to assure themselves of sound construction.[15] As a result, buyers did not need to rely on seller disclosures regarding any defects or hidden information.[16] During that time period, real property was often exchanged locally between neighbors who were familiar with one another and the property's

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9. Leonard A. Bernstein & George F. Magera, *Seller Disclosure Laws Gain Popularity*, 9 LOY. CONSUMER L. REP. 43, 44 (1997).

10. Binder, *supra* note 1, at 14.

11. T & E Indus., Inc. v. Safety Light Corp., 587 A.2d 1249, 1257 (N.J. 1991) (citing RESTATEMENT (SECOND) OF TORTS § 352 cmt. a (1977)).

12. Robert H. Shisler, Note, *Caveat Emptor Is Alive and Well and Living in New Jersey: A New Disclosure Statute Inadequately Protects Residential Buyers*, 8 FORDHAM ENVTL. L.J. 181, 183 (1996) (citing Walter H. Hamilton, *The Ancient Maxim Caveat Emptor*, 40 YALE L. J. 1133 (1931)).

13. *Id.* at 183-84 (citing Green v. Super. Ct., 517 P.2d 1168, 1172 (Cal. 1974)).

14. Alan M. Weinberger, *Let the Buyer Be Well Informed?—Doubting the Demise of Caveat Emptor*, 55 MD. L. REV. 387, 392 (1996) (citing Wilhite v. Mays, 232 S.E.2d 141, 142-43 (Ga. Ct. App. 1976)).

15. *Id.*

16. *Id.*

condition.[17] The price was usually set according to the risks involved, with the buyer fully aware of such risks.[18] Therefore, there was no need to impose a rule of liability for seller nondisclosure of property defects.[19]

While some historians argue that caveat emptor was "merely a rule of legal convenience reflecting the fact that most land transactions involved vacant land," others believe laissez-faire judges created the doctrine.[20] Under the laissez-faire perspective, caveat emptor was viewed as a simple and efficient means "to prevent the manufacture and sale of defective commodities without interference from vast systems of governmental regulation."[21] Although occasional injustices occurred under caveat emptor, they served as a lesson to other purchasers.[22] The laissez-faire political philosophy of the time was consistent with caveat emptor by "leaving the parties where they lay in real estate transactions."[23]

In any event, the rationale behind caveat emptor was the assumption that the equal bargaining power between the parties enabled both to discover the condition of the property prior to sale.[24] Each party needed to look out for itself, and the buyer could bargain to reduce risk if necessary.[25]

"[T]he doctrine of caveat emptor had become a central governing principle of land conveyancing law in the United States by the nineteenth century."[26] In 1870, the United States Supreme Court acknowledged that caveat emptor had been adopted in every jurisdiction but one.[27] The doctrine of buyer beware continued "into the first half of the twentieth century."[28]

C. *The Effects of Caveat Emptor*

At common law, caveat emptor required that buyers bear the burden of examining and finding any obvious defects in real estate.[29] If buyers failed to

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17. *Id.*
18. *Id.*
19. *Id.*
20. Strawn v. Canuso, 657 A.2d 420, 425 (N.J. 1995).
21. Weinberger, *supra* note 14, at 394.
22. *Id.*
23. Binder, *supra* note 1, at 14-15.
24. *Id.* at 14.
25. *Id.*
26. Weinberger, *supra* note 14, at 393.
27. Barnard v. Kellogg, 77 U.S. (10 Wall.) 383, 388-89 (1870) (noting South Carolina was the only state that had not adopted the doctrine).
28. Strawn v. Canuso, 657 A.2d 420, 425 (N.J. 1995).
29. Swanson v. Baldwin, 85 N.W.2d 576, 578 (Iowa 1957).

meet this duty, they were precluded from recovering damages.[30] This was the case all across the country as courts placed upon sellers a "general limited disclosure obligation," but required buyers to conduct an investigation into the property's condition.[31] "A buyer who failed to make an adequate inspection, or to extract an express warranty from the seller, was just out of luck."[32] In fact, courts viewed purchasing a home as a game of chance.[33] This brought hardship to homebuyers because they found themselves bound by uninformed decisions regarding the condition of their newly purchased homes.[34]

D. *The Erosion of Caveat Emptor*

In the context of new homes, caveat emptor has eroded because of the dramatic change in the residential real estate landscape.[35] The agrarian context has evolved into modern practices "where mass developers build dozens of homes at one time, and sell the homes to buyers using standardized form contracts."[36] Now, the builder-vendor has more bargaining power over the buyer because the buyer does not have the same knowledge and skills.[37] In *Schipper v. Levitt & Sons, Inc.*,[38] the leading case establishing an implied warranty in mass produced homes, the court stated, "Buyers of mass produced development homes are not on an equal footing with the builder vendors and are no more able to protect themselves in the deed than are automobile purchasers in a position to protect themselves in the bill of sale."[39] For these reasons, the courts made exceptions to protect the buyer.[40]

Courts began to recognize an implied warranty of habitability or workmanship in the sale of new homes.[41] Under this principle, a builder-vendor warrants that the home "has been constructed in a reasonably good and

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30. Arthur v. Brick, 565 N.W.2d 623, 625 (Iowa Ct. App. 1997).
31. Bernstein & Magera, *supra* note 9, at 44.
32. Kirk v. Ridgway, 373 N.W.2d 491, 493 (Iowa 1985).
33. *Id.*
34. *Id.* at 493-94.
35. Shisler, *supra* note 12, at 185.
36. *Id.*
37. *Id.*
38. Schipper v. Levitt & Sons, Inc., 207 A.2d 314 (N.J. 1965).
39. *Id.* at 326.
40. Shisler, *supra* note 12, at 185.
41. Kirk v. Ridgway, 373 N.W.2d 491, 496 (Iowa 1985); *see also* Schipper v. Levitt & Sons, Inc., 207 A.2d at 325-26 (holding the implied warranty principles "should be carried over into the realty field").

workmanlike manner and that it will be reasonably fit for its intended purposes."[42] The elements of the implied warranty are as follows:

> 1. That the house was constructed to be occupied by the warrantee as a home;
> 2. that the house was purchased from a builder-vendor, who had constructed it for the purpose of sale;
> 3. that when sold, the house was not reasonably fit for its intended purpose or had not been constructed in a good and workmanlike manner;
> 4. that, at the time of purchase, the buyer was unaware of the defect and had no reasonable means of discovering it; and
> 5. that by reason of the defective condition the buyer suffered damages.43

A "builder-vendor" is defined as follows:

> [A] person who is in the business of building or assembling homes designed for dwelling purposes upon land owned by him, and who then sells the houses, either after they are completed or during the course of their construction, together with the tracts of land upon which they are situated, to members of the buying public.[44]

The courts recognized a distinction between homeowner-vendors who sell homes built for their personal use, and builder-vendors who build homes specifically for resale.[45] Builder-vendors owe a higher duty of care to buyers than do private homeowner-vendors.[46] The implied warranty of habitability has become a well-settled exception to caveat emptor.[47]

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42. Kirk v. Ridgway, 373 N.W.2d at 496.

43. *Id.*

44. *Id.* (quoting Jeanguneat v. Jackie Hames Const. Co., 576 P.2d 761, 762 n.1 (Okla. 1978)).

45. *See* Holloman v. D.R. Horton, Inc., 524 S.E.2d 790, 794 (Ga. Ct. App. 1999) ("Georgia law has placed a special duty of disclosure on the builder-seller that markets its new homes to consumers."); Flom v. Stahly, 569 N.W.2d 135, 142 (Iowa 1997) (holding the theory of implied warranty did not apply because defendant physician built the house as a hobby, which did not qualify him as a builder-vendor); Parmely v. Hildebrand, 603 N.W.2d 713, 717 (S.D. 1999) (holding private homeowner who worked as masonry or concrete contractor was not held to the same standard as a professional home builder when he sold his home); Bagnowski v. Preway, Inc., 405 N.W.2d 746, 748-50 (Wis. Ct. App. 1987) (holding that homeowner who installed a defective fireplace is not considered a builder-vendor "because he was not in the business of building homes for sale").

46. Parmely v. Hildebrand, 603 N.W.2d at 717; *see also* Compass Point Condo. Owners Ass'n v. First Fed. Sav. & Loan Ass'n, 641 So. 2d 253, 255 (Ala. 1994) (stating that the court has

In the used home market, courts began to recognize the unfairness and injustice that resulted when buyers of used homes had to bear the risks of defects known only to the sellers.[48] Caveat emptor began to erode first in cases addressing the seller's duty to disclose facts about dangerous conditions that the buyer could not reasonably discover.[49] Later, courts began to require disclosure for latent defects but not patent material conditions.[50] Latent defects are those defects known to the seller and substantially affecting the property value or habitability, but are unknown to the buyer and not reasonably discoverable by inspection.[51] Whether a defect is latent depends on factors such as "[t]he nature of the defect and the ability of the parties to determine through a reasonable inspection that a defect exists."[52]

In some states, not only must a seller disclose hidden physical conditions of the property, but the seller must also disclose off-site conditions[53] and

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abrogated caveat emptor in the sale of a house by a builder-vendor, but continues to hold no implied warranty of habitability applies in the sale of used homes).

47. *See* Radaker v. Scott, 855 P.2d 1037, 1042 (Nev. 1993) ("At least thirty-eight of the forty-one states which have addressed the issue of whether a builder/vendor impliedly warrants habitability have ruled in favor of the warranty.").

48. Weintraub v. Krobatsch, 317 A.2d 68, 72 (N.J. 1974) ("'The attitude of the courts toward nondisclosure is undergoing a change and . . . it would seem that the object of the law in these cases should be to impose on parties to the transaction a duty to speak whenever justice, equity, and fair dealing demand it.'" (quoting W. Page Keeton, *Fraud—Concealment and Non-Disclosure*, 15 TEX. L. REV. 1, 31 (1936))); *see* Hughes v. Stusser, 415 P.2d 89, 92 (Wash. 1986) (holding caveat emptor may not be applicable when the seller has a "moral and legal obligation to disclose material facts not readily observable upon reasonable inspection by the purchaser").

49. Karen Eilers Lahey & David A. Redle, *The Ohio Experience: The Effectiveness of Mandatory Real Estate Disclosure Forms*, 25 REAL EST. L.J. 319, 321 (1997); *see* Anderson v. Harper, 622 A.2d 319, 324 (Pa. Super. Ct. 1993) (concluding that a defective sewage system is a dangerous condition requiring seller disclosure).

50. *See* Lahey & Redle, *supra* note 49, at 324-25 (listing several sources on the expansion of the seller disclosure rule). *But see* Compass Point Condo. Owners Ass'n v. First Fed. Sav. & Loan Ass'n, 641 So. 2d at 255 ("[T]his Court has continued to hold that there is no implied warranty of habitability in the sale of used residential real estate, and the rule of *caveat emptor* still applies in such a sale.").

51. Binder, *supra* note 1, at 21 (citations omitted). Latent defects include termites, malfunctioning sewage systems, and water damage. *See* Miles v. McSwegin, 388 N.E.2d 1367, 1369 (Ohio 1979) (holding the existence of termites is a latent defect that constitutes an exception to caveat emptor); Czarnecki v. Basta, 679 N.E.2d 10, 13 (Ohio Ct. App. 1996) (noting caveat emptor did not apply to latent and concealed water damage that buyer discovered when a wall collapsed); Anderson v. Harper, 622 A.2d at 324 (stating that defects in a septic system are inherently latent).

52. Van Camp v. Bradford, 623 N.E.2d 731, 735 (Ohio Misc. 2d 1993).

53. *See* Strawn v. Canuso, 657 A.2d 420, 431 (N.J. 1995) (holding that home builder may be liable for failing to disclose existence of a nearby landfill if it materially affects the property value); *see also* Timm v. Clement, 574 N.W.2d 368, 371 (Iowa Ct. App. 1997) (holding

nonphysical problems, such as a violent neighborhood, the presence of ghosts, or previous murders on-site.[54] The rationale behind such cases is that the scenarios are very unusual and not readily observable, and therefore buyers should not be held responsible for inquiring into such possibilities.[55]

Caveat emptor is now a "mere shell of its former self."[56] While the buyer is still obligated to take notice of observable conditions on the property, the seller bears the burden to disclose any other conditions.[57] The risk of property defects has shifted from buyer to seller of residential real estate.[58]

E. *The Erosion of Caveat Emptor in Iowa*

Iowa traditionally embraced the caveat emptor doctrine.[59] However, the law first changed in the sale of personal property, showing a trend toward recognizing implied warranty claims in that area.[60] The tendency was to "enlarge the responsibility of the seller and restrict the application of caveat emptor."[61] In 1985, the Iowa Supreme Court adopted an implied warranty of workmanship in the sale of new homes, joining the prevailing view.[62] The court noted caveat emptor applied during a time when "the purchase of a new home in a completed

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the seller was obligated to disclose off-site conditions that were undetectable by the buyer in a commercial property sale).

54. *See* Reed v. King, 193 Cal. Rptr. 3d 130, 133 (Ct. App. 1983) (finding that buyer stated a cause of action against the seller for failing to disclose that home was the site of a multiple murder); Stambovsky v. Ackley, 572 N.Y.S.2d 672, 677 (App. Div. 1991) (holding seller had a duty to inform purchaser of poltergeists in the home); Van Camp v. Bradford, 623 N.E.2d at 739-40 (stating that seller may be held liable for failing to disclose that rapes had occurred on and around the property when buyer specifically inquired into the safety of the neighborhood).

55. Reed v. King, 193 Cal. Rptr. 3d at 133; *see* Strawn v. Canuso, 657 A.2d at 431 (holding a buyer does not have a duty to inquire into off-site conditions unknown to buyer and not reasonably observable); Stambovsky v. Ackley, 572 N.Y.S.2d at 677 (holding seller liable for nondisclosure when buyer would be unlikely to inquire about the possibility of poltergeists in the house); Van Camp v. Bradford, 623 N.E.2d at 740 (stating that a prospective buyer could not have discovered through reasonable inspection that the home was the site of a violent crime because of the defect's intangible nature).

56. Lahey & Redle, *supra* note 49, at 321.

57. *Id.*

58. *Id.* at 319.

59. N. Fin. Corp. v. Meinhardt, 226 N.W. 168, 170 (Iowa 1929) ("The rule of caveat emptor prevails in this state.").

60. Kirk v. Ridgway, 373 N.W.2d 491, 493 (Iowa 1985) (citing Mease v. Fox, 200 N.W.2d 791, 74 (Iowa 1972)).

61. Arthur v. Brick, 565 N.W.2d 623, 625 (Iowa Ct. App. 1997) (citing Peters v. Lyons, 168 N.W.2d 759, 763 (Iowa 1969)).

62. Kirk v. Ridgway, 373 N.W.2d at 495-96.

stage was fairly rare."[63] Because home construction techniques have now become complex and the owner often cannot supervise the construction, the court acted to protect consumers.[64]

Iowa has now rejected caveat emptor in most business transactions.[65] Currently, the trend in Iowa is to enhance the duties of agents and fiduciaries who are in positions of trust so that they will perform their obligations with complete honesty.[66] Iowa Code Chapter 558A continues the trend to abandon caveat emptor in real estate sales.[67]

III. MANDATORY DISCLOSURE STATUTES

A. *The Push for Mandatory Disclosure Legislation*

Approximately half of the states have recently enacted mandatory disclosure statutes.[68] California began the trend by enacting the first Homeowner Disclosure Act in 1985.[69] The California model has been used by many other states when enacting the disclosure statutes.[70] The residential disclosure laws usually require the seller to provide a description of the following:

> the condition of the property, including known physical defects in homes, and cover items such as water supply, sewage system, basement/crawl space, structural components, mechanical systems, insect infestation, presence of hazardous substances, code violations, and underground storage tanks. Flooding, drainage, settling or grading problems are often covered by the statutes.[71]

The push for mandatory disclosure legislation initially came from the real estate brokerage industry.[72] The National Association of Realtors has estimated that about three quarters of the lawsuits filed against real estate agents and sellers

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63. *Id.* at 493.
64. *Id.*
65. *See* Arthur v. Brick, 565 N.W.2d at 625 (citing Mease v. Fox, 200 N.W.2d 791, 794 (Iowa 1972) ("We have now dislodged the antiquated concept of caveat emptor in most business transactions.")).
66. *Id.* (quoting Miller v. Berkoski, 297 N.W.2d 334, 340 (Iowa 1980)).
67. *See* IOWA CODE ch. 558A (2001) (requiring the seller to inform the purchaser of "the conditions and important characteristics of the property and structures located on the property"); *see also* Arthur v. Brick, 565 N.W.2d at 625.
68. *See supra* note 6.
69. Binder, *supra* note 1, at 32.
70. *Id.* at 34.
71. *Id.*
72. Weinberger, *supra* note 14, at 388.

result from lack of disclosure concerning property conditions.[73] Brokers have urged legislatures to shift the burden of disclosure to sellers, and so far, their efforts have been successful.[74] The effect of the mandatory disclosure laws has been to "shield real estate agents from liability to purchasers for misstatements and omissions by sellers in complying with their statutory disclosure obligation."[75] As a result, sellers now have a strong motivation to seek legal counsel to advise them on what to disclose in a residential property sale, and how to comply with the mandatory disclosure laws.[76]

Although some argue that mandatory disclosure statutes are overly burdensome and ineffective, others proclaim the statutes are a success.[77] One study has shown a significant decrease in post-transaction surprises and complaints, which the researchers link to the passage of mandatory disclosure legislation.[78] This increased satisfaction in home purchases has caused some commentators to conclude that mandatory disclosures provide "improved market efficiency."[79] Buyers have noted they are able to make a more informed purchasing decision.[80] In one survey, almost twenty percent of the buyers indicated that price negotiations were influenced by the disclosed information.[81]

B. *Mandatory Disclosure Legislation in Iowa*

1. *The Content of Iowa's Disclosure Law*

The Iowa legislature enacted a provision that became effective on July 1, 1994, requiring that a seller of real estate complete a disclosure form to inform the buyer about the condition of the property.[82] In addition, the statute imposes liability on a transferor, broker, or salesperson if "that person has actual knowledge of the inaccuracy, or fails to exercise ordinary care in obtaining the

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73. Richard Brack, *New Rules Require Home Buyers Be Told Just What They're Getting*, DES MOINES REG., June 11, 1994, at 1A.

74. Weinberger, *supra* note 14, at 388.

75. *Id.* at 419.

76. Katherine A. Pancak et al., *Residential Disclosure Laws: The Further Demise of Caveat Emptor*, 24 REAL EST. L.J. 291, 316 (1996).

77. Gary S. Moore & Gerald Smolen, *Real Estate Disclosure Forms and Information Transfer*, 28 REAL EST. L.J. 319, 336 (2000).

78. *Id.* at 336-37 (citing surveys conducted in 1990 and 1996 measuring the satisfaction level of buyers before and after the mandatory disclosure legislation).

79. *Id.* at 337.

80. *Id.* at 329.

81. *Id.* at 335.

82. IOWA CODE § 558A.4(1) (2001).

information."[83] The statute requires a good faith disclosure of the information, allowing sellers to use an approximation if a reasonable effort has been made to ascertain the information.[84]

The disclosure statement must be delivered to the buyer either: (1) prior to the seller accepting a written offer from the buyer, or (2) prior to the buyer accepting a written offer from the seller for the sale, exchange, or lease with option to buy real estate.[85] If the disclosure statement is not delivered prior to the acceptance of the offer, the buyer may withdraw the offer or cancel the contract, without liability, within three days following personal delivery of the statement, or within five days following delivery by mail.[86] Iowa law does not require a certain form to be used for the disclosures, but the Iowa Real Estate Commission provides sample language for the disclosure statement, which contains minimum standards that must be included in the statement.[87] Under Iowa law, a transaction shall not be invalid solely because of a failure to comply with the disclosure provisions.[88]

Iowa law only requires the disclosure statement to be used on the transfer of residential property when the property includes at least one, but not more than four, dwelling units.[89] Examples of transfers excluded from the disclosure requirements are as follows: court-ordered transfers; foreclosures; mortgage companies reacquiring property; transfers by fiduciaries when administering a decedent's estate, guardianship, conservatorship, or trust; transfers between joint tenants or tenants in common; transfers between spouses; transfers to or from the state or United States; and transfers by quitclaim deed.[90]

The sample statement provided by the Iowa Real Estate Commission includes questions pertaining to basements, foundations, wells and pumps, roofs, septic tanks, sewer systems, heating systems, plumbing, electrical systems, asbestos, zoning, and structural damage, among others.[91] The statement requires that the seller "disclose all known conditions materially affecting this property."[92] In addition, the statement requires that the information be provided in good faith and that the seller make a reasonable effort to ascertain the required

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83. *Id.* § 558A.6(1).
84. *Id.* § 558A.3(1).
85. *Id.* § 558A.2(1).
86. *Id.* § 558A.2(2).
87. IOWA ADMIN. CODE r. 193E-1.39(6) (1997).
88. IOWA CODE § 558A.8.
89. *Id.* § 558A.1(4).
90. *Id.*
91. IOWA ADMIN. CODE r. 193E-1.39(6).
92. *Id.*

information.[93] According to the statute, sellers, or their expressly authorized agents, must complete the form and licensees must obtain a completed form signed and dated.[94] A seller may choose to attach a report prepared by a qualified expert in order to satisfy the disclosure requirement, but the seller or expert must identify which items of the disclosure are intended to be satisfied by the report.[95]

2. *Iowa Court Decisions Under Chapter 558A*

Since the statute's enactment in 1994, Iowa appellate courts have decided several cases under Chapter 558A. The cases provide assistance in interpreting the provision, but also leave unanswered questions that will be discussed in Part IV.

The first decision came in *Arthur v. Brick*,[96] in which the buyers discovered flooding in the basement after they moved into the house.[97] Upon investigation, the buyers found that a drain in the backyard was connected illegally to the sewer system.[98] On the disclosure statement, the seller had indicated that there were no sewer problems.[99] The buyer sued to rescind the real estate contract and sought damages on the basis of misrepresentations on the disclosure statement.[100] The court stated that the traditional seven elements to be proven under fraudulent misrepresentation must be considered in conjunction with the new disclosure standards under Chapter 558A.[101] Those seven elements are as follows: representation, falsity, materiality, scienter, intent to deceive, reliance, and resulting injury and damage.[102]

The court also noted the information required in the disclosure form was held to a good faith standard.[103] Looking at the facts of the case, the court held none of the evidence indicated the seller knew the hookup was improper.[104] The seller did not live on the property and was not "intimately aware of any latent

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93. *Id.*
94. IOWA CODE § 558A.2.
95. *Id.* § 558A.4(2).
96. Arthur v. Brick, 565 N.W.2d 623 (Iowa Ct. App. 1997).
97. *Id.* at 624-25.
98. *Id.* at 625.
99. *Id.*
100. *Id.*
101. *Id.* at 626.
102. *Id.* at 625.
103. *Id.* at 626.
104. *Id.*

structural infirmities that may have existed."[105] Therefore, the court held the seller made proper and reasonable disclosures on the form.[106] In addition, the court noted the sewer connection was in plain view, and the buyers were aware of the sump pump's importance in keeping water out of the basement.[107] The court held the buyers did not prove a misrepresentation by the seller.[108]

Next, the Iowa Supreme Court considered Chapter 558A in *Peterson v. Bottomley*.[109] In *Peterson*, the sellers filled out a disclosure statement, stating that they knew of no water seepage in the basement.[110] The sellers also did not disclose damage to the roof of the home.[111] After the buyers moved in, water flowed into the crawl space and rotted the floor joists.[112] The trial court found for the buyers under Chapter 558A although the buyers had argued solely common law claims.[113] The Iowa Supreme Court reversed, holding it was improper for the trial court to decide the case on the statute when it was not argued by the plaintiff-buyer.[114] The court stated that if the sellers had known "they were facing a statutory disclosure claim, they may have been able to show compliance with the disclosure requirement concerning the roof damage."[115]

The Iowa Court of Appeals considered another statutory disclosure issue under Chapter 558A in *Hulsing v. Henzen*.[116] In *Hulsing*, the seller's disclosure form indicated no problems with water in the basement.[117] However, the buyers soon discovered that the basement flooded every spring.[118] The court agreed that the seller "knowingly made a false representation of a material fact with the intent to deceive and induce the Plaintiffs into purchasing the subject property."[119] The seller had owned the property for twenty-three years, and his mother lived in the house for fourteen years.[120] The house was over 130 years old, and the court of appeals agreed with the magistrate's opinion that "[i]t is simply not believable that this property has been in existence for over 130 years

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105. *Id.*
106. *Id.*
107. *Id.* at 626-27.
108. *Id.* at 627.
109. Peterson v. Bottomley, 582 N.W.2d 187 (Iowa 1998).
110. *Id.* at 188.
111. *Id.*
112. *Id.*
113. *Id.*
114. *Id.* at 189.
115. *Id.*
116. Hulsing v. Henzen, No. 98-1738, 1999 WL 668576 (Iowa Ct. App. Aug. 27, 1999).
117. *Id.* at *1.
118. *Id.*
119. *Id.* at *2.
120. *Id.* at *1.

Other states have stricter rules for concealments, holding a seller can be held liable for concealment even when there was no duty to speak.[190] In *Van Deusen v. Snead*,[191] the Virginia Supreme Court held no duty existed for the sellers to disclose defects even though the sellers had actual knowledge of the problem.[192] However, the court held the buyer stated a proper cause of action for the fraud against the sellers for concealing the defects by placing materials in front of cracks in the basement.[193] The court stated, "In our view, an allegation of concealment by conduct is equivalent to an allegation of a verbal misrepresentation of a material fact, made intentionally to mislead prospective purchasers and to divert them from 'making the inquiries and examination which a prudent man ought to make.'"[194]

The court noted Virginia now has a Residential Property Disclosure Act which requires the seller to either disclose known defects or provide an "as is" disclaimer.[195] However, because the dispute arose prior to the Act, the court applied previous law.[196] The Virginia courts continue to hold a seller has no affirmative duty to disclose defects absent a property disclosure form; thus, a seller will not be liable for an omission.[197] However, if the seller goes beyond omission and actually conceals a defect, the court equates concealment with an affirmative misrepresentation.[198]

Other states have agreed with Virginia that a concealment of material defects is equivalent to an affirmative misrepresentation. For example, in *Sewak v. Lockhart*,[199] the court held the sellers liable for concealing the fact that a steel support column was removed from the basement and a jack used for temporary support was hidden in a closet, which would have resulted in the eventual

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190. *See, e.g.*, Van Deusen v. Snead, 441 S.E.2d 207 (Va. 1994) (finding buyer effectively stated a cause of action under theory of fraud against the seller for concealing property defects from buyer).

191. Van Deusen v. Snead, 441 S.E.2d 207 (Va. 1994).

192. *Id.* at 210.

193. *Id.*

194. *Id.* (quoting Armentrout v. French, 258 S.E.2d 519, 524 (Va. 1979)).

195. *Id.* at 210 n.1 (citing VA. CODE ANN. §§ 55-517 to -525).

196. *Id.*

197. *See* Norris v. Mitchell, 495 S.E.2d 809, 812-13 (Va. 1998) (applying the doctrine of caveat emptor).

198. Van Deusen v. Snead, 441 S.E.2d 207, 210 (Va. 1994).

199. Sewak v. Lockhart, 699 A.2d 755 (Pa. Super. Ct. 1997).

collapse of the house.[200] However, a mere omission without concealment does not render the seller liable.[201]

D. *Reliance on Seller's Representations*

Another question arising from the statute is whether a buyer would ever be justified in relying on a seller's representation. The Iowa Supreme Court addressed this question in *Lockard v. Carson*[202] before the statute was enacted, and held a buyer is not justified in relying on a misrepresentation when the buyer has "'equal information of certain knowledge'" as the seller.[203] The court also held buyers cannot recover if they rely on misrepresentations that would have been obvious had they made a cursory investigation.[204] The court rejected an objective standard, which would require that plaintiffs in fraud actions use ordinary care.[205] Instead, the court used a subjective test that asked whether the buyer, "in view of his own information and intelligence, had a right to rely on the representations."[206]

Although *Lockard* was decided before Chapter 558A was enacted, the Iowa Court of Appeals recently affirmed the subjective test in *Hulsing v. Henzen*,[207] in which it stated that Iowa requires proof of justifiable reliance, rather than reasonable reliance.[208] Justifiable reliance depends on the subjective test, which does not use the reasonable person standard, but considers whether the plaintiff had a right to trust the seller's representations, taking into account the plaintiff's knowledge and intelligence.[209] The court's use of a subjective test gives an advantage to a plaintiff because the case will depend on what a person in the plaintiff's shoes would have done, not what the "ordinarily prudent person would do to protect his or her interests."[210]

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200. *Id.* at 759-61. Similarly, in *Brickell v. Collins*, 262 S.E.2d 387, 389 (N.C. App. 1980), the court stated, "It is settled that where there is a duty to speak, the concealment of a material fact is equivalent to fraudulent misrepresentation."

201. *See, e.g.*, Mitchell v. Skubiak, 618 N.E.2d 1013, 1017 (Ill. App. Ct. 1993) ("[A] seller's silence in not disclosing defects, standing alone, does not give rise to a cause of action for misrepresentation."); Sewak v. Lockhart, 699 A.2d at 759 ("[M]ere silence without a duty to speak will not constitute fraud.").

202. Lockard v. Carson, 287 N.W.2d 871 (Iowa 1980).

203. Id. at 878 (quoting Andrew v. Baird, 265 N.W. 170, 175 (Iowa 1936)).

204. *Id.*

205. *Id.*

206. *Id.*

207. Hulsing v. Henzen, No. 98-1738, 1999 WL 668576 (Iowa Ct. App. Aug. 27, 1999).

208. *Id.* at *3.

209. *Id.*

210. Lockard v. Carson, 287 N.W.2d 871, 878 (Iowa 1980).

It is helpful to look at the standards that other states have used to determine the extent a buyer may rely on the seller's representations. For example, in *Nelson v. Wiggs*,[211] a Florida court held the buyer to an objective standard.[212] The court stated that a seller only has a duty to disclose a material fact if it is unknown to the buyer and not "readily observable."[213] The seller did not have a duty to disclose flooding because the information was available to the buyers through "diligent attention."[214] Therefore, a buyer has a duty to take reasonable steps to discover material facts concerning the property if they are reasonably ascertainable.[215] The court held buyers cannot rely on a mere visual observation of the property; they must "investigate any information furnished by [sellers] that a reasonable person in the buyer's position would investigate."[216] The court noted the buyers had access to the flooding information, and therefore, could not be excused for their failure to acquire the information.[217]

Florida has not enacted a mandatory statutory disclosure requirement. Therefore, buyers must still take the initiative to find defects that could reasonably be discovered, and the court applies an objective test to determine what a reasonable person would have investigated.[218]

In Virginia, a buyer may be excused for not investigating if the seller has acted to cover up the need for an investigation.[219] The Supreme Court of Virginia has held as a general rule that the purchaser bears the burden to discover defects in a home.[220] However, an exception to that rule provides that the seller must not act to divert the purchaser and prevent him from making inquiries that a reasonable person would make.[221] The court held a cause of action existed when the sellers concealed defects from the buyers by placing materials in front of cracks in the basement.[222] Furthermore, the buyers were excused from not conducting an inspection to discover the defects.[223]

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211. Nelson v. Wiggs, 699 So. 2d 258 (Fla. Dist. Ct. App. 1997).
212. *See id.* at 261 (holding buyers "must take reasonable steps to ascertain the material facts").
213. *Id.* at 260.
214. *Id.* at 261.
215. *Id.*
216. *Id.* at 260-61.
217. *Id.*
218. *See id.* ("The flood-prone nature of the area was within the diligent attention of [the buyer], thus [the seller] had no duty to disclose it.").
219. Van Deusen v. Snead, 441 S.E.2d 207, 210 (Va. 1994).
220. *Id.*
221. *Id.*
222. *Id.*
223. *Id.*

V. CONCLUSION

The mandatory disclosure statute in Iowa Code Chapter 558A was necessary to reverse the eroding principle of caveat emptor and codify the evolving common law exceptions.[224] Iowa has taken the step to protect buyers of residential real estate; however, it remains to be seen how far the legislature and courts will take mandatory disclosure. Will Iowa courts follow California courts and require disclosure for homes that are psychologically impaired or tainted by reputation?[225] Will the duty of disclosure for used homes eventually require the same standard as the duty for newly constructed homes? And the question remains as to what effect the mandatory disclosure statutes will have on the real estate market.

At any rate, it is clear that the buyer of residential real estate in Iowa is now protected from the principle of "let the buyer beware." Because the burden of disclosing defects has shifted to sellers, it would seem that buyers should only be held responsible for those obvious defects that they could see for themselves or, in light of their own knowledge and experience, should have investigated. Any material defects known to the seller or readily discoverable by the seller should be disclosed to the buyer, according to the disclosure form. A buyer should be able to rely on a seller's representations concerning the condition of property and trust that no material conditions affecting the value of the property are being hidden. However, until case law clearly establishes the buyer's and seller's standards of care under Iowa's real estate disclosure statutes, buyers may want to act as though caveat emptor still exists and be proactive in discovering defects to protect themselves.

Megan Peterson

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224. *See* IOWA CODE ch. 558A (2001).

225. *See* Reed v. King, 193 Cal. Rptr. 130, 133 (Ct. App. 1983) (finding that buyer stated a cause of action against the seller for failing to disclose that home was the site of a multiple murder); *see also* H.F. 670, 77th Leg. (Iowa 1997), *available at* http://www2.legis.state.ia.us/GA/77GA/Legislation/HF/00600/HF00670/Current.html (accessed on February 5, 2001) (proposing amendment to Chapter 558A to exclude from required disclosures the fact that a home has been psychologically impacted). Thus far in Iowa, efforts to pass legislation clarifying the seller's or agent's duty to disclose psychological defects have not been successful. David R. Mark, ***When Bad Things Have Happened in a House, Should the Agent Tell the Buyer?***, DES MOINES REG., May 30, 1997, at 3R.