

An Economic Analysis of the Duty to Disclose Information: Lessons Learned From the Caveat Emptor Doctrine

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* Perre Bowen Professor of Law, University of Virginia School of Law. The genesis of this Article began almost twenty years ago when I first read Professor Carol M. Rose's article, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577 (1988). Since that time, I have worked on this Article in fits and starts, time permitting, given my other duties, most recently Dean at the University of Minnesota Law School. As such, many—too many to name them all—research assistants have worked with me in finalizing this Article. Most prominent among them is my research assistant during the 1997–1998 academic year, Matthew Rinka. This Article benefited as well from comments received from attendees at the 2006 Canadian Law and Economics Annual Conference, where this Article was presented.

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Several leading law scholars have attempted to explain why certain legal rules require a party to disclose information to the other contracting parties, often competing parties, in certain transactions. Most notably, Dean Anthony Kronman, in his article, *Mistake, Disclosure, Information, and the Law of Contracts*, presents an economic theory explaining why unilateral mistake is allowed as a defense to preclude contract formation in some cases, but not others.¹ As part of his argument, Dean Kronman discusses when a party has a duty to disclose information to the other contracting party when the other contracting party does not ostensibly possess that information.² The obverse of the rule mandating disclosure is also discussed—when a party is privileged to remain silent even though the party possesses relevant information (a material fact) that the other contracting party would prefer to know.³ Dean Kronman concludes that there is no duty to disclose relevant information that is a product of deliberate investment, but that one has a duty to disclose relevant information that is “casually acquired.”⁴

Similarly, Professors Cooter and Ulen in their economic treatise, *Law and Economics*, put forth a theory to determine when the disclosure of a material fact is required from the knower to the knowee.⁵ They attempt to draw a distinction between those facts which they determine are *productive* (wealth producing or enhancing), which are not required to be disclosed between contracting parties, and those facts which are merely *redistributive*, which the knower is required to disclose to the knowee.⁶ Lastly, in a fascinating book addressing the legal issues and rights that flow from, and are related to, the phenomenon of “secrecy,”

1. Anthony T. Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1, 1–2 (1978).

2. For a fuller explanation of Dean Kronman’s thesis, see *infra* notes 19–23 and accompanying text.

3. For ease of discussion, the party possessing knowledge of the material fact will hereafter be referred to as the *knower* and the party to whom the fact will either be disclosed or not, depending upon the rule and the allocation of duty, will hereafter be referred to as the *knowee*.

4. Kronman, *supra* note 1, at 13–14. For further discussion, see *infra* notes 19–28 and accompanying text.

5. ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 281–86 (4th ed. 2004).

6. For a fuller explanation of Cooter and Ulen’s thesis, see *infra* notes 31, 33–35, 100 and accompanying text.

Professor Scheppele theorizes that one party to a contract is privileged to keep a secret premised on the relative cost of each party's access to the material fact or relevant information.⁷ Briefly, Professor Scheppele's disclosure theory mandates disclosure of secret information if the marginal cost of that information is much less for one party to the contract than for the other party to the contract.⁸

Although most of these theories have been articulated to explain why disclosure is or is not required in certain contracting situations having to do with the sale of personalty, it is clear that these theories, if correct, must also apply to contracting situations involving the sale of realty. That is, when the vendor and vendee enter into the contract for the purchase and sale of real property, they execute a contract that allocates their respective rights and liabilities. A critical issue at the time of contract formation has to do with what, if any, facts the vendor-seller (knower) must disclose to the vendee-buyer (knowee) regarding the condition of the premises being sold. Enter the doctrine of caveat emptor, which at common law, in its purest form, provides a safe harbor to the vendor-seller not to disclose *any* information to the vendee-buyer.⁹ Caveat emptor, then, is a huge exception to any doctrine

7. KIM LANE SCHEPELE, LEGAL SECRETS: EQUALITY AND EFFICIENCY IN THE COMMON LAW 109–26 (1988).

8. *Id.* In contrast, Scheppele rejects an efficiency explanation and reinterprets the line of cases similar to *Laidlaw v. Organ*, 15 U.S. (2 Wheat.) 178 (1817), in terms of an equal access principle, according to which disclosure is mandatory if the marginal cost of information is much less for one party to the contract than for the other party. *See also* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 260 n.8 (1st ed. 1988); SCHEPELE, *supra* note 7, at 112–24. In *Laidlaw*, the British blockaded the port of New Orleans during the War of 1812, which caused the price of exported goods—in this case, tobacco—to drop. *Organ*, a purchaser of tobacco, received information before the market that the war had ended by treaty and purchased tobacco at the depressed blockade price. When the treaty was made public, the price of tobacco soared. *Laidlaw*, 15 U.S. (2 Wheat.) at 183–84. This is the prototypical case involving unilateral mistake; *Organ* knew about the treaty but the seller, *Laidlaw*, did not, and the seller sought to set the contract aside based on the unilateral mistake in formation. Ultimately the Supreme Court affirmed the contract. *Id.* at 195. It is this case that is discussed by Dean Kronman, Professors Cooter and Ulen, and Professor Scheppele to test their various justifications for rules requiring the disclosure of information for contracting parties.

9. Although discussed in more detail in Part II, simply put, the common law doctrine of caveat emptor, or “let the buyer beware,” means that in the absence of fraud, misrepresentation, or active concealment, the seller is under no duty to disclose any defects—except those latent defects known to create an unreasonable risk of harm to persons on the premises—in the subject premises to the putative buyer, and the buyer has a duty to discover such defects upon a reasonable examination of the property. *See* ALEX M. JOHNSON, JR., UNDERSTANDING MODERN REAL ESTATE TRANSACTIONS

requiring the disclosure of information from the knower to the knowee.

This Article examines the economic theories that model rules requiring the disclosure of information between contracting parties in light of the development and evolution of the doctrine of caveat emptor. If correct, these theories predicting when information must be disclosed must account for the common law usurpation of disclosure requirements in the purchase and sale of realty. In other words, if the economic analysis is correct, these theories must explain why no disclosure of information is required with respect to the sale of realty at common law. The alternative explanation is that the caveat emptor doctrine should not be applied with respect to the sale of realty—that its use has been erroneous for centuries. Hence if the theories are accurate, some disclosure is or should be required with respect to the sale of realty. Conversely, if the economic theory mandates disclosure of certain information even with respect to the sale of realty, perhaps the common law doctrine of caveat emptor is ill-suited to address issues that arise from modern-day real estate transactions.

Mapping these economic theories on the doctrine of caveat emptor is, however, not without problems. The doctrine has not remained static over time. Indeed, although it is fair to say that the common law doctrine is fairly easy to articulate and apply, the doctrine itself, as applied by the courts, has become riddled with exceptions and has been made null and void by certain legislative enactments. Thus, a case can be made that the rationale for the use of caveat emptor with respect to the sale of realty may have been appropriate at the time the doctrine was developed. However, changes in the nature of the property being sold may have resulted, over time, in the need for information to be disclosed consistent with the theories discussed above. This requirement of disclosure of information from seller to buyer in the residential real estate transaction, expressed as exceptions to the caveat emptor doctrine, may demonstrate the efficacy of the economic theories put forth to explain disclosure rules. However, in one final twist, these theories must also explain why the doctrine of caveat emptor, in a modified form that I characterize as “caveat emptor light,” is now emerging as a result of court opinions and legislative enactments.

In other words, applying these economic theories to the doctrine may have power to explicate what is currently a puzzle: Why has the common law doctrine of caveat emptor been obliterated through exceptions causing yet another version of caveat emptor—caveat emptor light—to emerge as a result? Factor in the changing nature of the real estate being

§ 2.06(A) (2d ed. 2007).

sold (agrarian land to complex residential dwellings) and the stage is set for a historical analysis of a doctrine that has transformed itself to adapt to current transactional norms. Consequently, following a brief primer on the three economic theories which attempt to explain when disclosure is or should be required among contracting parties and which would tend to eliminate or disprove the need for caveat emptor in any real estate transaction, this Article begins with a historical exegesis of the doctrine of caveat emptor.¹⁰

As a result, this Article examines the evolution of the caveat emptor doctrine from its common law origins to its current status in American law. In so doing, this historical analysis tests several economic theories and attempts to analyze the same in light of the doctrine's evolution. By using economic theory regarding when material facts should be disclosed, I hope to demonstrate that the original formulation of caveat emptor at common law was the correct and efficient rule for the parties at that time. Conversely, I demonstrate that the exceptions which have become associated with the caveat emptor rule—which have riddled the rule—represent attempts by the courts to align disclosure requirements to parties to a transaction which bears little resemblance to the vendor-vendee transaction that originated at common law in agrarian England.

What I hope to demonstrate is that caveat emptor in its pristine common law form is deemed inapposite for the modern residential real estate transaction, yet perfectly suited for the real estate transactions that took place as the doctrine was originally developed and applied. It is the change in the very nature of the real estate transaction that caused the doctrine of caveat emptor to become inapposite for real estate transactions. However, the mandatory disclosure of all information from seller, or knower, to buyer, or knowee, as mandated by courts and laws focusing on the *status* of the parties, is also incongruent and inapposite with the economic theories requiring the disclosure of information. This is so because these new laws require inefficient disclosure of information by mandating the disclosure of all information, including that which is the product of deliberate investment and, relatedly, information that is equally available to both parties. As a result, and efficiently, caveat emptor light is emerging, which I will document is consistent with the economic theories requiring disclosure of information and correctly establishes the correct duty for disclosure of

10. See *infra* note 43 and accompanying text.

information from the knower, or vendor-seller, to the knowee, or vendee-buyer.

The evolution of caveat emptor also serves to validate Professor Rose's theory in her article, *Crystals and Mud in Property Law*,¹¹ which is addressed in the fourth and final part of this Article.¹² Professor Rose, analyzing the evolution of common law through judicial opinions, hypothesizes that, broadly speaking, judicial opinions often have the effect of taking what she terms a "crystal" rule—a rule that is easy to interpret and apply because its contours are certain, like caveat emptor—and ultimately transforming it into a "mud" rule—the antithesis of a crystal rule or a rule that is difficult to interpret and apply because of the rule's complexity or the fact-related nature of the rule which requires precise application of certain facts to a rule to produce a predictable outcome.¹³ In effect, I argue that the courts have done to the caveat emptor rule exactly what Professor Rose hypothesized. The courts have taken a simple and easy-to-apply rule and have muddied it to the extent that treatises and articles are now written regarding its applicability.¹⁴ The evolution of caveat emptor light represents an attempt to transform what is now a mud rule into a new crystal rule. This process by which the crystal rule becomes the mud rule and is in the throes of becoming crystal again is caused by courts' attempts to align the parties' duties to disclose information in the residential real estate transaction consistent with their acquisition of information about the residences being sold.

This Article is divided into four parts. Part I briefly summarizes the existing literature which provides an economic justification determining when material facts must be disclosed to an opposing party as part of the contracting process. Part II spends considerably more time analyzing the common law caveat emptor doctrine and its evolution to its current status as a doctrine heavily riddled with exceptions and on the verge of obsolescence. It pays particular attention to the evolution of the doctrine of caveat emptor by focusing on those exceptions to the doctrine to demonstrate that the common law doctrine of caveat emptor is premised on the parties having equal bargaining power and, as theorized by Professor Scheppele,¹⁵ is based on access to equal information which can be thwarted by the delivery of erroneous information or the

11. Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 580–83 (1988).

12. The impetus for this Article, in part, is Professor Rose's use of the caveat emptor doctrine—actually its erosion in modern law—as one of three examples of crystal rules evolving into mud rules. See *infra* notes 116–33 and accompanying text.

13. See Rose, *supra* note 11, at 580–83.

14. See *infra* note 120 and accompanying text.

15. See *supra* note 7 and accompanying text.

complexity of the dwelling conveyed. It then contrasts the economic theories in Part I with the caveat emptor doctrine examined in Part II to expose the conflict between the economic theories that explain when information must be disclosed and the evolution of the caveat emptor doctrine.

Part III continues the focus on caveat emptor light and demonstrates that courts and legislatures are attempting to align the disclosure rules regarding real property so that they are consistent with the economic theories regarding optimal disclosure rules postulated by Dean Kronman and Professors Cooter and Ulen. The problem, however, is the ad hoc nature of the determinations given the complexity of the property being transferred and the potential defects that can also arise. The modern residential dwelling is so complex and full of potential defects that can affect or impede value that ex post determinations regarding when disclosures must be made become factually driven rather than driven by any consistent theory.

Furthermore, the key to the judicial treatment of caveat emptor is the fact that the determination of breach of the duty of requisite disclosure is made with judicial hindsight; it is only later—after the sale—that one can determine whether the disclosure is or should have been required. Thus, the duty to disclose quickly evolves into the opposite of caveat emptor—the requirement that a seller make mandatory disclosures of every fact to the buyer and the safe harbor provisions of statutes detailing which facts must be disclosed.¹⁶

Thus, the concluding portion of Part III also traces the reemergence of caveat emptor, as provided by statutes which allow sellers to once again make no representation or warranty with respect to the quality of the premises sold, thereby allowing the seller to sell the property as is. This new imposition of caveat emptor is accomplished by a shift in the default rules that has heretofore gone unnoticed, but represents an important aspect of the development of the new rules of caveat emptor, or caveat emptor light.¹⁷

16. By delineating which disclosures must be made from seller to buyer, these statutes make residential real estate transactions homogenous—assume all properties are similarly situated and that all buyers and sellers possess and request the same information—and remove the probity of nondisclosure of facts or conditions not covered by the statutes from any hindsight determination. For further discussion, see *infra* notes 85–92 and accompanying text.

17. The important shift in the default rule is that at common law, the seller could remain silent and take advantage of the doctrine of caveat emptor as long as the seller

The fourth and concluding part of the Article returns briefly to the doctrine of caveat emptor in order to reconcile the apparent conflict between the economic theories and the doctrine of caveat emptor. I argue that this apparent conflict disappears when the caveat emptor cases are viewed through a historical prism in which the sale of real property is viewed as evolving from a transaction in which certain information is never produced or acquired because that information is easily accessible to both parties, to its current “modern” iteration in which deliberate and casually acquired information is routinely produced. To support my thesis, and as noted above, I demonstrate that caveat emptor light has emerged and will continue to develop and solidify in a process eloquently described by Professor Rose.¹⁸

When coupled with Professor Rose’s analysis, the economic theories on disclosure of information serve as powerful explanatory theories to make pellucid why the caveat emptor doctrine in its pristine common law formulation is ill-suited for modern transactions and, as a result, has become riven with exceptions giving rise to caveat emptor light. Lastly, I add one observation to Professor Rose’s theory that may explain why crystal rules become mud rules in some areas, but not others. Professor Rose’s theory more likely applies to areas in which the subject area of the law is also changing or evolving. As technological advances alter, modify, or redefine that which is the subject or object of the law, the law must also adapt to internalize the changes that have created new forms of property subject to old or inapposite rules.

I. THE ECONOMIC THEORIES REGARDING DISCLOSURE OF INFORMATION

By examining cases involving unilateral mistake and, more particularly, when a unilaterally mistaken promisor is excused from performing per the contract when her error is known or should be known to the other party, Dean Kronman presents a theory of when information possessed by one contracting party—the knower—must be disclosed to the other contracting party—the knowee—and, conversely, when nondisclosure is privileged in the same setting. Dean Kronman first establishes that the possession of information should be treated by the state as a property right in order to allow individuals to benefit from the possession of secret or semi-secret information.

remained silent. *See infra* notes 92, 95–100, 112 and accompanying text. Under the modern formulation of caveat emptor, the seller can remain silent but in so doing must alert the buyer that the silence has legal consequences—the purchaser buying the property as is—that the buyer must internalize as part of the sale.

18. *See* Rose, *supra* note 11.

One effective way of insuring that an individual will benefit from the possession of information (or anything else for that matter) is to assign him a property right in the information itself—a right or entitlement to invoke the coercive machinery of the state in order to exclude others from its use and enjoyment. The benefits of possession become secure only when the state transforms the possessor of information into an owner by investing him with a legally enforceable property right of some sort or other. The assignment of property rights in information is a familiar feature of our legal system. The legal protection accorded patented inventions and certain trade secrets are two obvious examples.¹⁹

Dean Kronman then extends this standard economic theory to contracting parties and explains that a property right in information is similarly created when a party possessing material or relevant information is permitted to enter and enforce contracts without disclosing the information to the other party. Concomitantly, a duty to disclose information is the equivalent of a requirement that the information be “publicly shared” and would destroy the legal protection afforded to private property.²⁰ From this basic theory of property rights, Kronman draws a distinction between information that must be disclosed—property in the public domain and which cannot be held privately—and information that need not be disclosed to the other contracting party.²¹ The latter is deemed and treated as private property that is protected by society through enforcement of the contract notwithstanding the nondisclosure and is premised on an economic justification. The economic justification that undergirds the theory is that society is better off when investments are encouraged or made in the creation or production of information that will subsequently affect investments or investment decisions. More importantly, the investment that creates the production of information will be made at a socially desirable level only if that information is protected by “a legal privilege of nondisclosure [that] is in effect a property right . . .”²²

19. Kronman, *supra* note 1, at 14 (footnotes omitted).

20. Imposing a duty to disclose upon the knowledgeable party deprives him of a private advantage which the information would otherwise afford. A duty to disclose is tantamount to a requirement that the benefit of the information be publicly shared and is thus antithetical to the notion of a property right which—whatever else it may entail—always requires the legal protection of private appropriation.

Id. at 15 (footnote omitted).

21. *Id.*

22. *Id.* at 2.

Hence, it is only when investments are made in the acquisition or production of information that the investor should be awarded the protection of a property right. Dean Kronman characterizes this information as deliberately acquired information and contrasts its antimony, casually acquired information.

In some cases, the individuals who supply information have obtained it by a deliberate search; in other cases, their information has been acquired casually. . . .

As it is used here, the term “deliberately acquired information” means information whose acquisition entails costs which would not have been incurred but for the likelihood, however great, that the information in question would actually be produced. These costs may include, of course, not only direct search costs (the cost of examining the corporation’s annual statement) but the costs of developing an initial expertise as well (for example, the cost of attending business school). If the costs incurred in acquiring the information . . . would have been incurred in any case—that is, whether or not the information was forthcoming—the information may be said to have been casually acquired. The distinction between deliberately and casually acquired information is a shorthand way of expressing this economic difference. Although in reality it may be difficult to determine whether any particular item of information has been acquired in one way or the other, the distinction between these two types of information has—as I hope to show—considerable analytical usefulness.²³

Relating this theory to the purchase and sale of real property and the doctrine of caveat emptor, Dean Kronman asserts that, except in one context involving patent defects, the information possessed by the typical homeowner and vendor is casually acquired information—information that would have been acquired in any event—which should lead to its disclosure.²⁴ With respect to patent or obvious defects, Dean Kronman agrees with the prevailing and almost universally held view that such defects need not be disclosed. He aligns this nondisclosure rule with his theory by noting that since the information not disclosed is patent, its disclosure is unnecessary since the party on whom the nondisclosure burden would be placed, the vendor-seller, assumes that

From a social point of view, it is desirable that information which reveals a change in circumstances affecting the relative value of commodities [for example] reach the market as quickly as possible (or put differently, that the time between the change itself and its comprehension and assessment be minimized). If a farmer who would have planted tobacco had he known of the change plants peanuts instead, he will have to choose between either uprooting one crop and substituting another (which may be prohibitively expensive and will in any case be costly), or devoting his land to a nonoptimal use. In either case, both the individual farmer and society as a whole will be worse off than if he had planted tobacco to begin with. The sooner information of the change [in the market] reaches the farmer, the less likely it is that social resources will be wasted.

Id. at 12 (footnote omitted).

23. *Id.* (footnotes omitted).

24. *Id.* at 22–25.

the other party, the vendee-buyer, is already in possession of that information given its obviousness. As a result, he states that a legal rule requiring communication of this sort would needlessly increase transaction costs, with no corresponding benefit, because knowledge of a patent defect is “equally available to the parties.”²⁵

Thus, Dean Kronman agrees with the emerging trend to require the disclosure of information regarding the status of the property being sold and the concomitant large-scale erosion of the doctrine of caveat emptor because the information being disclosed is casually acquired and the disclosing seller is the “cheapest cost avoider” given the seller’s obvious access to information concerning the quality of the dwelling and any potential defects.²⁶ In other words, the rule should protect nondisclosure only if the “seller has made a deliberate investment in acquiring his knowledge which he would not have made had he known he would be required to disclose to purchasers of the property any defects he discovered.”²⁷ Discovering termites, for example, would not be the type of deliberately acquired information that the homeowner would be privileged to withhold from—not to disclose to—the vendee-purchaser.

To the contrary, this information would have to be disclosed because it is either casually acquired by the homeowner-seller during the course of living in the residence or, even if it is the product of a deliberate investment, such as hiring a termite inspector to search for latent termite infestation, it is an investment that the homeowner-seller would make in any event to protect his investment in the property. In other words, even if it were the product of a deliberate investment, a disclosure requirement would not likely reduce the production of such information in the future. Hence, there is no societal incentive to privilege that information—protect it as property—when the information regarding the existence of termites is initially possessed solely by the homeowner-seller.

To sum up, Dean Kronman’s theory, as it pertains to the sale of real property, states that the information possessed by typical homeowners selling their house is casually acquired information or, if the product of investment, is information that would have been acquired in any event which should lead to its disclosure. The only exception relates to patent or obvious defects in the property being sold.

25. *Id.* at 23.

26. *Id.*

27. *Id.* at 25.

Assuming arguendo that Dean Kronman is correct, it does not explain why the common law rule was and is to the contrary. In other words, the doctrine of caveat emptor, which is discussed in detail below,²⁸ establishes the exact opposite rule—that the seller has no duty to disclose any information to the buyer, and it is the buyers of the realty who must conduct their own inspection and assume the risk of loss caused by any latent defects if they decide to purchase.²⁹

Of course, as noted below, the modern doctrine of caveat emptor is riddled with exceptions and is on the decline.³⁰ Hence, one could make the argument that the doctrine in its original formulation was improperly applied to the sale of real property and should no longer be applied to the sale of realty. Although this flies in the face of historical reality, one can defend the erosion of the doctrine of caveat emptor and, relatedly, the lack of duty imposed on the seller to disclose patent defects, as positive developments from an efficiency or economic standpoint, because when the seller is forced to disclose information that is casually acquired, the disclosing seller is the cheapest cost avoider. In addition, and perhaps just as importantly, such a disclosure requirement with respect to the condition of the realty being sold would not likely reduce the production of such information in the future.

As noted above, there are two additional theories which attempt to determine and explain when disclosure is or should be required by and between contracting parties. Professor Scheppele's theory, expressed in her book and discussed in an earlier edition of Cooter and Ulen's treatise, is premised on an equal access principle.³¹ As I understand it, Professor Scheppele believes that disclosure should be mandatory if the production costs or the marginal cost of information is much less for one party to the contract than it is for the other party. Thus, Professor Scheppele's theory puts the burden for the acquisition and disclosure of information on the person with the most effective or efficient access to the information and reduces or eliminates costs that could inhibit or increase the cost of the transaction thereby precluding or impeding same.

Pursuant to this theory, akin to Dean Kronman's theory, the selling homeowner and occupier of the house being sold has easier and greater access to the condition of the premises sold than the vendee-buyer of the

28. See *infra* notes 59–62 and accompanying text.

29. Compare, however, latent defects that are dangerous, that is they represent a serious risk of harm to the purchaser or visitors to the property and are known to the seller. These latent defects that are dangerous and known to the seller must be disclosed to the buyer. This represents the only exception in the common law doctrine of caveat emptor. See JOHNSON, *supra* note 9, § 2.06(B)(1).

30. See *infra* notes 63–83 and accompanying text.

31. SCHEPPELE, *supra* note 7, at 109–26; COOTER & ULEN, *supra* note 8, at 260 n.8.

house. Consequently, the vendor-seller would have the duty to disclose material information to the vendee-buyer. The only exception, again, would be with respect to patent defects. Since those defects are by definition obvious and apparent to both parties, the seller no longer has better or easier access to the information regarding this particular defect and, correspondingly, no duty to disclose it. As addressed below, applying this theory to the sale of real estate results in the large-scale eradication of the doctrine of caveat emptor and raises new questions regarding its efficacy with respect to the sale of real property.³²

The third and last theory to address the efficient production of information from one contracting party, the knower, to the other, the knowee, is that elaborated by Professors Cooter and Ulen in their exceptional treatise, *Law and Economics*.³³ Professors Cooter and Ulen base their theory on the distinction between so-called productive versus redistributive information. Simply put, productive facts are those facts that are used to increase wealth.³⁴ On the other hand, redistributive facts are those facts that simply reallocate wealth between the contracting parties. It is information that creates a bargaining advantage that can be used to redistribute wealth in favor of the knowledgeable party, the knower, but does not lead to creation of new wealth, or does not grow the pie.

Professors Cooter and Ulen recognize that their distinction between productive and nonproductive facts differs from Dean Kronman's distinction between deliberately and casually acquired information, but assert that they are related tests in that both distinctions seek to validate those facts and the search for information or production of facts that is efficient and, therefore, encourages and rewards that efficient behavior.³⁵

Professors Cooter and Ulen also concede that the distinction between productive and redistributive facts is not often clear and that most new facts acquired by the knower are mixed in that they both produce new wealth and redistribute existing wealth. Hence, the authors conclude that most new facts acquired by the knower are mixed, and that in their analysis of contracts that are enforced versus those that are set aside for

32. See *infra* notes 36–42 and accompanying text. Access to information is a very broad term because the seller will always know more than the buyer even if the buyer has exercised the right to inspect the property and has done so thoroughly.

33. COOTER & ULEN, *supra* note 5, at 281–86.

34. *Id.* at 281.

35. *Id.* at 283 n.37.

nondisclosure of information, the contracts that are enforced are those where the knower has knowledge of mixed facts—productive and redistributive—and those that are set aside are those where the knower has knowledge of purely redistributive facts and fails to disclose them to the knowee. From these scenarios, they draw the conclusion that knowledge and the creation of private rights in productive facts should be encouraged, and gains based on private knowledge of purely redistributive facts should be discouraged through the use of contractual remedies.

Without going into too much detail, it should be obvious that Dean Kronman's theory of deliberate versus casually acquired facts and Professors Cooter and Ulen's theory of productive versus redistributive facts can be combined to produce one theory in which there are four cells. The cell that would be the most supportive of nondisclosure on the part of the knower would be that cell that consists of deliberately acquired information that is productive. Its antimony is casually acquired redistributive facts in which disclosure is required under both theories. In these two bipolar extremes, one would expect to see the cases decided consistently—no disclosure required for deliberately acquired productive facts and disclosure required for casually acquired redistributive facts known to the knower. If these theories are accurate or at all explanatory, one would expect to see mixed outcomes in cases in which the two theories point in different directions—deliberately acquired facts that are redistributive or casually acquired facts that are wealth-enhancing or wealth-producing.³⁶

36. Professor Scheppele's theory, which is premised on access and is discussed *supra* at note 31 and accompanying text, can also be combined here to strengthen the two bipolar cells that lead to divergent outcomes in all cases. By that I mean, if the deliberately acquired and productive fact is accessible to both parties and discovered by one, this fact should not have to be disclosed by the knower. Conversely, if the casually acquired, distributive fact is accessible to only one party—or accessible to the knowee at a much greater cost—then the fact should be disclosed.

At this time I want to disaggregate Professor Scheppele's theory from the theories of Dean Kronman and Professors Cooter and Ulen because I believe her theory may, in many cases, be too subjective and difficult to apply for the trier of fact. Determining access to facts or knowledge and the costs of that access or knowledge will require some inquiry into the state of knowledge or mind of both parties before the fact is discovered. That inquiry differs from the hindsight, or later, determination regarding whether a fact is deliberately acquired, which focuses on the objective steps the knower took to gain control or knowledge of the pertinent fact, or whether a fact is productive or merely redistributive, which simply requires a calculation of wealth affects after the fact is known by one or both parties. However, Professor Scheppele's theory is pertinent to the residential real estate market given its focus on access that is clearly divergent and dispositive in residential real estate transactions where the seller, or knower, has lived in the property being sold and the buyer, or knowee, does not and will not have access until after the transaction is concluded.

Mapping these theories onto the sale of residential real estate, one initially faces a hurdle: How did the doctrine of caveat emptor—“let the buyer beware”—with its concomitant lack of duty of disclosure, emerge in the sale of residential real property? A quick review of the three theories discussed and their applicability to the residential real estate transaction almost immediately leads to the contrary conclusion that the seller of residential real estate—the knower in the hypotheticals above—should have a duty to disclose information known to the buyer—the knowee above—given any of the three theories posited to explain and require the disclosure of information. That, of course, is the antithesis of the caveat emptor rule, which, in its purest form, requires that the seller say nothing to the buyer with respect to the condition of the premises sold.³⁷

Take, for example, the homeowner who has owned her home for a period of ten years and who during that time has incurred costs for plumbing, electric, and heating repairs, as well as paid a professional exterminator to rid the house of termites, the latter of which were discovered in the second year of occupancy. As a result of this owner’s occupancy of the premises, she is aware that when it rains more than four inches in a twenty-four hour period, the basement floods. Similarly, the owner-seller is aware that the termite infestation will more than likely reoccur unless the home is treated annually. Finally, although this will become important later, the homeowner is selling the house because her spouse was murdered in the house by an intruder, and she no longer views the house as a home.³⁸

37. Indeed, in certain situations silence is a safe harbor that the seller should be encouraged to take advantage of lest the seller be accused of misrepresenting facts by omission:

The doctrine of caveat emptor does not protect the seller of a pre-owned home from tort liability for affirmative misrepresentation or concealment of defects in the property. Though some “puffing” and sales talk is permissible, sellers must act reasonably in order to avoid a future misrepresentation claim. Sellers must disclose any known information that might affect the buyer’s decision to purchase, and they are held just as liable for concealing the truth as they are for telling outright lies.

JOHNSON, *supra* note 9, § 2.06(B)(2) (footnote omitted).

38. I posit this last fact situation to plumb the issues that have arisen recently regarding whether there is a duty on the part of the seller to disclose so-called reputational or psychic harms associated with the dwelling to the putative buyer. For further discussion, see *infra* note 47 and text accompanying notes 109–10.

At common law, as long as these conditions were not dangerous and latent, and there was no active concealment of any of these conditions or misrepresentations about them if asked directly, the seller had no duty to disclose these conditions even though the conditions were material and relevant to the price of the property sold. If the buyer did not discover these conditions during his inspection, and if there were no warranties or guarantees with respect to the sale—the property is sold as is—the buyer purchased the property with its defects and the buyer was forced to accept said property in that condition with no recourse—rescission or damages—against the nondisclosing seller.

And yet according to the three economic theories regarding disclosure of information, the selling homeowner presents perhaps the clearest case that the homeowner should disclose all of the information described above to the buyer before the sale is consummated to accomplish the efficient and correct outcome. Taking first the most prominent theory, that put forth by Dean Kronman,³⁹ it would appear obvious that information acquired by the homeowner in the context of owning one's home is or will be defined as information that is casually acquired as opposed to information that is the product of an investment and deliberately acquired.⁴⁰

Without going into great, and I believe unnecessary, detail, I think it is beyond doubt that a homeowner's acquisition of the information described above regarding the quality of the house in question is information that is casually acquired, like that information acquired by the businessperson riding the bus overhearing a conversation between two other riders that provides the businessperson with valuable information regarding an initial public offering (IPO).⁴¹ The principal purpose for purchasing the house is to reside in the house—to occupy the dwelling. The information regarding the quality of the house is information that is ancillary to the occupation of the house. In other words, the costs of producing that information would have been incurred as a byproduct of living in the home, and the costs to produce that information would have been incurred whether the information in question would have actually been

39. See *supra* notes 19–28 and accompanying text.

40. In some cases, the individuals who supply information have obtained it by a deliberate search; in other cases, their information has been acquired casually. A securities analyst, for example, acquires information about a particular corporation in a deliberate fashion—by carefully studying evidence of its economic performance. By contrast, a businessman who acquires a valuable piece of information when he accidentally overhears a conversation on a bus acquires the information casually. Kronman, *supra* note 1, at 13 (footnotes omitted). For a definition of deliberately acquired information, see *supra* note 23 and accompanying text.

41. See Kronman, *supra* note 1, at 13.

produced.⁴² The production of this information was a byproduct of the costs of living in the home and not the result of any deliberate search for any information or expenditure of special costs to obtain information that would not otherwise be produced. I can belabor the point, but it appears to be an obvious one. The typical information possessed by a homeowner acquired as a byproduct of the occupation and use of a dwelling would appear to be the prototypical example of casually acquired information. Therefore, that information is clearly the type of information that, per Dean Kronman's theory, must be disclosed, if relevant to the other contracting party—the vendee-knowee purchasing the property.

Turning to the two other theories discussed above, it should also be obvious that the homeowner possesses information that is clearly redistributive as opposed to information that will produce new wealth. The fact that the basement floods periodically, that the home has been infested by termites, and that a murder took place in the home will not in any circumstances create any new wealth for either the seller or the buyer in this situation. Quite the contrary, the possession of this information by one party, to the exclusion of the other party, could and should lead to the redistribution of the wealth between the parties as reflected in the sales price. The buyer may pay more than warranted for the house without knowledge of the relevant information. Conversely, if the buyer is aware of the property's defects, the price paid for the property may be reduced, leaving more wealth in the hands of the buyer and providing less to the seller.

Examining the last theory discussed above, access to information put forward by Professor Scheppele, this is yet another example where the answer is obvious: the seller who has occupied the house for several years has much better access to the information than the buyer, even one who has hired an inspector to undertake an inspection of the building, and therefore should be required to disclose that relevant information to the buyer. Again the point is an obvious one, but living in the home full time over a period of years clearly provides the seller with more and better access to the dwelling and the pertinent facts regarding the quality

42. *Id.* In this setting, information that would be deliberately acquired would be information obtained by a housing inspector if hired by the purchasing vendee to inspect the home and provide the vendee with a report on the quality of the house. That information "entails costs which would not have been incurred but for the likelihood, however great, that the information in question would actually be produced." *Id.*

of the dwelling as opposed to the episodic and limited searches or inspections undertaken by the putative buyer and the buyer's agents.

Consequently a review of all the theories reveals a puzzle—all point to disclosure by the vendor, the knower, to the vendee, the knowee. Yet the rule is the opposite: at common law the seller has no duty to disclose any facts regarding the quality of the premises to the vendee under the common law doctrine of *caveat emptor*. Thus, none of these theories can adequately explain the rationale and development of the doctrine of *caveat emptor* with respect to the sale of realty and its evolution in the common law.

However, after giving the matter some thought and doing some historical homework, I have reached the conclusion that all three theories detailing when it is efficient to disclose information—deliberately acquired facts, wealth-producing facts, and facts inaccessible or less accessible to the other contracting party—do indeed support the use of a historical development of *caveat emptor* in the sale of real estate. The conundrum is resolved via the recognition that the *caveat emptor* doctrine, in its pristine form, only requires the disclosure of latent dangerous defective conditions and has never required the dissemination or disclosure of patent or obvious defects. Indeed, as the doctrine of *caveat emptor* has eroded to become a shell of the pristine common law doctrine, the one constant rule embodied in the doctrine, no matter what the exceptions or limitations on the common law doctrine, is that the seller, the knower, does not and has not ever had the duty to disclose patent or obvious defects to the knowee. It is that limitation on the erosion of the *caveat emptor* doctrine that holds the key to the explication of the primary premise of this Article—the doctrine of *caveat emptor*, its erosion, and its reemergence in the guise of *caveat emptor* light are consistent with economic theories requiring the efficient disclosure of information from one contracting party to the other.

Thus, it is not the doctrine of *caveat emptor* that has evolved to accommodate efficient legal theories or to adapt to the alleged change in bargaining power and knowledge by the contracting parties with respect to the sale of real estate, which is said to be the usual reason for the erosion of the common law doctrine of *caveat emptor*.⁴³ Instead, the

43. The sale of residential property, traditionally viewed as an arena involving buyers and sellers, is increasingly the subject of legislative scrutiny. Previously, buyers and sellers, dealing at arms length, were presumed to have the essential skills and bargaining power to negotiate an equitable transaction. Buyers were presumed to investigate each potential purchase to determine whether the particular piece of property met the buyer's criteria. Upon discovering any undesirable characteristics or "defects" in the parcel, the buyer presumably presented these concerns to the seller and either used the information as a

focus should be on the evolution of the character of the property transferred that is the subject of the doctrine that has shaped and caused its evolution to its current form consistent with the three economic theories detailing the efficient disclosure of information. That fact is tacitly recognized by Dean Kronman when he concludes that with one exception—patent defects—the information possessed by a typical homeowner is casually acquired information, or information that would have been acquired in any event. As a result, the selling homeowner should disclose that information which is contra to the doctrine of caveat emptor.⁴⁴

Although Dean Kronman does not explain why caveat emptor was initially the doctrine employed by the courts with respect to the sale of realty, he does address the situation in which a selling party is privileged *not* to disclose even casually acquired information with respect to the sale of realty. The exception occurs with respect to patent or obvious defects. Since this class of defects is obvious, its disclosure is unnecessary since the party on whom the disclosure burden is or would be placed assumes that the other party is already in possession of that information given the patent nature of the defect.⁴⁵ The key is tying that observation to the type of property being sold at the time that the caveat emptor doctrine was developed.

At the time the common law doctrine of caveat emptor developed, the property being transferred was agrarian in nature and disclosure of any information was unnecessary because the party upon whom the

bargaining tool to adjust the consideration in the transaction or decided that the defective property was no longer desirable and terminated the negotiations.

This format was the means of facilitating real estate transactions for many years, until it was considered out of harmony with modern concepts of justice.

Steven C. Tyszka, Note, *Remnants of the Doctrine of Caveat Emptor May Remain Despite Enactment of Michigan's Seller Disclosure Act*, 41 WAYNE L. REV. 1497, 1497 (1995) (emphasis added) (footnotes omitted).

44. Kronman, *supra* note 1, at 23.

45. *Id.* With respect to latent defects and the emerging trend to require their disclosure and the concomitant erosion of the doctrine of caveat emptor, Dean Kronman defends that erosion and characterizes it as a beneficial development from an efficiency or economic standpoint because when the information is casually acquired, the disclosing seller—the knower—is the cheapest cost avoider. If the rule should be the obverse, it would be inefficient in that the “seller has made a deliberate investment in acquiring his knowledge which he would not have made had he known he would be required to disclose to purchasers of the property any defects he discovered.” *Id.* at 25. The common law doctrine of caveat emptor, its erosion, and its current iteration are all efficient.

disclosure burden was placed—the knower-seller—assumed that the other party—the knowee-buyer—was already in possession of that information. The buyer was in possession of this information because the entire quality or character of the premises was accessible to the buyer upon a reasonable inspection of the premises. As a result, at the time the doctrine developed, disclosure of defects of the typical agrarian structure would have been unnecessary since the party upon whom the disclosure was placed correctly assumed that the other party—the purchasing party—was in possession of that information as a result of that party's inspection of the premises. At this stage in the development of real property, all defects were patent and discoverable by the buyer.

The problem with the application of the caveat emptor doctrine to modern residential dwellings is that the original premise supporting the use of the common law doctrine of caveat emptor is no longer true—all defects are no longer patent. The common law caveat emptor doctrine presupposes that all defects in a property are patent and that there is no need for the communication of them from seller to buyer. Today, however, most defects are latent and not easily discoverable upon a visible inspection, even a carefully conducted inspection, of the premises. It is the change in the nature of the dwelling that is the subject of the doctrine, the possession of valuable casually acquired information by the seller, and, lastly, the concomitant duty to disclose imposed on sellers today in most jurisdictions that have caused the erosion of the common law doctrine.

Hence, over time patent defects became latent defects, requiring disclosure which is consistent with the economic theories addressed above because the knower was aware of these latent defects and acquired that information not as a result of a deliberative search for information. Furthermore, the seller is clearly the party who has the most efficient access to the dwelling to determine the quality of the premises demised. These facts, coupled with the additional fact that the knowledge of these latent defects do not create wealth, but simply cause the redistribution of wealth, explain why the common law doctrine of caveat emptor is riddled with exceptions and is no longer viable in today's society.

In Part II, I turn my attention to the evolution of the doctrine of caveat emptor to demonstrate how the changing character of the property being conveyed forced the exceptions to the caveat emptor doctrine that have now swallowed the rule. In so doing, I confront and address a new issue raised by the evolution of the caveat emptor doctrine—the demise of caveat emptor in its common law iteration and its reemergence as caveat emptor light. As the common law caveat emptor doctrine became inapposite to the sale of real property, courts, and subsequently legislators, were left to decide which facts, those that are casually acquired and

redistributive being the easiest to identify, must be disclosed by the seller to the buyer.

I hope to demonstrate that because casually acquired information is determined after the sale has occurred in a transaction in which no new wealth is being created, because the sale of a house typically does not cause the creation of new assets or growth in existing assets, it is quite easy to come to the conclusion that any knowledge possessed by the seller-knower is casually acquired, redistributive information that must or should have been disclosed to the buyer-knowee. The court's hindsight-based decision that facts must be disclosed has ultimately caused the abolition of the doctrine of caveat emptor by essentially requiring the disclosure of every fact.

The problem with the disclosure of all casually acquired information is that it is hard to police and discriminate between casually acquired and deliberately acquired information when the judgment is made ex post in a setting like the sale of residential real estate. The problem is exacerbated because if the seller lives in the home, the act of living in the home will result in the acquisition of casually acquired information and deliberately acquired information, and it will be impossible to distinguish between the two in any principled way.

In Part II, I address a related problem created by the ex post nature of the determination of whether facts are casually or deliberately acquired in the context of a residential real estate sale. Once it is recognized that litigation will occur regarding whether disclosure was required for those facts which were not disclosed—this seems rather obvious but raises an important point that facts adequately disclosed create issues perhaps involving misrepresentation or fraud, but not nondisclosure—what courts are essentially deciding is whether a fact should have been disclosed after the relevance of the fact, at least to the buyer who is ostensibly bringing the lawsuit, has already been at least partially proven.⁴⁶ This hindsight or ex post determination will almost inevitably result in a decision that it should have been disclosed if the fact affects the value of the premises, even those facts that the seller had no reason to know of or facts that the seller in good faith believed were patent or insignificant with respect to its impact on value. The erosion and obliteration of the common law doctrine has, in effect, caused the seller to become the *guarantor* of the value of the premises as it exists on the

46. See *infra* notes 63, 65, and accompanying text.

date of sale, warranting its value as to the state of facts as they exist on the date of sale.⁴⁷ Hence, the doctrine of nondisclosure has come full circle to become the doctrine of total and absolute disclosure as to all relevant facts, with the relevant facts being determined much later, with hindsight, by a trier of fact.⁴⁸

This has led to the final piece of the puzzle—why caveat emptor light has emerged. In a juridical world in which the relevance of facts are decided only after their relevance has been proven, it may be impossible for the seller to adequately perform its duty of disclosure if the seller, acting in good faith, is unaware of the fact, the relevance of the fact to the buyer or the larger real estate market, or its impact on value.⁴⁹ The seller, as guarantor of the value of the premises, may be unwilling to act as guarantor as to those unknown facts or facts that later cause a diminution in value over which the seller has no control. This has created an incentive for sellers to limit their duty of disclosure in order to limit their role as guarantors as to the value of the premises. This has led to the reemergence of caveat emptor in the guise of caveat emptor light. Caveat emptor light realigns the relationship of the parties consistent with their expectations and establishes appropriate default rules that the parties can bargain in light of given their respective positions. Furthermore, caveat emptor light is premised on the recognition that neither party is the so-called jack-of-all-trades agrarian farmer that represented the typical buyer and seller at the time the doctrine of caveat emptor emerged and came to dominate.⁵⁰

II. CAVEAT EMPTOR: A COMMON LAW DOCTRINE GONE AWRY— FOR GOOD AND EFFICIENT REASONS

The caveat emptor doctrine is a historical anomaly. Although originally conceived in the Middle Ages to allocate disclosure rights between

47. See, e.g., *Van Camp v. Bradford*, 63 Ohio Misc. 2d 245, 259–60 (C.P. 1993) (holding the seller liable for not disclosing the property’s psychological stigma—violent crimes that had occurred at or near the premises—to the buyer). *Van Camp* and cases like it represent the cutting edge of disclosure cases because information is not “visible” in the sense of a patent defect, but it is or can be discovered in many cases by a thorough search of the public record which would disclose the fact that a crime was committed on the subject property, that the owner died of AIDS, or that the house is haunted. For more on the latter, see *Stambovsky v. Ackley*, 572 N.Y.S.2d 672, 674 (App. Div. 1991), discussed *infra* at note 85 and accompanying text.

48. For further discussion, see *infra* notes 78–79 and accompanying text.

49. It is more common than you might think that a seller may not be aware of facts with respect to the quality of the premises that later cause a significant diminution in value. For a discussion of this issue, see *infra* notes 107–09 and accompanying text.

50. For further discussion of this point, see *infra* notes 113–15 and accompanying text.

buyers and sellers of real property, the doctrine survived for centuries even though the nature of the property governed by the doctrine changed—agrarian versus residential—as did the respective knowledge of the parties to the transactions—the prototypical jack-of-all-trades farmer in the Middle Ages to the clueless buyer and seller who have difficulty changing light bulbs in a residence. However, its survival was not without cost. The doctrine became riddled with exceptions and ultimately has been effectively abolished in several jurisdictions. Perversely, the judicial and statutory abolition of the caveat emptor doctrine has paved the way for the return of the doctrine, a doctrine I now call caveat emptor light.

To truly understand the issue, and obviously the evolution of the doctrine of caveat emptor, a historical exegesis is appropriate to place the issue in its appropriate historical context. Hence, this Part is divided into three chronologically oriented subparts. In the first, I briefly detail the original (or more accurately, historical) formulation of the doctrine of caveat emptor tracing its origination to England, of course, and the common law. From there, I document the erosion of the document by cases and statutes, focusing on the seller and the brokers, who are agents of the sellers and who have the duty to disclose certain information that was previously protected by the common law doctrine of caveat emptor. I conclude with my thesis that what is emerging is something akin to caveat emptor light, which requires the selling homeowner to disclose selective information or expressly disclaim the communication of any information from seller to buyer, reestablishing the default rule of caveat emptor as it existed at common law. That will lead to a discussion in Part III of the optimal rule for disclosure and whether caveat emptor light is such a rule.

A. *The Common Law Baseline*

Caveat emptor is part of a much larger Latin phrase which roughly translated means “let the buyer beware, who ought not be ignorant of the amount and nature of the interest he is about to buy, exercise caution.”⁵¹ The doctrine first emerged in ancient Rome and was quickly embraced as a common law rule governing residential real estate transactions in

51. See James R. Pomeranz, Note, *The State of Caveat Emptor in Alaska as it Applies to Real Property*, 13 ALASKA L. REV. 237, 237 (1996).

sixteenth-century England.⁵² At the time the rule developed, England was largely an agrarian society and the asset to which the rule applied, land being sold, was agrarian as well, with the land being transferred worth much more than the value of the structures built upon the land.⁵³ Since the structures constructed upon the land were so basic, and the knowledge of their quality was equally accessible to both parties—the buyer and seller—the buyer was easily able to inspect the land and discover any defects in the premises conveyed. Essentially, the buyer and seller had equal access to the condition of the premises and possessed equal bargaining power with respect to their knowledge and value of the premises conveyed.⁵⁴

Pursuant to the traditional doctrine of caveat emptor, the seller was under no obligation to disclose facts known to him but unknown to the buyer, irrespective of their impact on value or use of the premises.⁵⁵ The buyer's recourse was to carefully inspect the premises for defects and to ensure that the premises were suitable for their intended purpose. If the buyer's inspection revealed some material defect, the buyer could reject the deal, negotiate further regarding price or remediation of the defect, or demand an express warranty from the seller covering the defect.⁵⁶ Indeed, the seller was under no duty to say anything with respect to the condition of the premises. In this situation, silence was golden.⁵⁷

Essentially, the common law doctrine of caveat emptor does not require a seller to disclose defects and precludes recovery by a buyer for structural and other defects in the property being sold where: (1) the alleged defective condition is open to observation and is discoverable upon a reasonable inspection; (2) the buyer has the opportunity to examine the premises; and (3) there was no fraud on the part of the vendor with respect to the condition of the premises.⁵⁸

Simply put, under the traditional doctrine of caveat emptor, the seller

52. See *Stormont v. Astoria Ltd.*, 889 P.2d 1059, 1062 n.5 (Alaska 1995); Nicola W. Palmieri, *Good Faith Disclosures Required During Precontractual Negotiations*, 24 SETON HALL L. REV. 70, 110 (1993).

53. See Caryn M. Chittenden, *From Caveat Emptor to Consumer Equity—The Implied Warranty of Quality Under the Uniform Common Interest Ownership Act*, 27 WAKE FOREST L. REV. 571, 578 (1992).

54. *Id.*; see also *Conklin v. Hurley*, 428 So. 2d 654, 656–57 (Fla. 1983) (summarizing the history of caveat emptor).

55. Chittenden, *supra* note 53, at 578.

56. *Id.*

57. As Lord Cairns stated in the landmark case of *Peek v. Gurney*, (1873) 6 L.R.E. & I. App. 377, 403 (H.L.) (U.K.): “Mere non-disclosure of material facts, however morally censurable . . . would in my opinion, form no ground for an action in the nature of an action for misrepresentation.”

58. See *Jacobs v. Racevskis*, 663 N.E.2d 653, 655 (Ohio Ct. App. 1995).

is not required to disclose to the buyer any facts that might affect the value of the premises.⁵⁹ Another way of stating this is that if the seller said nothing about the condition or value of the property to be conveyed in her negotiations with the buyer, the seller could not be liable for any defects in the property sold to the buyer that are subsequently discovered by the buyer upon taking possession of the conveyed premises. In its pristine form, the doctrine of caveat emptor protected the silent seller of real estate whether the defects were latent or patent, whether they were known to the seller or not, and whether they were discoverable by the buyer upon a cursory or thorough inspection. Without active misrepresentation or fraud, of which more anon,⁶⁰ the buyer purchased the property as is and was indisputably and irrevocably the owner of the property following the transfer of title.

As previously indicated, the common law doctrine of caveat emptor does not bar recovery against the seller when the real estate seller has engaged in misrepresentation with respect to the condition of the demised premises. Notwithstanding the caveat emptor doctrine, under the common law, there are three theories pursuant to which the buyer can bring an action against the seller based on some species of misrepresentation by the seller: (1) intentional misrepresentation or fraud; (2) negligent misrepresentation; and (3) so-called innocent misrepresentation. Under any of these three theories, the buyer must prove that the innocently, negligently, or intentionally misrepresented fact was material and that the buyer justifiably relied on the representation in making the purchase.⁶¹

Quite clearly the common law doctrine of caveat emptor does not protect the seller against the buyer's claim when the seller has actively misrepresented the condition of the premises and in which the purchasing plaintiff can prove that the seller made:

“(1) a material representation which is (2) false and (3) known to be false, or made recklessly as an assertion of fact without knowledge of its truth or falsity, and (4) made with the intention that it be acted upon, and (5) acted upon with damage. . . .” In addition to these elements, it must also be proved that the [purchasing] plaintiff “(6) relied upon the representations, (7) was induced to

59. Again, the seller cannot misrepresent, by concealment or active statements, the condition of the premises to the detriment of the buyer. For a discussion of the doctrine of misrepresentation, see *infra* notes 61–67 and accompanying text.

60. See *infra* note 62 and accompanying text.

61. Kenneth M. Nakasone, *Seller Beware: New Law Protects Hawai'i Home Buyers*, 18 U. HAW. L. REV. 981, 984 (1996).

act upon them, and (8) did not know them to be false, and by the exercise of reasonable care could not have ascertained their falsity.”⁶²

Each of the numbered elements must be proven in order to establish a cause of action for fraud or intentional misrepresentation.

As indicated above, the caveat emptor doctrine is or at least began as a rule of silence. If the seller remains silent and takes no steps to warrant the condition or quality of the premises, caveat emptor provides a safe harbor for the seller. However, once the seller begins to speak to the quality of the premises, even short of fraud, courts are willing to impose a duty on the seller to be truthful and nonnegligent with respect to those representations. Indeed, the erosion of the common law caveat emptor doctrine began and continues with respect to these nonfraudulent cases of misrepresentation. It is to these cases, and the erosion of the doctrine, that I now turn, focusing specifically on court-imposed duties to disclose.

B. The Erosion of the Doctrine—the Beginning of Efficient Mandatory Disclosure Rules

The beginning of the erosion of the common law caveat emptor doctrine began with the negligent and innocent misrepresentation cases. These cases, which are unremarkable, laid the groundwork for the usurpation of the common law doctrine of caveat emptor in cases where the seller did exactly what was typically required by the caveat emptor doctrine—remaining silent and making no representation. Furthermore, the cases of negligent and innocent misrepresentation began to exhibit the efficiency norms produced by the economic theories to disclose information that are addressed above. In other words, a close review of these cases reveals that what is actionable is not the communication, which in some sense is innocent and lacks the scienter necessary to prove fraud, but the *effect* the communication has on the duty to gather information on the part, the buyer, to whom the communication is made. It is the effect of the communication on the buyer that negates the safe harbor, and the rationale for, the caveat emptor doctrine.

Negligent misrepresentation occurs when one party to a transaction fails to exercise reasonable care or competence in obtaining or communicating material information about the transaction or the property being sold pursuant to the transaction. As a result of this negligence or inadvertence, the seller supplies false information to the buyer upon

62. Jeff Govern, *Toward a Theory of Warranties in Sales of New Homes: Housing the Implied Warranty of Advocates, Law and Economics Mavens, and Consumer Psychologists Under One Roof*, 1993 WIS. L. REV. 13, 18 n.17 (quoting Coffin v. Dodge, 76 A.2d 541, 543 (Me. 1950)).

which the buyer relies in going forward or completing the transaction. Thus, when a seller, without actual fraudulent intent (*scienter*), fails to exercise reasonable care and provides the buyer with incorrect information regarding the condition of the soon-to-be demised premises in a residential real estate transaction, the seller is liable for negligent misrepresentation.

A few cases will illustrate the parameters of the cause of action. In *Asleson v. West Branch Land Co.*, the seller was liable to the buyer when the seller failed to verify the exact acreage that was being sold and asserted that the property was zoned for thirty-five townhouses, a fact that appeared in the multiple listing service.⁶³ Instead, the property was zoned for only thirty such units.⁶⁴

Quite often the case for negligent misrepresentation is made against the seller's agent, the broker, for representations made by the broker on behalf of its principal, the seller, to the buyer. Often the broker is passing on information it received from the seller, and it is the broker's negligence in verifying the information before communicating it to the buyer that results in the successful cause of action against the seller.⁶⁵

Innocent misrepresentation represents even more of an incursion on the doctrine of *caveat emptor* and imposes liability when there is no fault—no intent to deceive and no negligence with respect to the representation on the part of the seller. As such, innocent misrepresentation is most aptly described as a species of strict liability.⁶⁶ To be clear, innocent misrepresentation occurs when the seller makes a misrepresentation

63. 311 N.W.2d 533, 535 (N.D. 1981).

64. *Id.* It is also possible for the seller to orally misrepresent a relevant fact about the property to the purchaser. Thus, if the seller orally informs the buyer that she owns land beyond a fence boundary that is suitable for gardening and, unknown to the seller, the boundaries are different from those described in the deed and the seller's representations, a cause of action for negligent misrepresentation will be sustained. See Frona M. Powell, *Relief for Innocent Misrepresentation: A Retreat From the Traditional Doctrine of Caveat Emptor*, 19 REAL EST. L.J. 130, 132 (1990).

65. A case in point is *Tenant v. Lawton*, 615 P.2d 1305, 1308 (Wash. Ct. App. 1980), in which the seller told the broker-realtor that the property in question had passed a percolation test, thereby making the property saleable, and the realtor conveyed the property to the buyers without verifying same. After the closing, the buyers discovered that the property had not passed a percolation test and were subsequently unable to obtain a septic tank permit. *Id.* The Washington Court of Appeals held that the realtor had negligently misrepresented a material fact to the purchasers by "fail[ing] to take the simple steps within her area of expertise and responsibility which would have disclosed the absence of any health district approved site on the subject property." *Id.* at 1310.

66. Clarence E. Hagglund & Britton D. Weimer, *Caveat Realtor: The Broker's Liability for Negligent and Innocent Misrepresentations*, 20 REAL EST. L.J. 149, 153 (1991).

of a material fact upon which the buyer justifiably relies in deciding to act or refrain from acting, *even though the misrepresentation is not made fraudulently or negligently*. In this setting, once the representation is made, the seller and the seller's agents have constructive knowledge of the defects of the real estate as it pertains to the misrepresented fact, whether or not those defects are discoverable by a reasonable inspection.⁶⁷

What is interesting and revealing about these cases is that the seller has no duty to make representations—to convey information—to the buyer, but in so doing becomes the warrantor of the information conveyed. In this situation, the seller can avoid liability for innocent and negligent misrepresentation simply by remaining silent—avoiding any representations concerning the absence of defects or other information that is communicated to the buyer.⁶⁸ Hence, the safe harbor for the seller in this setting is the common law doctrine of *caveat emptor*, pursuant to which the seller remains silent, and the buyer purchases the property based solely on the buyer's knowledge of the property gleaned from the buyer's inspection of the demised premises.

Furthermore, it is the recognition that the seller has deviated from the safe harbor of nondisclosure provided by the common law rule of *caveat emptor* that provides the key to explaining these cases as exceptions to the common law doctrine. Such recognition further validates the economic theories detailed above regarding optimal disclosure rules. Recall that under the common law doctrine of *caveat emptor*, it is assumed that the parties have both equal bargaining power and equal access to information concerning the condition of the premises to be conveyed. Consequently, if the seller makes no representations, it is incumbent upon the buyer to make her own inspection of the premises to determine its quality.

That calculus changes radically when the seller makes either a negligent or innocent misrepresentation to the buyer, and there is the requisite reliance. In this case the reliance means that the buyer, relying on the information conveyed by the seller, opts not to inspect the premises in such a manner to verify the misinformation conveyed to the buyer by the seller, instead relying on the mistaken state of affairs to the buyer's detriment. By making the communication to the buyer, the seller is warranting that she has access to information that the buyer cannot obtain or need not obtain given the seller's representations. That

67. *Id.* at 152.

68. Of course, in the case of negligent misrepresentation, the seller can also avoid culpability by conveying accurate, nonnegligent information about the condition of the premises to the buyer. Silence, however, will ensure that nonnegligent information is not conveyed since no information of any type would be conveyed from seller to buyer.

eliminates the buyer's duty to further investigate to obtain the requisite information and imposes liability on the seller for the damages or harm that ensues.

In addition, this deviation from the common law rule of caveat emptor makes perfectly good sense when it is remembered that the seller is privileged to make no representations regarding the state or condition of the premises. By making the representation, either innocently or mistakenly, the seller is indicating that this is information that the seller acquired in her ownership of the property that is both casually acquired⁶⁹ and redistributive, as opposed to wealth-enhancing.⁷⁰ This is self-evident from the nature of the communication. If the information is the product of deliberate investment or wealth-enhancing, as described above,⁷¹ it would be inefficient and not in the seller's interest to convey same to the buyer.⁷²

Take for example the cases that are addressed above with respect to innocent and negligent misrepresentations. At first glance it might appear that the acreage being conveyed and how many units can be built upon the property as a result,⁷³ the boundaries of a property as stated in a deed,⁷⁴ and lastly, whether a property has passed a percolation test that will allow for a certificate of occupancy because a septic system may be installed,⁷⁵ are facts that are or may be the product of deliberate investment—although I think that is stretching it; perhaps the percolation case provides the best case for this argument. However, that determination is irrelevant because in all three settings or cases the information is in the public domain and subject to verification, thus making it the equivalent of casually acquired information—information that the seller has no privilege or property right in protecting from others. The three facts that were the subject of the misrepresentation were easily subject to verification. However, it is the very fact of the representation that precludes the investigation that could lead to the acquisition of information. As a result, information that is available to both parties is controlled by one party. Moreover, by usurping the buyer's right to

69. *See supra* notes 25–27 and accompanying text.

70. *See supra* notes 33–35 and accompanying text.

71. *See supra* notes 25–35 and accompanying text.

72. *See supra* notes 19–22 and accompanying text.

73. *See supra* note 63.

74. *See supra* note 64.

75. *See supra* note 65.

obtain that information, the seller is warranting the quality and veracity of the information and is therefore held liable for both negligent and innocent misrepresentations.

Similarly, the information conveyed by the seller to the buyer is not wealth-enhancing information, but simply redistributive. This also flows from the fact that the information is publicly available, and the market has already internalized the production and publication of the information in the price of the property.

Consistent with Professor Scheppele's theory regarding the efficient disclosure of information, the information conveyed to the buyer by the seller in the negligent and innocent misrepresentation cases is, somewhat perversely, information that originally is accessible to both parties, thereby creating no duty to disclose.⁷⁶ The subsequent disclosure of the information from the seller to the buyer in the absence of a duty to disclose transforms that information into information that has to be conveyed accurately to the buyer because the mere disclosure of the information, whether accurate or inaccurate, precludes the buyer from undergoing further investigation to obtain this information. By conveying this information, the seller transforms the safe harbor of *caveat emptor*, with the expectation that both parties have equal access to information akin to patent defects, into information that is casually acquired and not wealth-enhancing, which the seller has the duty to disclose *accurately* to the buyer.

The cost of the seller's incorrect dissemination of information is the negation of the buyer's duty to perform its obligations—undertaking an inspection of the premises—under the doctrine of *caveat emptor*. This forestalls production by the buyer of “information whose acquisition entails costs which would . . . have been incurred but for the likelihood, however great, that the information in question would actually be produced.”⁷⁷ From the buyer's perspective, the seller's representation precludes the acquisition of deliberately acquired information that is imposed on the buyer under the common law doctrine of *caveat emptor*. Moreover, the buyer is able to rely on the fact that the information being conveyed to the buyer by the seller is accurate and verifiable because the seller acquired this non-wealth-enhancing information casually.

76. This information also need not be disclosed pursuant to Dean Kronman's theory, as well as Professor Cooter and Ulen's theory, due to the fact that although the information is casually acquired and redistributive, as opposed to wealth-enhancing, it is nevertheless information that, because of its accessibility, is deemed to be patent, and imposing a duty on the seller to convey that information to the buyer would be needless and inefficient.

77. Kronman, *supra* note 1, at 13.

The development of negligent and innocent misrepresentations represents the first erosion of the common law doctrine, and it is a significant one. However, it is consistent with the economic theories discussed above detailing when disclosure is imposed on the knowee. The more significant and, at first glance, puzzling erosion of the caveat emptor doctrine continued with respect to cases in which there was no representation, either mistaken or negligent, made by the seller to the buyer, yet the seller was liable for damages caused by the transfer of the defective premises. These “no representation” cases seem to fly in the face of the common law rule of caveat emptor because the seller is doing exactly what is required by the doctrine: remaining silent.

In these, what I will characterize for want of a better term, “passive misrepresentation” cases, the courts have laid the groundwork for imposing a mandatory duty to disclose information. As a result of these cases, which are now legion, in which the seller says nothing and yet is held liable for nondisclosure—sometimes designated with the term “fraudulent nondisclosure”—the caveat emptor doctrine has been negated.⁷⁸ As Professor Weinberger has noted:

[C]ourts have recognized a duty to disclose information to prospective purchasers in a variety of contexts involving cracked foundations, leaking roofs, structural defects, unstable soil conditions, infestation by cockroaches, and defective sewage disposal. Additionally, nondisclosure of environmental contamination, radon, and asbestos has become a fertile source of litigation in recent years.

A legal duty to “speak up” does not arise simply because two parties may have been sitting across the bargaining table when a deal was struck between them. The common theme running through the nondisclosure jurisprudence is the prevention of situations in which buyers labor under serious misapprehension and are unable to rationally assess the true level of risk involved in the bargain. The duty to disclose arises when contracting parties do not stand on equal footing because one possesses superior knowledge not reasonably available to the other.⁷⁹

One particularly egregious case is *State v. Brooks*, in which a buyer purchased a home with a carbon monoxide leak in the home’s snow

78. See Renee D. Braeunig, Note, *Johnson v. Davis: New Liability for Fraudulent Nondisclosure in Real Property Transactions*, 11 NOVA L. REV. 145, 145 (1986); Steven W. Koslovsky, *To Disclose or Not to Disclose: An Overview of Fraudulent Nondisclosure*, 50 J. MO. B. 161, 161 (1994).

79. Alan M. Weinberger, *Let the Buyer Be Well Informed?—Doubting the Demise of Caveat Emptor*, 55 MD. L. REV. 387, 402–03 (1986) (footnotes omitted). As discussed previously, this duty to disclose is also supported by the fact that the information disclosed is casually acquired information and redistributive in nature.

melting unit, which the buyer was unaware of and which was not discoverable by a casual inspection of the premises.⁸⁰ The seller, however, was aware of the defect because his girlfriend and daughter became ill from breathing the fumes before he sold the house. The repairman, who serviced the unit and discovered the defect, told the seller he was playing Russian roulette with his life if he did not get the system repaired. Instead of making the repairs, the seller hired a realtor and sold the home to the buyers without disclosing the defect. When the buyer, his wife, and his four-year-old daughter died of carbon monoxide poisoning, the seller was convicted of involuntary manslaughter and Vermont abandoned the doctrine of caveat emptor with respect to dangerous conditions that are not discoverable upon an inspection by the buyer.⁸¹

In addition to physical defects that impact the quality and the value of the real estate being conveyed, recent cases have focused on so-called psychological defects that impair the value of the premises. Like physical defects, these psychological defects, which are known to the seller and not to the buyer, give rise to a claim for damages or rescission with respect to the sale of residential real estate. Again, quoting Professor Weinberger:

Well-publicized cases involving murder, AIDS, and poltergeists have focused public and state legislative attention on an evolving legal duty to disclose the existence of nonphysical, psychological defects to prospective purchasers. The market value of affected real estate is significantly reduced once potential purchasers become aware of this information. As a result, these properties are sometimes described as “stigmatized.”⁸²

Without going through a litany of cases requiring disclosure, it is fair to note what all of these cases have in common:

[I]n the vast majority of cases, material information about the condition of a residence will be peculiarly within seller’s knowledge and difficult for purchasers to obtain. Most homebuyers [prospective purchasers] will be unable to achieve a parity of information with long-time homeowners, even by conducting a professional building inspection. Judicial recognition that vendors and purchasers are not equal players challenges the basic underlying assumption of the doctrine of caveat emptor.⁸³

What these cases seem to imply is that when the defective condition is open to observation or otherwise reasonably discoverable, and a buyer has an opportunity to inspect the premises before purchasing, the seller may still perhaps be protected by the doctrine of caveat emptor. The

80. 658 A.2d 22, 24–26 (Vt. 1995).

81. *Id.*

82. Weinberger, *supra* note 79, at 407 (footnotes omitted).

83. *Id.* at 404 (footnotes omitted).

problem from the seller's perspective is the ex ante determination regarding what is "open to observation and otherwise discoverable." If the seller fails to make the requisite disclosure because of the belief that the defect is open to observation and otherwise discoverable, and the buyer later claims that the defect was not open, the seller runs the serious risk of losing if a court later makes a fact-based determination that the defect was not open to observation or otherwise discoverable. This provides impetus to the seller to make the requisite disclosures so that the buyer cannot later claim that the defect was neither disclosed nor open and discoverable.

The problem, of course, with the sale of a residence is that as to those matters that are disclosed or open and discoverable (patent defects), no lawsuits will arise because the parties have contemplated or discussed those defects, internalizing them in the bargaining process and properly documenting or acknowledging them. It is only those undisclosed and undiscoverable defects that will later give rise to a cause of action and claims by the buyer that the matter should have been disclosed and counterclaims by the seller that the alleged defect was either obvious, implicitly disclosed, not material, or not known to the seller in order to impose a duty to disclose. This uncertainty as to undisclosed matters has been responsible, in large part, for the erosion of the common law doctrine of caveat emptor and the imposition of caveat emptor light.

However, before turning directly to the rise of caveat emptor light, it is important to note that the erosion of the common law doctrine of caveat emptor becomes explicable if it is acknowledged that the caveat emptor rule is premised not only on the basis that the information acquired by the seller is casually acquired and not wealth-enhancing, but that the seller's duty to disclose is negated because that information is equally accessible to the buyer upon inspection. When that premise is eroded, as it is in the cases discussed above, the premise for the entire doctrine is eroded and a corresponding duty is placed on the seller to disclose accurate information. It is the quality and the quantity of the information that has caused the rise of caveat emptor light.

C. Caveat Emptor Light—Providing Safe Harbors for Sellers

Recall that under the common law doctrine of caveat emptor the seller was privileged to say nothing about the quality of the property and could

be confident that she would be immune from any subsequent lawsuit alleging defective condition of the premises sold. Silence was the key.⁸⁴ In recent years the duty to disclose defects has been imposed on the seller when the seller knows of facts materially affecting the value or desirability of the property when those facts are known or accessible to the seller and not known or accessible by the buyer.⁸⁵ The upshot of all of these cases is that in many, indeed, most states today, the seller must disclose not only physical defects that are latent, but also psychological impairments—so-called stigmatized property—arising out of past events occurring on the subject premises, including the fact that the house was formerly a “house of ill repute.” This has led to debates regarding which facts must be disclosed to the seller including, most recently, a debate regarding whether the seller has to disclose that the house was occupied by someone who is or was HIV positive given the impact such occupancy may have on the market value of the premises.⁸⁶

84. Home sellers in the 1950s had no obligation to mention property defects to buyers as long as they resisted the temptation to conceal latent defects or to lie about the condition of the property. To become liable for concealment, sellers would have needed to do more than just keep quiet: they would have needed to do something such as placing a mattress over a gaping hole to hide dry rot and termites or painting over water stains from an unrepaired roof leak. As one commentator put it, in those days, sellers’ lawyers could reasonably have copied a page from *Miranda* and counseled their clients: “You have the right to remain silent. Anything you say can and will be used against you during the contract negotiations.”

George Lefcoe, *Property Condition Disclosure Forms: How the Real Estate Industry Eased the Transition from Caveat Emptor to “Seller Tell All,”* 39 REAL PROP. PROB. & TR. J. 193, 195 (2004) (footnotes omitted).

85. In *Alexander v. McKnight*, the court imposed a duty on the seller to disclose the existence of noisy neighbors to the potential purchasers. 9 Cal. Rptr. 2d 453, 456 (Ct. App. 1992). Similarly, in *Reed v. King*, the court required the seller to disclose the fact that multiple homicides had taken place at the residence. 193 Cal. Rptr. 130, 133 (Ct. App. 1983). As previously mentioned at *supra* note 47, in *Stambovsky v. Ackley*, the court, in a very tongue-in-cheek fashion that is worth a read, held that the seller had to disclose the existence of a poltergeist or ghost residing in the house. 572 N.Y.S.2d 672, 677 (App. Div. 1991). Lastly, in *Van Camp v. Bradford*, the court required the seller to disclose that a rape had taken place in the dwelling. 63 Ohio Misc. 2d 245, 259–60 (C.P. 1993).

86. Weinberger, *supra* note 79, at 409. In an apparent attempt to prevent the courts from recognizing a wide range of psychological defects creating stigmatized property, legislatures in seven states—Connecticut, Georgia, Oklahoma, Oregon, Rhode Island, South Carolina, and Utah—have enacted legislation shielding sellers from liability for failure to disclose that the subject property was the site of a murder, suicide, or other felony, or that a member of the seller’s household suffers from the HIV/AIDS virus. In addition, legislatures in four states—California, Florida, Kentucky, and Texas—have passed laws shielding the seller from liability for failure to disclose that a member of the seller’s household suffers from HIV/AIDS. See Sharlene A. McEvoy, *Caveat Emptor Redux: “Psychologically Impacted” Property Statutes*, 18 W. ST. U. L. REV. 579, 579 n.2 (1991).

Given the cases discussed above, uncertainty has arisen regarding which facts have to be disclosed from seller to buyer, with the seller running the risk that at some later date some trier of fact will determine that there was some fact known to the seller, but unknown to the buyer, that materially affected the value and should have been disclosed by the seller to the buyer. This uncertain state of affairs has created two different results that I collectively term caveat emptor light. The first reaction is for the legislature, as a result of lobbying by realtors, to create a mandatory disclosure form that imposes a duty on the seller to disclose certain facts regarding the condition of the property to the buyer, thereby abrogating the common law doctrine of caveat emptor. This duty is not necessarily limited to disclosing defects, and indeed may even extend to warranting the condition of the premises per the claims made in the disclosure form. The second development, which seems counterfactual, is the judicially or legislatively created option on the part of the seller to make no claims or statements with respect to the quality of the premises and to sell the premises as is. This latter development looks remarkably similar to the common law doctrine of caveat emptor, but actually is not.

Taking the former development first, thirty-four states, by my count, have now detailed statutes requiring general disclosure of the quality of the premises to be conveyed by either the seller or the seller's realtor with respect to the condition of the premises.⁸⁷ Many remaining states require either (1) limited disclosure by real estate brokers retained by the seller of material or adverse conditions affecting the value of the premises; or (2) disclosures by sellers of the presence of specific items designated by the statute such as methamphetamine labs, radon, or mold.⁸⁸ As a result, it is fair to conclude that the vast majority of sellers

87. By my count, thirty-four states have enacted detailed statutes requiring some sort of disclosure by real estate sellers or brokers or both. *See, e.g.*, CAL. CIV. CODE §§ 2079–2079.10 (Deering 2008) (requiring disclosure of material facts by the seller's broker); *id.* §§ 1102–1102.15 (requiring disclosure by seller).

88. For example:

- (b) A broker engaged by a seller shall timely disclose the following to all parties with whom the broker is working:
- (1) All adverse material facts pertaining to the physical condition of the property and improvements located on such property including but not limited to material defects in the property, environmental contamination, and facts required by statute or regulation to be disclosed which are actually known by the broker which could not be discovered by a reasonably diligent inspection of the property by the buyer; and

of residential property in the United States, pursuant to these statutes, must disclose information regarding the condition or quality of the premises that they did not have to disclose under the common law doctrine of *caveat emptor*.⁸⁹

These statutes provide a form of safe harbor to the seller regarding the seller's duty to disclose certain defects. By complying, the seller can be reasonably assured that she will not be liable for the failure to disclose material facts that she has a duty to convey to the buyer.

The property condition disclosure form may be embedded in a disclosure statute, drafted by the state agency responsible for broker licensing, or written by state and local Realtors associations or brokerage firms. Often, lawyers prefer using statutory forms, relying upon them as safe harbors, an assured way of achieving full compliance with the law. But in this situation, no safe harbors can be found because the disclosure statutes do not purport to pre-empt the evolving common law. Sellers remain obligated to disclose all known material latent defects—whether mentioned in the form or not.⁹⁰

At the other end of the statutory perspective are those statutes that allow the seller to sell the property with limited or no representations with respect to its apparent quality.⁹¹ In certain states, sellers are able to opt out of any disclosure requirements mandated by statute and essentially sell the property as is as long as no misrepresentations are made and latent defects are disclosed.⁹² Although there is some disagreement regarding whether these “waivers” should be allowed, the seller can obtain something akin to the protection of the common law doctrine of *caveat emptor* by availing herself of the statutory safe harbor

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- (2) All material facts pertaining to existing adverse physical conditions in the immediate neighborhood within one mile of the property which are actually known to the broker and which could not be discovered by the buyer upon a diligent inspection

GA. CODE ANN. § 10-6A-5(b) (2007).

89. Seller disclosure forms usually are four to eight pages, single spaced. The forms vary considerably in the items covered. . . .

Most of the forms also list structural components, such as driveways, retaining walls, bearing walls, chimneys, windows, doors, exterior stucco, floors, foundations, roofs, sewer hook-ups, water systems, sump pumps, cut and fill, termite and rodent infestation. The better ones ask about the type of roof (e.g., asphalt, shingle, metal), its age, the date of the last repair or replacement, and whether the seller has had any specific problems with it, such as water leakage, ice damming, or other damage, and whether the seller has made any insurance claims based on such damage.

Lefcoe, *supra* note 84, at 232–33.

90. *Id.* at 226.

91. Once again, however, latent defects must be disclosed.

92. “Some disclosure statutes allow sellers to opt out unilaterally, some require the buyers’ consent, and some prohibit waivers and disclaimers entirely. Unfortunately, few statutes actually specify . . . whether the waiver must take any particular form.” Lefcoe, *supra* note 84, at 235–36 (footnotes omitted).

of nondisclosure, thereby shifting the burden of inspection to the buyer.⁹³

These two statutory remedies, mandatory disclosure pursuant to statutory mandates and disclosure of no or limited information as it pertains to nonlatent defects and the quality of the premises conveyed, seem to be polar opposites, embracing disparate policy objectives. It seems rather odd to state as a matter of public policy that the seller must disclose pursuant to a statutory form to provide requisite information to the seller or, if the parties agree, in the same jurisdiction the seller can, by using another form, disclose no information. The latter seems to undercut the former and would appear to put the seller and buyer at odds or at war over which form will be used in a state like Virginia or Minnesota in which the seller has both options.⁹⁴

On the contrary, both types of statutes serve the same purpose given the relative bargaining power of the parties and their access to information. Consistent with economic theory and the original purpose of the caveat emptor doctrine, these two apparently inapposite rules have the same goal and effect of equalizing the bargaining power between the transacting parties and allowing for the efficient transfer of information regarding the quality of the property by and between the parties in these arms-length transactions. An economic analysis of caveat emptor light reveals that each rule is efficiency maximizing, providing appropriate incentives to the buyer and seller in a complex transaction that has

93. Scholars are divided on whether sellers should be able to waive their common-law right to seller disclosure. Some scholars contend that sellers should be able to waive this right. They see no good reason to deny enforcement of a contract between a risk-averse seller and a risk-seeking buyer—the very model of an economically efficient transaction. . . .

A good case can be made against allowing waivers and disclaimers of seller disclosures. Rational risk allocation starts with a rational risk assessment. Even the best home inspector is likely to overlook some defects unless the seller reveals them or points the inspector in the right direction. No buyer can sensibly waive the seller's disclosure until the buyer learns what the seller is trying not to disclose.

Id. at 236–37.

94. See, e.g., MINN. STAT. ANN. §§ 513.51–.59 (West 2007) (requiring the seller to disclose material facts regarding the condition of the premises). Section 513.60 provides, however, that “[t]he written disclosure required under sections 513.52 to 513.60 may be waived if the seller and the prospective buyer agree in writing.” *Id.* § 513.60; see also VA. CODE ANN. §§ 55-517 to -525 (2007) (stating similar provisions).

evolved over the five centuries since the common law doctrine was articulated.⁹⁵

III. CAVEAT EMPTOR LIGHT—AN ECONOMIC ANALYSIS

The common law doctrine of caveat emptor is predicated on two fundamental assumptions: the first assumption is that the premises being conveyed are simple and easy to inspect, while the second is that each party to the transaction has equal access to information regarding the quality of the premises conveyed. The second premise or assumption follows logically from the first. What is interesting to note is that at the time the doctrine of caveat emptor developed, the fact that the seller owned the property for a period of time was irrelevant in terms of what I characterize as the “equal access principle” with respect to the conveyed property. It was assumed at common law that the seller did not possess information that was not accessible to the buyer following the buyer’s visible inspection of the premises, regardless of how long the seller owned the property.

At the time the doctrine developed, this was a factually accurate assumption. Without the mechanical, complex plumbing, heating, air, and ventilation systems that are integral to a modern dwelling—along with other factors today such as a nontoxic, non-mold, non-radon, et cetera environment—the property being conveyed at common law consisted typically of four walls, a dirt floor, and a rudimentary, typically thatched, roof.⁹⁶ The kitchen, if you could call it that, consisted of a stone hearth in the middle of the room.⁹⁷ There was, of course, no indoor plumbing and nothing akin to a modern bathroom. There were rarely windows and the door was, well, a wooden door.⁹⁸ Hence, inspecting the premises for defects was a relatively easy task for the buyer. Indeed, given the condition of the housing or dwelling to be conveyed, it is hard to imagine what could be viewed as a defective dwelling.⁹⁹ Nevertheless, what information there was to be gleaned about the condition of the premises could easily be accomplished by a visual inspection of the premises.

95. See *supra* Part II.B.

96. See Learner.org, The Middle Ages—More About Homes, <http://www.learner.org/exhibits/middleages/morehome.html> (last visited Mar. 20, 2008).

97. *Id.*

98. *Id.*

99. I assume that if the walls were rotted or the roof failed to keep water out, those things were discoverable upon visually inspecting the premises. Beyond that, I am not sure what a buyer would look for to determine that the premises were defective and uninhabitable.

The bottom line at common law is that the owner-seller's use and occupation of the premises, no matter how long, gave that seller no advantage or extra insight or information with respect to the soon to be conveyed premises. Thus, consistent with the economic theories of Kronman, Cooter and Ulen, and Scheppele, there should be no duty to disclose information from seller to buyer with respect to conveyed property.¹⁰⁰ Ergo, the common law doctrine of caveat emptor—no duty to disclose and the seller's privilege to remain silent.

Fast forward to the last forty years as the doctrine of caveat emptor has been eroded. The modern dwelling bears little resemblance to the dwelling conveyed in the Middle Ages. Suffice it to say, the modern dwelling, replete with modern plumbing, heating, ventilation and air conditioning systems, complex lighting and electrical systems, powered by gas, electricity with heat pumps, and furnaces, built with composite and nonnatural materials, four to five times the size of the Middle Age dwellings, costing hundreds of thousands of dollars,¹⁰¹ cannot be compared to the dwelling conveyed in the Middle Ages.

Not only has the complexity of the dwelling changed, just as importantly, the level of complexity of the dwelling or structure is magnified and exacerbated by the fact that dwellings are themselves largely unique and nonfungible.¹⁰² Whereas the dwelling conveyed in the Middle Ages was largely indistinguishable from other dwellings being built and sold at the same time—in large part due to the rudimentary nature of the structure—today's modern dwelling is anything but uniform and typical. Quite the contrary, most homeowners and builders seek and prize individuality and uniqueness and the more unique a dwelling, the more valuable it may be as a result.

100. See *supra* notes 1–8 and accompanying text.

101. According to the U.S. Census Bureau, the median sale price of new one-family houses in the United States was \$240,900 in 2005. U.S. CENSUS BUREAU, STATISTICAL ABSTRACT OF THE UNITED STATES: 2007, at 603 (2006).

102. It is hornbook law that specific performance will be granted with respect to real estate contracts because the subject of the contract, real property, is by definition unique. See, e.g., Anthony T. Kronman, *Specific Performance*, 45 U. CHI. L. REV. 351, 355 (1978). At common law, the land made the contract unique, justifying the remedy of specific performance. Today it could be argued that the dwelling that sits on the land and its uniqueness are what justify the remedy of specific performance. See JOHNSON, *supra* note 9, § 5.04(A). But see *Centex Homes Corp. v. Boag*, 320 A.2d 194, 198–99 (N.J. Super. Ct. Ch. Div. 1974) (refusing to allow specific performance where the object of the suit was one of 3600 condominium apartments which were held to be nonunique and fungible).

I contend that a comparison of one hundred dwellings in a community chosen at random would reveal one hundred different homes when measured by size, design, features, complexity, et cetera. That uniqueness increases, and in some cases makes impossible, the search cost for the average buyer purchasing property. The idiopathic nature of the dwelling being sold precludes the buyer from becoming an expert *ex ante* with respect to the dwelling being purchased. The buyer cannot school herself on what to look for when purchasing a home because the buyer cannot determine the type of home, and its various features, that the buyer will ultimately purchase. Further, given the complexity of the dwelling conveyed, even if the buyer could identify *ex ante* the type and features of the dwelling conveyed, the effort it would take to educate the buyer in order to qualify the buyer to make a meaningful inspection would be and is prohibitive.¹⁰³

Just as importantly, the status of seller and buyer has changed radically as well. The common law doctrine of *caveat emptor* presupposes that the parties have equal bargaining power with respect to the condition of the premises and that each can independently verify the condition of the premises. That supposition, accurate with the jack-of-all-trades vendor and vendee at common law, is totally inaccurate with respect to the skills and knowledge of the seller and buyer today, which is not to say that the seller is more skilled than the buyer in assessing the condition of the premises or detecting defects. Neither party is skilled at assessing the quality of the premises; so to that extent, there is equality of bargaining power. However, that equality changes given the seller's occupation of the premises and the knowledge of the condition of the premises acquired as a result.

Putting these three factors together—the complexity of the dwelling, the uniqueness of dwellings being conveyed, and the lack of skills possessed by the buyer, and to a lesser extent, by the seller—results in a transaction that is radically different from the transaction of a dwelling in the Middle Ages. The continued imposition of a doctrine, *caveat emptor*, on a transaction in which the parties possessed asymmetrical information about the property conveyed caused the erosion of the doctrine as detailed above.¹⁰⁴ The cases finding liability for nondisclosure are a logical outgrowth of the change in bargaining power and knowledge

103. The increase in the use of a professional home inspector for the sale of residential realty is a natural byproduct of the increased complexity of the dwelling. However, as discussed *supra* at note 43 and accompanying text, even hiring a professional inspector to inspect a home prior to the sale does not result in the equalization of bargaining power and the playing field between buyer and seller with respect to information regarding the condition of the premises.

104. See *supra* Part II.B.

possessed by seller and buyer with respect to the condition of the premises and are easily explainable pursuant to the economic theories dealt with above.¹⁰⁵

A. *The Development of Mandatory Disclosure Rules:
The New Safe Harbor*

The passive nondisclosure cases which are premised on the seller's superior knowledge of the dwelling as a result of the seller's habitation of the dwelling is consistent with all three theories because the information possessed by the seller is casually acquired, redistributive, and accessible to the seller as opposed to the buyer. Hence, it makes perfect sense that caveat emptor would be jettisoned in favor of a disclosure rule. What is interesting are the two inapposite default rules that have developed as exceptions to the common law doctrine of caveat emptor. At first glance, the safe harbor of mandatory disclosure of a prescribed laundry list of items alongside a safe harbor of no disclosure—essentially a return to the common law doctrine of caveat emptor—would seem counterfactual and self-defeating. However, given the relationship between seller and buyer, the fact that the determination of a breach of duty of disclosure is made with judicial hindsight, and the preexistence of the common law rule as a default rule between buyer and seller, have combined to produce these two seemingly disparate safe harbor outcomes.

Perhaps the most important fact leading to mandatory disclosure statutes is the fact that decisions breaching the common law rule of caveat emptor are made after the sale has occurred. It may take a while to connect this, but the problem with the erosion of the caveat emptor doctrine is that one cannot predict *ex ante* which information must be disclosed to the buyer by the seller. Even with respect to casually acquired information that is redistributive and accessible to one party to the transaction, the problem is determining *which* of these casually acquired facts must be disclosed to the buyer *ex ante*. What has heretofore gone unnoticed and unrecognized is that the seller's relationship to the land is akin to what has, in another context, been characterized as a relational contract.¹⁰⁶ That may seem to be an odd claim, but it is one

105. *See supra* Part II.B.

106. A relational contract is defined as follows:

that may explain why the erosion of caveat emptor has occurred in the manner described.

It is beyond doubt that the knowledge of the premises acquired by an owner of property is casually acquired and merely redistributive. Focusing on access, it is also clear that the seller has greater access to these facts than the buyer. The real question, however, is which facts must be disclosed to the buyer given the seller's greater knowledge and access to the home. A homeowner acquires knowledge of his property that is both vast and unique. It is vast given the complexity of the property today and the owner's lengthy occupancy of the premises.¹⁰⁷ It is unique because it applies only to the land or property being sold. Given the permanence of property, the myriad of factors that can affect value, both objective and subjective, and the degree and volume of the casually acquired information that is produced and known to the seller, which is not uniform among sellers as not all sellers living in the same house for the same period would have the same knowledge of casually acquired facts,¹⁰⁸ how is the determination made regarding which facts must be disclosed to the buyer?

The answer to that question is impossible to predict without knowing the knowledge of the seller, the needs of the buyer, and the condition of the property. The seller's position is akin to that of a relational contractor because ex ante the seller is unable to reduce the knowledge

A contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations. Such definitive obligations may be impractical because of inability to identify uncertain future conditions or because of inability to characterize complex adaptations adequately even when the contingencies themselves can be identified in advance. . . . [L]ong-term contracts are more likely than short-term agreements to fit this conceptualization, but temporal extension per se is not the defining characteristic.

Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1091 (1981).

107. Although I have not developed a formal formula to express this sentiment, I think it is fair to state that the longer the owner has owned the property, the more knowledge she accumulates regarding its condition, quality, defects, et cetera. Indeed, my thesis is premised on the notion that an owner who has never occupied the premises—say, someone who has inherited property and is selling it soon after—would have no or a very limited duty to disclose facts regarding the property given her lack of familiarity with the premises.

108. This assumes that the skill of the homeowner-seller may impact the data that is acquired during one's period of occupancy. It seems reasonable to assume that one seller noticing a few inches of damaged wood may recognize termite infestation—only because this particular unlucky homeowner previously lived in a house with extensive termite damage—whereas a neophyte homeowner may not. See, e.g., MICHAEL F. POTTER, UNIV. OF KY. COLL. OF AGRIC., PROTECTING YOUR HOME AGAINST TERMITES, <http://www.ca.uky.edu/entomology/entfacts/entfactpdf/ef605.pdf> (last visited Mar. 20, 2008).

that he has of the premises to a well-defined obligation. Deciding with certainty or uniformity which facts must be disclosed ex ante is impractical because of the complexity of the dwelling, the temporal nature of the relationship—the longer the ownership, the more knowledge one acquires—and, perhaps most importantly, the contingencies that can be identified in advance as being relevant. Take for example, the infestation of termites. As noted, one seller may be aware of a potential termite infestation given the wood damage that he has seen accumulate over a period of time. Another seller, an ignorant seller, may not. However, after the property is sold and the buyer discovers the existence and extent of the termite infestation, it is inevitable that the seller will be sued for passive misrepresentation or nondisclosure if the termite infestation remained undisclosed. The trier of fact will determine that the reasonable seller would know of the termite infestation and hold the seller liable, notwithstanding his claim of ignorance.

What is even more frustrating to the seller is that the seller will disclose all those things that are known or believed to be known or relevant to the buyer but will not be able to predict ex ante all of those facts. It stands to reason that if the seller believes the fact to be relevant to the buyer, the seller will disclose that fact. It is only those facts that the seller is either unaware of or believes to be trivial and unimportant that the seller will refuse to disclose.¹⁰⁹ And here is the problem or conundrum: a truthful and honest seller will have in her possession millions of facts—knowledge—about the house being sold and will have to determine which ones to disclose to the buyer. Choose wrong, and the seller exposes himself to liability.

Take, for example, the psychic harm cases. On the one hand, these cases seem ludicrous because they require the seller to disclose stigmatic harms to the property. From the seller's perspective, how does she determine which harms are stigmatic? Noisy neighbors, a skunk under

109. The objection to this assertion is that a seller will intentionally omit the disclosure of facts that reflect negatively on the value of the property in order to consummate the sale of the property. This strategy is irrational and inefficient because, given the permanency of property and the persistence of defects, this will lead to a lawsuit that the seller will likely lose. Instead of negotiating a price to reflect the existence of the defect—transacting over a property rule—the seller would be voluntarily choosing to exchange this property rule for a liability rule in which a court would ex post set the damages to be assessed against the seller. Given the uncertainty with respect to damage awards, it makes much more sense for the seller to accurately and adequately disclose all defects when there is a rule requiring disclosure of material facts.

the rear porch, a swastika painted on the wall five years ago, a break-in and robbery two years ago, a rape that occurred when the home was occupied by a prior owner, or the fact that the house was a fraternity twelve years ago? The list goes on and on. On the other hand, when the buyer, after the sale, presents evidence that any one of these occurrences is relevant to her and impacts the property's value, the court has to determine whether that fact should have been disclosed.¹¹⁰ In some cases they will find for the buyer, in others for the seller given the evidence presented.

Furthermore, many of these cases will be correctly decided because what the courts are attempting to do, with limited success, is to achieve the correct balance between disclosure and nondisclosure of information as mandated by the efficiency norms discussed above. Given the losses that occur as a result of nondisclosure, the lack of accessibility and the fact that this is indeed casually acquired information, the courts are correctly imposing disclosure duties on sellers. However these decisions also create problems for the seller seeking to comply with the new disclosure regime due to the complexity of the modern dwelling—how does one determine what is adequate disclosure, especially when that disclosure requirement is often impacted by the buyer's knowledge and proposed future use of the premises?

The response on one hand is the formulation of mandatory disclosure rules that prescribe which conditions must be disclosed by the seller to the buyer and provide the seller with a safe harbor once there is compliance. Given the seller's relational ownership of the property, the knowledge acquired as a result, and the imposition of the duty to disclose imposed, that duty has to be circumscribed—homogenized, if you will—by rules limiting the duty to reduce the seller's exposure *ex post*. This mandatory disclosure also serves a related function in the identification and communication of those common facts regarding the condition of the premises that should or are relevant to most or all sellers and buyers. It thereby eliminates from the disclosure requirement idiosyncratic facts that are important to the buyer, and perhaps known to the seller, and impact value. As a result, it places the burden on the buyer who is interested in either the verification or elimination of the idiosyncratic fact that is relevant to that buyer to verify the existence of that fact or verify its elimination or nonoccurrence with respect to the property conveyed. The new mandatory disclosure rules, therefore, shift the burden to the buyer to elicit information regarding the condition of

110. Once again, it should be self-evident that if the seller had any inkling that the fact would be the subject of a later lawsuit, the seller would have disclosed the fact to the buyer. *See supra* note 109.

the premises once the baseline determination mandated by the statute is made from seller to buyer.

B. The Reemergence of Silence, The Return of Caveat Emptor

At the other end of the spectrum is the reemergence of the common law doctrine of caveat emptor, but not as an uncommunicated default rule that the parties ostensibly bargain in light of and with full knowledge. Recall that at common law the prevailing rule was silence, and it was assumed by all, both buyer and seller, that caveat emptor was the norm and that if the seller opted out of the norm, by making a representation regarding the quality of the property, that representation had to be accurate and truthful.¹¹¹ The reemergence of caveat emptor in those states that allow the seller to remain silent is not premised on both the buyer and seller having knowledge that the caveat emptor rule is the standard default rule in the sale of real property.¹¹²

Quite the contrary, caveat emptor, or seller's silence, can only be deployed in these states if that doctrine is essentially chosen by the seller and communicated expressly to the buyer. The default, or off-the-rack rule, that the parties bargain in light of, is disclosure, but in these states the parties may opt out of the default rule by choosing caveat emptor. Consequently, to some extent, the law has come full circle in this area in those states where the seller is privileged to make no disclosure to the buyer as long as that fact is clearly communicated to the buyer prior to the consummation of the sale.

Has this return to an express caveat emptor accomplished anything? Yes, I believe so, and the key, once again, is to focus on the parties' knowledge of the property and access to information. At common law where the default rule was caveat emptor, the law presumed the parties were aware of the default rule because of the equal access and equal bargaining power that the parties possessed. The modern buyer and seller, however, do not have that equal access to information, nor the equal bargaining power possessed by their historic predecessors. In the modern setting, the imposition of a default rule of caveat emptor puts the buyer at a serious disadvantage unless the buyer is made aware of the fact that she has a duty to undertake an investigation of the property because the property is indeed being sold as is. In other words, the

111. See *supra* notes 55–62 and accompanying text.

112. See *supra* notes 96–100 and accompanying text.

common law default rule is not aligned with the parties' reasonable expectations in the modern transaction. The new default rule, which requires the seller to put the buyer on notice with respect to his disadvantaged position in terms of access to information regarding quality of the premises, corrects this lacuna.

The common law caveat emptor doctrine is also premised on the supposition that the putative buyer may casually acquire information regarding the quality of the premises based on the buyer's self-inspection of the premises. As pointed out above, today's buyer is ill-equipped to undertake a meaningful and quality inspection of the premises, and the seller's notification to the buyer that the property is being sold as is serves as notification to the buyer to obtain such an inspection or purchase or "let the buyer beware, who ought not be ignorant of the amount and the nature of the interest he is about to buy, exercise caution."¹¹³

This new safe harbor for nondisclosure differs from the common law because it assumes that there is no equal bargaining power or equal access between buyer and seller—the seller may have access to information that is casually acquired, but that information cannot be casually acquired by the buyer—but nevertheless places the burden on the seller to notify the buyer that there is potentially valuable information regarding the quality of the property that may be acquired by the buyer by undertaking a thorough and meaningful investigation. In effect, the default rule has changed to alert the buyer and align with the parties' expectations with respect to the parties' duties for information seeking or gathering.

Hence, there have been two shifts in the law of caveat emptor in response to the change in the character of the property and the diminution of the assessment skills of the seller and buyer. First, given the myriad of details that are learned about the property by the seller given the seller's occupancy and its possible relevance to the buyer, the law now provides a safe harbor by dictating what must be disclosed. What seems to be the converse is the development of the doctrine that permits the seller to make no disclosure. This rule is premised on the notion that the buyer can undertake a meaningful inspection of the premises, but only if alerted to do so by the seller.

The first shift in the caveat emptor doctrine—mandatory disclosure rules—levels the playing field and puts the parties back into the same position they were in before the erosion of caveat emptor. By that I mean that the first shift guarantees equal access to information and equal

113. Pomeranz, *supra* note 51; *see also supra* notes 106–08 and accompanying text.

bargaining power by prescribing which information must be disclosed. It therefore prevents opportunistic behavior on the part of the seller, but also assures a baseline state of information for the buyer and provides a starting point to the acquisition of additional information. The second shift in the caveat emptor doctrine, nondisclosure, accomplishes the same result, equality of access and bargaining power, by expressly shifting to the buyer the duty to deliberately acquire information. In effect, this second rule presupposes that once no casually acquired information is communicated from seller to buyer, the buyer will make deliberate investment in acquiring the requisite information since it may not be casually acquired from the seller.¹¹⁴

What the seller cannot do in those jurisdictions which have adopted one or both of these two new rules, mandatory disclosure or no disclosure, is telling and informative. The seller cannot choose which facts to disclose and rely on the truth of those statements to serve as a safe harbor from liability. It is the selectivity of the disclosure that creates issues because it may assure the buyer that other facts either are unimportant or not necessary to be disclosed. The selectivity of the disclosure—some facts and not others—can easily lead to liability for innocent misrepresentation.¹¹⁵

IV. FROM CRYSTALS TO MUD TO CRYSTALS: THE IMPACT OF TECHNOLOGY AND CHANGE

Professor Rose's oft-cited article, *Crystals and Mud in Property Law*, elegantly presents a theory about how crystal rules in property—hard-edged rules that are definitive and easy to apply and manage—are often replaced by what she characterizes as “fuzzy, ambiguous rules of decision,” or mud rules.¹¹⁶ Crystal rules are said to emerge when goods or resources become scarce and parties must trade and bargain over these valuable entitlements. The puzzle, as articulated by Professor Rose, is why then are mud rules substituted for crystal rules, especially

114. Although this seems contrary to the efficient theory of disclosure of information, requiring the buyer to make an investment in acquiring information that could be easily conveyed to the buyer by the seller, the fallacy of that statement or position is that the seller cannot determine *ex ante* which facts must be conveyed. *See supra* notes 109–10 and accompanying text.

115. *See supra* notes 77–78 and accompanying text.

116. Rose, *supra* note 11, at 577–78.

when these crystal rules, once muddied, are replaced by crystal rules, which are then subjected to being muddied anew?¹¹⁷

One prime example,¹¹⁸ cited by Professor Rose, of this modification-crystallization cycle is the common law doctrine of caveat emptor, which she states began as a crystal rule—let the buyer beware—but has evolved into a mud rule, given the myriad exceptions to the common law rule for which the seller can be held liable for failure to disclose defects.¹¹⁹

For several hundred years, and right up to the last few decades, caveat emptor was the staple fare of the law of real estate purchases, at least for buildings already constructed. The purchaser was deemed perfectly capable of inspecting the property and deciding for himself whether he wanted it, and if anyone were foolish enough to buy a pig in a poke, he deserved what he got. Short of outright fraud that would mislead the buyer, the seller had no duties to disclose anything at all.

One chink in this otherwise smooth wall was the doctrine of “latent defects,” which, like the exception for fraud, suggested that perhaps the buyer really can’t figure things out entirely. . . .

Within the last few decades, the movement to mud in this area has become even more pronounced as some courts and legal commentators maintain that builder/vendors implicitly warrant a new house “habitable.”¹²⁰

117. Quite aside from the wealth transfer that may accompany a change in the rules, then, the change [from crystal to mud rules] may sharply alter the *clarity* of the relationship between the parties. But a move to the uncertainty of mud seems disruptive to the very practice of a private property/contractual exchange society. Thus, it is hardly surprising that we individually and collectively attempt to clear up the mud with new crystal rules—as when private parties contract out of ambiguous warranties, or when legislatures pass new versions of crystalline record systems—only to be overruled later, when courts once again reinstate mud in a different form.

These odd permutations on the scarcity story must give us pause. Why should we shift back and forth instead of opting for crystal when we have greater scarcity [of resources]? Is there some advantage to mud rules that the courts are paying attention to? And if so, why do we not opt for mud rules instead?

Id. at 579–80 (footnotes omitted).

118. *Id.* at 580–83. Other doctrines that have allegedly gone through a similar process are: (1) mortgage foreclosures, which were once strictly enforced when there was a default on the mortgage—an objective fact—to the current state of affairs in which the mortgagor is given the right of the “equity of redemption” in certain situations that cannot ordinarily be conveyed to the mortgagee by the mortgagor *ex ante*; and (2) recording acts, which evolved from strict “race” statutes in which the first to record—an objective fact—prevailed over those subsequent into “notice” and “race-notice” recording acts that precluded the first to record from prevailing if that prior recorder had “notice” of another’s interest in the property. *Id.* at 583–90.

119. For more on the exceptions, see *supra* notes 63–65 and accompanying text.

120. Rose, *supra* note 11, at 580–81 (footnotes omitted).

Moreover, what I have characterized as the reemergence of caveat emptor in the guise of caveat emptor light,¹²¹ Professor Rose characterizes, in part, as the reemergence of a crystal rule:

But there is a countermove as well: Even if the legal rules have moved toward mud, private bargainers often try to install their own little crystalline systems through contractual waivers of warranties or disclosure duties (for example, the “as is” or “no warranty” sale). These private efforts in effect move things into the pattern of a circle, from crystal to mud and back to crystal. And the circle turns once again when the courts ban such waivers, as they sometimes do, and firmly re-establish a rule of mud—only to be followed by even more artful waivers.¹²²

In her brief essay, Professor Rose speculates that the crystal rules, which are more efficient rules and therefore favored by academics, become mud rules because of their overuse and extension to areas for which they were not originally designed. As a result, these crystal rules become ill-suited to police and regulate the transactions they were promulgated to govern:

But the driving force of the movement to mud rules seems to be an overuse in the “commons” of the crystal rules themselves: We are tempted to take rules that are simple and informative in one context—as, for example, “first in time, first in right” may be in a small community—and extend them to different or more complex situations, where the consequences may be unexpected and confusing. It is in these “overload” situations that crystal rules may ultimately impede trade.¹²³

Another factor contributing to mud rather than crystal rules pertains to the relationship between the contracting parties. Professor Rose’s theory, supported by existing economic literature, is that we are more likely to find crystal rules employed when the contracting parties are engaged in a one-shot, contingent contracting relationship rather than a relational contract.¹²⁴ Mud rules are used in the relational context because they allegedly provide the flexibility necessary for the parties to make adjustments as their relationship develops and matures.

But what is easily overlooked is that mud rules, too, attempt to recreate an underlying non-legal trading community in which confidence is possible. In those communities, the members tend to readjust for future complications, rather than drive hard bargains. Mud rules mimic a pattern of post hoc readjustments that people *would* make if they were in an ongoing relationship with each other. . . .

121. See *supra* notes 84–95 and accompanying text.

122. Rose, *supra* note 11, at 582–83 (footnotes omitted).

123. *Id.* at 600 (footnotes omitted).

124. See *supra* notes 11–13 and accompanying text.

Now we can see why crystal and mud are a matched pair. Both are distilled from a kind of non-legal commercial context where people already in some relationship arrive at more or less imperfect understandings at the outset and expect post hoc readjustments when circumstances require. Just as the parties call on courts to enforce promises and protect entitlements that would otherwise be enforced by the threat of informal sanctions, so too do they call on the courts to figure out the post hoc readjustments that would otherwise have been made by the parties themselves.¹²⁵

The final piece of the puzzle, according to Professor Rose, is the tendency of the judiciary to impose mud rules in resolving disputes that it adjudicates due to the ex post nature of adjudication.¹²⁶ To sum up:

Here, then, the circular pattern emerges: If things *matter* to us, we try to place clear bounds around them when we make up rules for our dealings with strangers so that we can invest in the things or trade them. The overloading of clear systems, however, may lead to forfeitures—dramatic losses that we can only see post hoc, and whose post hoc avoidance makes us (as judges) muddy the boundaries we have drawn. Then, at some point we may become so stymied by muddiness that as rulemakers we will start over with new boundaries, followed by new muddiness, and so on.¹²⁷

Caveat emptor, then, represents the epitome of a rule that evolves from crystal to mud and thence to crystal. First, crystal rules are extended—overused—to situations that are inapposite leading to inefficient and unjust outcomes. Caveat emptor, in its pristine common law form, applied to a very simple structure in which all defects were essentially immediately visible.¹²⁸ Furthermore, the seller, by residing in the dwelling, gained no particular unique knowledge of the premises as a result. Hence, the parties to the common law transaction possessed equal bargaining power and equal knowledge with respect to the quality of the building. Subsequently, as a result of the increasing complexity of the dwelling, these positions changed, although the doctrine did not. Sellers became more knowledgeable about defects in the premises that were not easily discoverable by the buyer. As a result, when the buyer found himself fleeced, now in the role of the mope, to use Professor

125. Rose, *supra* note 11, at 602–03.

126. [J]udges, who see everything ex post, really cannot help but be influenced by their ex post perspectives. They lean ever so slightly to mud, in order to save the fools from forfeiture at the hands of scoundrels. Indeed, if judges have even an occasional preference for post hoc readjustments, to avoid forfeiture, this preference will gradually place an accretion of mud rules over people’s crystalline arrangements. These considerations suggest a modification of claims about the efficiency of common law adjudication. We are more likely to find that judicial solutions veer towards mud rules, while it is legislatures that are more apt to join with private parties as “rulemakers” with a tilt towards crystal.

Id. at 603–04 (footnotes omitted).

127. *Id.* at 604.

128. See *supra* note 9 and accompanying text.

Rose's terminology,¹²⁹ courts were more willing to muddy the crystal rule to provide exceptions in order to grant the buyer relief from her necessitous circumstances.

Second, although the contract is not relational, the requirement that information not be conveyed, as allowed by caveat emptor, is once again inapposite in a situation where the seller acquires information in a relational context and is privileged not to convey same in the context of the contingent contract entered into with the buyer. That inequality of bargaining power—relational knowledge in a contingent contract setting—leads to scoundrels fleecing, sometimes inadvertently, sometimes not, the foolish (mope) buyers who fail to adequately protect themselves by undertaking an adequate inspection and the acquisition of the necessary information regarding the quality of the premises. Just as predicted by Professor Rose, courts in these settings were moved to make post hoc readjustments that led to the erosion of the doctrine and resulted in the imposition of a mud rule.

But in addition to the three factors that Professor Rose has identified to explicate why crystals turn to mud and thence crystals, an examination of caveat emptor reveals two heretofore additional reasons why these rules change and become muddied. Professor Rose's theory is incomplete in one respect because she does not take into account how the property or resource that is the subject of the crystal rule might also evolve to become inapposite to the crystal rule.¹³⁰ In other words, these are not static rules or doctrines affecting static and unchanging properties.

129. The seller in this setting plays the role of the scoundrel. Rose, *supra* note 11, at 599–600.

130. Indeed, technological changes in the property might also be a proximate cause of the shift from crystal to mud rules. For example, the evolution of the law of caveat emptor via decisional law may reflect the fact that the housing that is subject to the rule is different and distinct from the type and quality of housing that initially produced the rule. That evolution in the law and its resultant impact on subsequent property transactions might then cause the law to continue to evolve so that a mud rule—created largely by the change in the nature of the premises—may eventually become a crystal rule through decisional authority as the law continually deals with the technological enhanced premises. For example, take the sale of residential real estate. Although we are currently in a cycle in which mud rules apply to the sale of real property, as opposed to the crystal rule embodied in the common law doctrine of caveat emptor, I predict that a crystal rule will emerge eventually. I contend that sellers will adapt to the muddy rules by embracing norms that will result in the standardization of implied warranties—default rules—given by the seller to the buyer in the sale of the premises. If that state is achieved, through norms or legislation, then a crystal rule may once again be imposed on the residential real estate transaction.

Quite the contrary, as technology evolves and changes, ill-fitting rules must also evolve and change to address those changes.

In other words just like the law is not static, neither is the object or subject of the rule being analyzed. What works initially for a crystal rule may not work for something that is called the same thing but has technologically evolved far beyond its original form or design. It should be self-evident that the caveat emptor doctrine worked as a default rule at common law due to the simplicity of the dwelling it was designed to regulate or govern. As the dwelling became more complex, morphing into something that is nothing like the agrarian dwelling to which the original rule applied, the courts were unable to declare the old rule obsolete and develop a new rule given how common law rules evolve via court decisions instead of legislative fiat and declaration. As the property evolved slowly and inexorably to its current form, the doctrine of caveat emptor also evolved to take into account the different characteristics of the property regulated.

This evolution of the property being regulated represents a different challenge than, say, the creation of a new property right like the Internet.¹³¹ The development of a new form of property also creates the recognition and awareness that there is a void in the existing regulatory structure to govern the new entity. Scholars and judges jump into the fray to fill the void created when the new property is created. With respect to existing and evolving property, no void exists. Instead judges and legislators must modify the crystal rules, making them mud, in order to regulate the newly evolved species of property. The insight that is missing from Professor Rose's theory regarding how mud rules become crystal is the lack of analysis and recognition of the evolution of the property that is being regulated by the rules. That evolution of the property should also force an evolution in the norms, mores, et cetera, and in the rules governing the property rights.

The second insight gained by an analysis of caveat emptor and its evolution into caveat emptor light is the fact that crystal rules are more likely to be used for what I designate "objective" determinations, and mud rules are more likely to be used for "subjective" determinations where multiple variants play into the equation concerning how resources or rights should be allocated. Put another way, as determinations become more subjective with more variables being considered by the courts, the muddier the rules become.¹³² An analysis of the three fact

131. See, e.g., David R. Johnson & David Post, *Law and Borders—The Rise of Law in Cyberspace*, 48 STAN. L. REV. 1367 (1996).

132. Here I may be stating the obvious or restating what Professor Rose has characterized as the "overuse" of the doctrine in situations not particularly suitable for

situations described by Professor Rose in her article as prototypical crystal rules involves objective determinations.¹³³ Thus the fact that the seller has no duty to disclose (*caveat emptor*); the mortgagor did not make the payment on law date (the equity of redemption); and the losing party was not the first to record (the operation of recording acts) entails a determination made by the trier of fact that is bipolar—yes or no—not maybe or partially, but definitive and dispositive. Crystal rules, thus, work best when the fact to be decided is either up-down or yes-no with no subtle gradations to be made.

Think of it this way: the common law sale of a house was a crystal transaction—objective and verifiable—something akin to a contingent one-shot transaction in which the parties were not repeat players. In fact, many have alleged that the residential real estate transaction is the epitome of a contingent contract that should lead to the use of crystal rules.¹³⁴ However, I contend that today's transaction is more subjective and akin to a relational contract. In order to determine the enforceability of the transaction, the court must determine what this seller knows and what is important to this buyer. It is individualized and subjectivized to an extent that was not relevant at common law. Hence, importantly, even though the parties in a real estate contract represent prototypical contingent contracting parties, the nature of the information sought is in fact relational. Underlying the theory of relational versus contingent contracts is the notion that in contingent contracts the parties are dealing at arms length and each can take the maximum steps to protect their respective positions. That is not true in the sale of the residence and has caused the further erosion of the doctrine of *caveat emptor*.

Consequently, adding these two elements to Professor Rose's theory makes its explanatory power more robust. I would expect to see crystal rules become mud rules not only when: (1) crystal rules are extended to nonobvious situations; (2) when parties are in a relational contract; and (3) when courts are called to make an *ex post* adjudication that will involve the forfeiture of a significant asset; but also (4) in situations

the extension of the doctrine. *See supra* notes 122–23 and accompanying text. However, I think it is important to note, if only as a descriptive matter, that when courts are called upon to look at fact situations that I have described as objective, they tend to adopt mud rather than crystal rules given the complexity of the fact situations and the variables involved.

133. Rose, *supra* note 11, at 580–90.

134. *See supra* note 124 and accompanying text.

where the variable being decided is subjectivized; and (5) the asset or variable about which the decision is made is itself evolving into a significantly different asset due to technological advances. When all five of these variables are aligned, crystal rules will inevitably become mud rules and lead to the development of crystal rules to replace the muddied rules.

V. CONCLUSION

This Article represents an attempt to wed two seemingly disparate theories to explain why the common law doctrine of caveat emptor has evolved as it has over the last five centuries. Taking first Dean Kronman's theory of the efficient disclosure of information, I have addressed a puzzle that has remained unresolved: why did the caveat emptor doctrine develop when the seller clearly has knowledge about the premises that should be disclosed pursuant to those apparently accurate efficient disclosure theories? By undertaking a historical analysis I have demonstrated why the common law rule of caveat emptor initially developed, why its erosion has been accomplished, and why it is currently reemerging pursuant to a doctrine I have designated as caveat emptor light.

Concurrently I have taken Professor Rose's elegant theory regarding the evolution of rules from crystal to mud and thence back to crystal and applied it to the caveat emptor doctrine. In so doing, I demonstrate first that the caveat emptor doctrine represents the perfect doctrinal theory to prove her thesis. Perhaps more importantly, I have also attempted to demonstrate that Professor Rose's analysis is somewhat incomplete and must take into account the relationship of the parties and the evolving character of the resource being regulated in order to be complete. An analysis of the caveat emptor doctrine and its evolution confirms that mud rules will be applied when objective situations become, over time, dependent on subjective determinations given the status of the parties. These subjective determinations are exacerbated by the technological evolution of the property being regulated. Just as law evolves, so, too, does the property subject to its strictures. As property evolves, so, too, must the law that governs and regulates its ownership and use.