The Property Condition Disclosure Act Celebrates Its Tenth Birthday

By Andrew D. Brodnick

Article 14 of the Real Property Law requires that the seller of a residential home either provide a Property Condition Disclosure Statement or provide a $500 credit at closing ("PCDA").[1] The PCDA, which became effective March 1, 2002, now celebrates its tenth birthday.

The PCDA was enacted to provide a better basis for the negotiation of the sale of a home.[2] In addition, its practical effect was to poke at least a dent in the mighty armor of caveat emptor, which provides that a seller with no fiduciary or confidential relationship to the buyer has no duty to disclose the existence of defects unless the defects are actively concealed or where the seller makes a misrepresentation or partially discloses the existence of a defect.[3] The PCDA, at least for those sellers who provide a disclosure statement rather than a credit at closing, changed caveat emptor. The seller was now required to come forward and provide information regarding the property which could assist the buyer in ascertaining defects. But the PCDA's intent was only to put a small dent in caveat emptor; the buyer was warned that the seller's statements were not "a warranty" and were not a substitute "for any inspections or tests."[4] The PCDA also "encouraged" buyers to obtain an independent professional inspection and to check public records.[5]

Surveys indicated that most downstate sellers opt out of the PCDA by providing a $500 credit at closing, while upstate attorneys reported that the disclosure statement was generally being provided.[6] A few of the sellers who chose to provide a disclosure statement were sued under section 465(2), which provides that the seller will be liable for the buyer's actual damages if the seller willfully fails to perform the requirements of the PCDA.

Not surprisingly, the effort to establish just how much of a dent the PCDA put into caveat emptor has befuddled the courts. The PCDA is not, as noted by at least one court, a model of clarity with respect to exactly how the PCDA was meant to change caveat emptor.[7] Karl Holtzschue suggested that the remedy provisions of the PCDA could be modified to address the confusion.[8]

This article will examine how the PCDA has fared towards changing judicial attitudes towards caveat emptor for the first ten years of its existence. It concludes with a suggestion as to how the PCDA should be applied so that it fulfills its function of modestly limiting caveat emptor.

I. Caveat Emptor

Caveat emptor provides that in an arm's length transaction involving real property, a seller (who does not make a misrepresentation and does not make partial disclosure) is not obligated to disclose defects unless: i) the seller actively concealed critical information at the time the contract was entered into,[9] or ii) there is a confidential or fiduciary relationship between the buyer and seller.[10] Some courts have recognized an exception where the seller has "superior knowledge" that the purchaser could not uncover through a reasonable inspection.[11]

II. The Property Condition Disclosure Act

The PCDA provides that every seller shall complete and deliver a property condition disclosure statement prior to the buyer signing a contract.[12] The Act applies to the sale of one-to-four family homes and excludes condominiums and cooperatives.[13] In all cases, the disclosure statement should be annexed to the contract of sale.[14]

The disclosure statement asks the seller a wide range of questions regarding the title and ownership of the home, and a series of questions regarding any environmental, structural or mechanical problems with the home. The seller responds to most questions by responding "yes, no, unkn [unknown], or n/a [not applicable]."[15] The seller concludes the disclosure by certifying that it is "true and complete to the seller's actual knowledge."[16]

The seller is put on notice that "a knowingly false statement or incomplete statement by the seller on this form may subject the seller to claims by the buyer prior to or after the transfer of title."[17]

In the event that the seller "fails to perform the duty prescribed in this article" the buyer receives a credit at closing of $500 against the purchase price.[18] The credit is not negotiated *into* the sales price; it is taken *out* of the sales price. If a seller provides a disclosure statement, the seller may be liable "only for a willful failure to perform the requirements of this article" which in turn entitles the buyer to "actual damages suffered...in addition to any other existing equitable or statutory remedy."[19]

The buyer is still required to perform due diligence, and cannot blindly follow the seller's representations. The seller's statements are not "a warranty" nor "a substitute for any home, pest, radon or other inspections or testing of the property or inspection of the public records"[20] The PCDA "encourages" buyers to have the home professionally inspected.[21]

III. Judicial Application of the PCDA

A. No Remedy

Malach v. Chuang was the first case to apply the PCDA and, in dicta, attempted to blunt its impact.[22] The

seller stated in the disclosure statement that it was "unknown" whether there was any rot or water damage. Although the buyer knew that repairs to the deck around the swimming pool were required, the buyer discovered after closing that the base of the pool was so rotted that it needed to be replaced.[23]

The court found that the seller did not make misrepresentations in the disclosure statement because the seller told the truth when representing that it was "unknown" whether there was rotting.[24] As a result, even though the buyer did not state a claim under the PCDA, the court opined that the PCDA does not provide a cause of action because "it is not clear...what... 'a willful failure to perform the requirements of'" the PCDA means.[25] The court therefore concluded that the PCDA did not provide a remedy and actually "obfuscate[d] the issue of a purchaser's available remedies."[26]

Similarly, in *Middleton v. Calhoun*, the court (reviewing a small claims action) found no evidence that the seller actually knew that the septic system was defective.[27] The buyer did not test the septic system even though the buyer's contract was contingent on such a test. As with *Malach*, the court correctly found there was no claim under the PCDA, but "threw out the baby with the bathwater" by holding that the PCDA "did not create a cause of action for an alleged willful misrepresentation...."[28]

Renkas v. Sweers went even further than *Malach*.[29] The court denied a claim by the buyer even though it found that the seller *made* misrepresentations. The court found no remedy because the condition complained of was a latent defect and asserted that the PCDA "supports and reinforces...caveat emptor."[30]

As has been noted by Karl Holtzschue,[31] while *Malach* correctly declined to award relief under the PCDA due to the facts of that case, it erred in declaring that there was no remedy under the PCDA.[32] *Renkas* and *Middleton* followed in *Malach*'s footsteps by finding that the PCDA reinforced—not mitigated—caveat emptor.

B. Remedy—But Not Under the Facts

In *Fleischer v. Morreale*, the seller provided a disclosure statement which represented that there were no material defects to the roof and no flooding or drainage problems.[33] The buyer discovered within days that the roof was defective, which in turn led to basement flooding. The court recognized that the PCDA created a new statutory remedy which entitled a buyer to actual damages suffered if the seller willfully fails to disclose a known defect.[34] Similarly, the court in *Gabberty v. Pisarz* held that while the PCDA provided a remedy, the buyer was not entitled to invoke the remedy because the seller's failure to answer questions in the disclosure statement put the buyer on notice that certain defects needed further investigation.[35]

C. Remedy Awarded

Other cases have forthrightly applied a remedy. In *Calventi v. Levy*, the court found that it would "nullify" the statutory remedy if a buyer were not awarded damages after a seller failed to disclose knowledge of previous water basement leakage.[36] Furthermore, in *Ayers v. Pressman*, the court upheld a buyer's small claims action for title search expenses and mortgage application fees after the seller knew but did not disclose that the septic system encroached on the neighbor's property.[37]

In *McMullen v. Properter*, the court upheld a claim under the PCDA, where the seller failed to disclose known defects involving the septic system and covered up the "tell-tale" smell of a failing system.[38] The court reasoned that the misrepresentation in the disclosure statement might constitute active concealment which permits a claim to proceed notwithstanding caveat emptor.[39] In addition, the court in *Pettis v. Haag* found that concealment by the seller of electrical problems and flooding problems warranted a remedy.[40]

The Second Department held that a misrepresentation in the disclosure statement may constitute proof of active concealment which removes the defense of caveat emptor.[41] Similarly, the Third Department held that a misrepresentation "constitute[s] active concealment."[42] Finally, in *Meyers v. Rosen*, the Third Department found that a cause of action under the PCDA was stated when a seller was charged with failing to disclose knowledge of rodent infestation.[43]

IV. Conclusion

The legislature intended to create a remedy when it enacted the PCDA. (Section 465 of Article 14 is entitled "Remedy.")[44] A seller's failure to disclose a known defect constitutes a misrepresentation (which is an exception to caveat emptor because the seller did not remain silent) or—as the Second Department held in *Simone*—constitutes "active concealment."[45]

However, even if the seller loses the benefit of a caveat emptor defense, a buyer must still establish that he or she reasonably relied on the alleged misrepresentation.[46] The PCDA expressly maintained the requirement that a buyer conduct due diligence and it strongly recommended that a buyer obtain a professional home inspection. A seller may fail to disclose a known defect, but if the buyer could have discovered the defect with a modicum of due diligence, then the buyer did not reasonably rely on the seller's failure to disclose a known defect. The adequacy of the buyer's due diligence reflects the adequacy of the buyer's reliance.

A willful failure to disclose under the PCDA constitutes an exception to caveat emptor, but the buyer must still prove reliance. Highlighting that distinction would go a long way towards recognizing the small dent which the PCDA put into caveat emptor while respecting that reliance must always be established under both a fraud claim *and* under a PCDA claim.

Endnotes

1. *See* N.Y. Real Prop. Law §§ 460-467 (McKinney 2012).
2. *See* Karl B. Holtzschue, *Property Condition Disclosure Act Enacted*, N.Y. Real Prop. L.J., Winter 2002, at 15.

3. *See generally* Holtzschue, *infra* note 6, at 7-8 (providing an overview of caveat emptor case law, and then detailing how the PCDA "changed the ground rules").
4. N.Y. Real Prop. Law § 462(2).
5. *See id.*
6. *See* Karl B. Holtzschue, *The Purchaser Hasn't a Ghost of a Chance: Update on PCDA Cases and PCDA Revision*, N.Y. Real Prop. L.J., Winter 2007, at 8.
7. *See generally* Malach v. Chuang, 194 Misc. 2d 651, 665, 754 N.Y.S.2d 835, 846 (N.Y. Civ. Ct. Richmond Cnty. 2002) (stating in conclusion that certain remedies "contained in RPL § 462 are void for vagueness and unenforceable in a legal or equitable proceeding. The legislature needs to redraft those sections to either create a new right of action, or eliminate them so as to avoid confusion.").
8. *See* Holtzschue, *supra* note 6, at 15 (discussing the hard questions that have arisen since the PCDA's passage, as well as some proposed revisions and clarifications).
9. *See* Devine v. Meili, 89 A.D.3d 1255, 932 N.Y.S.2d 581 (3d Dep't 2011).
10. *See* Moser v. Spizzirro, 31 A.D.2d 537, 295 N.Y.S.2d 188 (2d Dep't 1968), *aff'd*, 25 N.Y.2d 941, 305 N.Y.S.2d 153 (1969).
11. *See* Karl B. Holtzschue, Holtzschue on Real Est. Cont. and Closing § 2:2.11[A] (2006) (citing Young v. Keith, 112 A.D.2d 625, 492 N.Y.S.2d 489 (3d Dep't 1985); 344 E. 72 Ltd. P'ship v. Dragatt, 188 A.D.2d 324, 591 N.Y.S.2d 28 (1st Dep't 1992) and McMillen v. Marzacano, 277 A.D. 977, 100 N.Y.S.2d 240 (1st Dep't 1950)); *see also* Stambovsky v. Ackley, 169 A.D.2d 254, 259, 572 N.Y.S.2d 672, 676 (1st Dep't 1991) (holding that caveat emptor will not apply where the seller had publicized the fact that the property was haunted and the buyer's reasonable inspection of the property could not have revealed "the property's ghoulish reputation").
12. *See* N.Y. Real Prop. Law § 462(1).
13. *See id.* § 461(5).
14. *See id.* § 462(1).
15. *Id.* § 462(2).
16. *Id.*
17. *Id.*
18. *See* N.Y. Real Prop. Law § 465(1).
19. *Id.* § 465(2).
20. *Id.* § 462(2).
21. *See id.*
22. *See generally* Malach v. Chuang, 194 Misc. 2d 651, 754 N.Y.S.2d 835 (N.Y. Civ. Ct. Richmond Cnty. 2002).
23. *See id.* at 652-53, 754 N.Y.S.2d at 837.
24. *See id.* at 653, 662-63, 754 N.Y.S.2d at 837, 844.
25. *See id.* at 656, 754 N.Y.S.2d at 839-40.
26. *Id.* at 657, 754 N.Y.S.2d at 840.
27. *See* 13 Misc. 3d 949, 956-58, 821 N.Y.S.2d 444, 450-51 (Rensselaer Cnty. Ct. 2006).
28. *Id.* at 956, 821 N.Y.S.2d at 450.
29. 10 Misc. 3d 1076(A), 814 N.Y.S.2d 892 (Sup. Ct. Monroe Cnty. 2005).
30. *Id.* at 5.
31. Karl B. Holtzschue, *First Court Case to Interpret Property Disclosure Act Holds Sellers Not Liable*, N.Y. St. B. J. March/April 2003, at 31.
32. The court also erred by misattributing the "sound and fury" soliloquy from Shakespeare's Macbeth to Lady Macbeth, rather than her husband. Malach v. Chuang, 194 Misc. 2d 651, 666, 754 N.Y.S.2d 835, 846 (N.Y. Civ. Ct. Richmond Cnty. 2002).
33. *See* 11 Misc. 3d 1004, 1005, 810 N.Y.S.2d 624, 625 (Dist. Ct. Suffolk Cnty. 2006).
34. *See id.* at 1008, 810 N.Y.S.2d at 627.
35. *See* 10 Misc. 3d 1010, 1016-17, 810 N.Y.S.2d 799, 804 (Sup. Ct. Nassau Cnty. 2005).
36. *See* 12 Misc. 3d 38, 40-41, 816 N.Y.S.2d 828, 829-30 (Sup. Ct. App. T. 2d Dep't 2006).
37. *See* 14 Misc. 3d 145(A), 836 N.Y.S.2d 496 (Sup. Ct. App. T. 9th & 10th Districts 2007).
38. *See* 13 Misc. 3d 1232(A), 831 N.Y.S.2d 354 (Sup. Ct. Yates County 2006).
39. *See id.*
40. *See* 84 A.D.3d 1553, 1554-55, 923 N.Y.S.2d 745, 747 (3d Dep't 2011).
41. *See* Simone v. Homecheck Real Estate Servs., Inc., 42 A.D.3d 518, 520-21, 840 N.Y.S.2d 398, 400 (2d Dep't 2007).
42. Anderson v. Meador, 56 A.D.3d 1030, 1035, 869 N.Y.S.2d 233, 238 (3d Dep't 2008) (citing *Simone*, 42 A.D.3d at 520-21, 840 N.Y.S.2d at 400).
43. *See* 69 A.D.3d 1095, 1099, 893 N.Y.S.2d 354, 358 (3d Dep't 2010).
44. *See* N.Y. Real Prop. § 465.
45. *See Simone*, 42 A.D.3d at 521, 840 N.Y.S.2d at 400.
46. *See* Eurycleia Partners LP v. Seward & Kissel, LLP, 12 N.Y.3d 553, 559, 883 N.Y.S.2d 147, 150 (2009) (explaining "The elements of a cause of action for fraud are a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages.").

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