South Carolina Law Review

Volume 40 | Issue 4 Article 10

Summer 1989

Latent Defects: Subsequent Home Purchasers Beware

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NOTES

LATENT DEFECTS: SUBSEQUENT HOME PURCHASERS BEWARE

I. INTRODUCTION

Sharing a single bedroom apartment with their new-born son's well-developed lungs convinced Mr. and Mrs. Subsequent Homebuyer that it was time to purchase their first home. Not only would it be nice to have more living space and a yard for Junior, a home also would be a great investment.

As soon as the Homebuyers discussed the matter, they contacted their local real estate agent. They discussed the location, their budget, and the type of home that they wanted to purchase. Two months and twelve open houses later, the young couple found their dream home, a ranch-style house located in the prestigious Sinking Sands subdivision.

Although it cost a little more than the Homebuyers wanted to pay, the house was perfect. It was in a good school district, had a nice yard, and fortunately, it was only one year old. The prior owners, Mr. and Mrs. Glad Wesoldit, hated to sell, but they had no choice because Mrs. Wesoldit's promotion required them to move to another city. The Homebuyer's real estate agent told them the home was built by Mr. Homebuilder, a reputable residential builder, and that the Wesoldits purchased it from Vendors Incorporated, the developer of Sinking Sands.

After the Homebuyers bought the house, they spent their weekends decorating, working in the yard, and best of all, sleeping. A year of peaceful home ownership, however, was soon to end. As the house settled, small cracks began to appear in the walls of their bedroom. At first, they were able to cover these cracks with paint; however, the cracks eventually became too large merely to paint over. To their horror, they soon discovered

cracks in their patio and brick walls. The Homebuyers realized that if nothing were done, they soon would be living in a subterranean tomb. In desperation, they contacted the attorney they had seen in a recent television commercial.

The Homebuyers frantically explained their problem to Mr. T.V. Lawyer. He assured them that although the law of *caveat emptor* (buyer beware) predominated in the United States until the 1950s,[1] today many remedies were available to them. Listening attentively, the anxious Homebuyers were calmed by the legal jargon. Mr. T.V. Lawyer explained that they may be able to recover their damages from a number of persons under a variety of legal theories. The builder, vendor, prior owner, real estate agent, and possibly the lender could be liable for their damages. Despite Mr. T.V. Lawyer's assurances, however, does the law really protect subsequent home purchasers? The Homebuyers qualify as "subsequent purchasers" because they bought their home from the Wesoldits rather than from the original vendor, Vendors Incorporated.

This Note explores the remedies available to subsequent home purchasers. Focusing on South Carolina law, it also examines the problem of finding a solvent party. Research reveals that the courts have attempted to abolish *caveat emptor* by relying on contract and tort theories, which are correspondingly limited by the requirements of privity, foreseeability, and the economic loss rule. Consequently, courts fashion remedies imperfectly and often inadequately to handle the myriad of problems unique to home purchasers.

Conclusions drawn from this Note's analysis suggest that *caveat emptor* still exists for many subsequent home purchasers and that legislation is needed to remedy this inequity that often denies recovery merely because of the unfortunate intervention of a prior owner. As one possible solution, this Note proposes a mandatory home warranty program, which would protect new and subsequent home purchasers for a designated period of time. Additionally, this program would require residential builders to purchase transferable home warranty insurance, thus assuring aggrieved home buyers a solvent source of recovery.

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1. *See* Roberts, *The Case of the Unwary Home Buyer: The Housing Merchant Did It*, 52 CORNELL L.Q. 835 (1967); Shedd, *The Implied Warranty of Habitability: New Implications, New Applications*, 8 REAL EST. L.J 291, 292-93 (1980).

II. Possible Sources of Recovery

A. *Builder-Vendors: Implied Warranty*

The majority of jurisdictions recognize that new home purchasers may maintain an implied warranty action against builder-vendors.[2] "Builder-vendor" has been defined as "one who buys land and builds homes upon that land for purposes of sale to the general public."[3] Although a few states have enacted statutes establishing this cause of action,[4] in the majority of states, including South Carolina, courts have created this remedy judicially.[5] Only Georgia continues to deny an implied warranty cause of action.[6] As a general rule, however, courts deny recovery if a reasonable inspection by subsequent home purchasers would have revealed any latent defects.[7]

Although states overwhelmingly recognize that an implied warranty arises from the sale of *new* homes, the courts are divided on whether this warranty extends to subsequent purchasers who are not in privity with builder-vendors.[8] In *Terlinde v.*

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2. *See* Grand, *Implied and Statutory Warranties in the Sale of Real Estate: The Demise of Caveat Emptor*, 15 Real Est. L.J. 44, 45-46 (1986); *see also* Annotation, *Liability of Builder-Vendor or Other Vendor of New Dwelling for Loss, Injury, or Damage Occasioned by Defective Condition Thereof*, 25 A.L.R.3d 383, 413 (1969 & Supp. 1988) (a number of cases have abandoned or relaxed the doctrine of caveat emptor).

3. Elderkin v. Gaster, 447 Pa. 118, 123 n.10, 288 A.2d 771, 774 n.10 (1972).

4. *See* Grand, *supra* note 2, at 46. *See, e.g.*, Conn. Gen. Stat. Ann. §§ 47-116 to -121 (West 1989); Md. Real Prop. Code Ann. §§ 10-201 to -205 (1988); N.J. Stat. Ann. § 46:3B-1 (West Supp. 1989); Va. Code Ann. § 55-70.1 (Supp. 1989); W. Va. Code §§ 36B-4-114 to -117 (Supp. 1988) (protecting condominium purchasers).

5. *See* Grand, *supra* note 2, at 46. Although Miller v. Cannon Hill Estates, Ltd., 2 K.B. 113 (1931), was the first common-law decision to recognize the implied warranty of habitability, the rule was first recognized in South Carolina by Rutledge v. Dodenhoff, 254 S.C. 407, 175 S.E.2d 792 (1970).

6. *See* Worthey v. Holmes, 249 Ga. 104, 287 S.E.2d 9 (1982); Grand, *supra* note 2, at 46; *see also* Note, *Implied Warranties in New Home Sales-Is the Seller Defenseless?*, 35 S.C.L. Rev. 469, 469 n.2 (1984) (stating that Georgia and Virginia have rejected implied warranty protection). Although the Note cited above states that Virginia rejects an implied warranty, Virginia now recognizes this cause of action. *See* Va. Code Ann. § 55-70.1 (Supp. 1988).

7. For cases imposing a reasonable inspection upon the home purchaser, see Annotation, *supra* note 2, at 392-94.

8. *See* Annotation, *Liability of Builder of Residence for Latent Defects Therein As Running to Subsequent Purchasers From Original Vendee*, 10 A.L.R.4th 385, 394-400 (1981 & Supp. 1988).

Neely[9] South Carolina placed itself in the vanguard of states by extending an implied warranty to remote home purchasers. The court reasoned that privity is no longer required in South Carolina and thus "an implied warranty for latent defects extends to subsequent home purchasers for a reasonable amount of time."[10] Similarly, the Wyoming Supreme Court noted that "any reasoning which would arbitrarily interpose a first buyer as an obstruction to someone equally as deserving of recovery is incomprehensible."[11] Other states extending the implied warranty to subsequent purchasers include: Arizona,[12] Illinois,[13] Indiana,[14] New Jersey,[15] Oklahoma,[16] Texas,[17] and Virginia.[18] In limited situations, Washington and Colorado also allow an implied war-

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9. 275 S.C. 395, 271 S.E.2d 768 (1980) (settling of the foundation caused extensive damage).

10. *Id.* at 399, 271 S.E.2d at 770. For a thorough discussion of *Terlinde*, see *Contracts, Annual Survey of South Carolina Law*, 33 S.C.L. REV. 33 (1981).

11. Moxley v. Laramie Builders, Inc., 600 P.2d 733, 736 (Wyo. 1979) (subsequent purchaser allowed to sue the builder-vendor for latent defects in the electrical system that created an unsafe condition). The court noted that recovery was "limited to latent defects which become manifest after the purchase." *Id.*

12. *See* Nastri v. Wood Bros. Homes, Inc., 142 Ariz. 439, 442-43, 690 P.2d 158, 160-61 (Ct. App. 1984) (attempted disclaimer of implied warranty of habitability in contract with first purchaser was void against the subsequent purchaser as a matter of public policy).

13. *See* Briarcliffe W. Townhouse Owners Ass'n v. Wiseman Constr. Co., 118 Ill. App. 3d 163, 167, 454 N.E.2d 363, 365 (1983) (latent defects must be discovered within reasonable period of time). *See generally* Niro, *Let the* Seller *Beware! Illinois Adopts the Implied Warranty of Fitness in the Sale of a New Home*, 68 ILL. B.J. 770 (1980) (history concerning Illinois' adoption of the implied warranty).

14. *See* Wagner Constr. Co. v. Noonan, 403 N.E.2d 1144, 1149-50 (Ind. Ct. App. 1980) (while recognizing that the implied warranty extends to subsequent purchasers, court disallowed recovery because of subsequent purchasers' failure to notify the builder, thus denying builder the opportunity to remedy the defect). For a discussion of the scope of the implied warranty in Indiana, see Note, *Indiana's Implied Warranty of Fitness for Habitation: Limited Protection for Used Home Buyers*, 57 IND. L.J. 479 (1981-82).

15. *See* Hermes v. Staiano, 181 N.J. Super. 424, 432, 437 A.2d 925, 929 (Ct. Law Div. 1981) (finding no logical reason to differentiate between initial and subsequent purchasers).

16. *See* Bridges v. Ferrell, 685 P.2d 409, 410 (Okla. Ct. App. 1984) (express warranty did not preclude an implied warranty action by the subsequent purchaser).

17. *See* Gupta v. Ritter Homes, Inc., 646 S.W.2d 168, 169 (Tex. 1983) (implied warranty, which protects against latent defects not discoverable upon a reasonable inspection, is automatically assigned to subsequent purchaser).

18. *See* VA. CODE ANN. § 55-70.1 (Supp. 1988) (implied warranty survives the transfer of title).

ranty to extend to subsequent purchasers.[19]

A majority of courts have held that an implied warranty does not extend to subsequent purchasers.[20] These courts reason that a warranty is fundamentally a contract and, therefore, privity is required. Because subsequent purchasers are not in privity with builder-vendors, these courts do not recognize a cause of action based upon an implied warranty.[21] Colorado,[22] Connecticut,[23] Florida,[24] Illinois,[25] Mississippi,[26] Missouri,[27] and New York[28] have held that lack of privity bars subsequent purchasers from an implied warranty claim. Because of an intermediate owner, these states, therefore, deny subsequent home purchasers the remedy afforded new home purchasers.

Although South Carolina allows subsequent purchasers a cause of action for breach of an implied warranty for latent defects,[29] the supreme court in *Arvai v. Shaw*[30] qualified this remedy. In *Arvai* the court held that an implied warranty attaches only to the sale of new, as opposed to used, homes.[31] Apparently,

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19. Although as a general rule in Colorado a subsequent purchaser has no implied warranty of habitability, in special circumstances the warranty will be extended. *See* Duncan v. Schuster-Graham Homes, Inc., 194 Colo. 441, 443-44, 578 P.2d 637, 638-39 (1978) (builder repurchased house from original purchaser, then sold it to subsequent purchaser). The Washington Court of Appeals allowed the first *occupant* to recover on an implied warranty theory despite two prior purchasers. *See* Gay v. Cornwall, 6 Wash. App. 595, 598, 494 P.2d 1371, 1374 (1972); *see also* Annotation, *supra* note 8, at 394.

20. *See* Note, *supra* note 6, at 499.

21. *See* Navajo Circle, Inc. v. Development Concepts Corp., 373 So. 2d 689, 692 n.3 (Fla. Dist. Ct. App. 1979) (court allowed tort action against builder despite lack of privity, but disallowed action for breach of warranty).

22. *See* H.B. Bolas Enters., v. Zarlengo, 156 Colo. 530, 535, 400 P.2d 447, 450 (1965) (house was previously occupied).

23. *See* Coburn v. Lenox Homes, Inc., 173 Conn. 567, 570, 378 A.2d 599, 600 (1977) (implied warranty does not extend to subsequent purchasers).

24. *See supra* note 21 and accompanying text.

25. *See* Mellander v. Kileen, 86 Ill. App. 3d 213, 215, 407 N.E.2d 1137, 1139 (1980) (lack of privity bars recovery).

26. *See* Hicks v. Greenville Lumber Co., 387 So. 2d 94, 96 (Miss. 1980) (implied warranty exists only if house is new and plaintiff is first purchaser).

27. *See* John H. Armbruster & Co. v. Hayden Co.-Builder Dev., Inc., 622 S.W.2d 704, 705 (Mo. Ct. App. 1981).

28. *See* Butler v. Caldwell & Cook, Inc., 122 A.D.2d 559, 505 N.Y.S.2d 288 (Ct. App. Div. 1986).

29. *See* Terlinde v. Neely, 275 S.C. 395, 399, 271 S.E.2d 768, 770 (1980).

30. 289 S.C. 161, 345 S.E.2d 715 (1986). The court, however, focused on who places a house into the stream of commerce. *See infra* notes 67-68 and accompanying text.

31. *See id.* at 164, 345 S.E.2d at 717. Shaw, the custom builder, built the house for the Farrs on their property. After completion the Farrs moved into the home but, when

therefore, a builder can avoid liability by building for an intermediate purchaser so that when the home is sold to the public it is no longer considered "new," but instead has become "used." Connecticut and Maryland, to solve this potential problem, have enacted provisions that prevent vendors from utilizing intermediate purchasers in an attempt to evade statutory liability.[32]

Courts have imposed restrictions upon the amount of time subsequent purchasers may discover latent defects. For example, in *Terlinde* the South Carolina Supreme Court held that "an implied warranty for latent defects extends to subsequent home purchasers for a *reasonable amount of time*."[33] The court did not, however, define what constitutes a reasonable amount of time. Does the traditional contract statute of limitations apply or is the court suggesting that some shorter time period is applicable?[34] Several states have addressed this question. For instance, in Maryland and Virginia an implied warranty extends for one year from the time title is delivered or from the time the original purchaser takes possession, whichever occurs first.[35] In contrast, New Jersey's New Home Warranty and Builders' Registration Act provides a comprehensive warranty program including a ten-year warranty for major construction defects.[36]

Therefore, although *caveat emptor* has been abandoned in the sale of new homes, a large number of states still deny subsequent purchasers an implied warranty cause of action. Assuming

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they became dissatisfied, reconveyed it to Shaw. Shaw then sold the home to the Semones. The Semones conveyed the home to the Arvais, the subsequent puchasers.

32. *See* CONN. GEN. STAT. ANN. § 47-119 (West 1986); MD. REAL PROP. CODE ANN. § 10-205 (1988). Neither statute allows subsequent purchasers an implied warranty cause of action.

33. *Terlinde*, 275 S.C. at 399, 271 S.E.2d at 770 (emphasis added). *See also* Briarcliffe W. Townhouse Owners Ass'n v. Wiseman Constr. Co., 118 Ill. App. 3d 163, 167, 454 N.E.2d 363, 365 (1983) ("[A]n implied warranty of habitability may extend to a subsequent purchaser who discovers a latent defect within a *reasonable time* after the purchase of a home . . . ." (emphasis added)).

34. South Carolina recently enacted a statute of limitations for actions based upon defective or unsafe improvements to real property. The action must be brought within 13 years after substantial completion of the improvement, absent a contractual agreement to extend the period. *See* S.C. CODE ANN. § 15-3-640 (Law. Co-op. Supp. 1989).

35. *See* MD. REAL PROP. CODE ANN. § 10-204(b)(1) (1988); VA. CODE ANN. § 55-70.1(E) (1986).

36. *See* N.J. STAT. ANN. § 46:3B-3(b)(3) (West Supp. 1989). For a thorough discussion of the New Home Warranty and Builders' Registration Act, see Grand, *supra* note 2, at 53-55. " 'Major construction defect' means any actual damage to the load bearing portion of the home . . . ." N.J. STAT. ANN. § 46:3B-2(g) (West Supp. 1988).

purchasers have a cause of action, the additional time hurdle must be cleared. In instances when purchasers are afforded only one year, or a comparably short period of time, to discover defects, home purchasers receive scant protection. Serious structural defects often take many years to manifest themselves. Ironically, for the first few years vendors may be liable for leaky faucets,[37] yet later escape liability when a defective foundation causes a home to sink. The one-year limit in Virginia and Maryland clearly illustrates the lobbying strength of the local Residential Home Builders Associations as compared to the unorganized political power of the home-buying public.

In the majority of states, therefore, Mr. and Mrs. Homebuyer would be unable to recover from Mr. Homebuilder based upon an implied warranty because of the privity limitation placed upon subsequent purchasers. The Homebuyers may have an implied warranty cause of action against Vendors Incorporated, but as will be discussed later, this avenue of redress also is limited.

B. Builder-Vendors: Tort Theory

Several states have held that builder-vendors may be liable for negligent construction,[38] and of these, a few permit subsequent purchasers to recover for latent defects negligently caused by builders.[39] The rationale for allowing negligence actions was well summarized by the Supreme Court of Colorado in *Cosmopolitan Homes v. Weller*.[40] Rejecting the economic loss rule as a bar to recovering damages caused by latent defects, the court

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37. For a discussion that minor defects do not constitute a breach of an implied warranty, see Note, *supra* note 6, at 494-96.

38. For a list of states recognizing a negligence cause of action, see Annotation, *supra* note 2, at 397-99 (including Arizona, California, Florida, Georgia, Indiana, Ohio and Wyoming). *But see* Florida Power & Light Co. v. Westinghouse Elec. Corp., 510 So. 2d 899, 901-02 (Fla. 1987) (Florida recently recognized that economic loss rule barred tort claim of a nuclear steam generator purchaser).

39. *See* Cosmopolitan Homes, Inc. v. Weller, 663 P.2d 1041, 1045 (Colo. 1983) (subsequent purchaser allowed to bring a claim for latent defects caused by builder's negligence); McMillan v. Brune-Harpenau-Torbeck Builders, Inc., 8 Ohio St. 3d 3, 4-5, 455 N.E.2d 1276, 1277 (1983) (action against builder-vendor); Barnes v. Mac Brown & Co., 264 Ind. 227, 229, 342 N.E.2d 619, 620-21 (1976) (subsequent purchaser may seek damages for economic loss caused by latent defects not reasonably discoverable by the subsequent purchaser).

40. 663 P.2d 1041 (Colo. 1987).

reasoned:

> [T]here is no rationale reason to distinguish between negligence resulting in personal injury and negligence resulting in property damage. Attempts to distinguish a cause of action for property damages as one sounding exclusively in contract because the damages represent an "economic loss" are unpersuasive. Logically, both injury to one's person and injury to one's property result in economic loss.[41]

Some courts, however, provide that purchasers may recover for economic loss only when negligent construction creates a dangerous or unsafe condition.[42]

Increasingly, states have held that home purchasers may not recover purely economic losses in negligence actions.[43] Moreover, the United States Supreme Court recently upheld the economic loss rule as barring a negligence claim in which the plaintiff sought to recover purely economic losses.[44] "Economic loss" refers to the cost of repairing a defective product, the loss of use, and lost profits.[45] Therefore, while a builder may be liable if a negligently constructed house causes personal injury or damage to tangible property located within that house, absent such damages the economic loss rule bars recovery of damages to the house itself. Rather, the courts upholding the economic loss rule

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41. *Id.* at 1044, n. 5 (citation omitted). *See Barnes*, 264 Ind. at 230, 342 N.E.2d at 621 ("The contention that a distinction should be drawn between mere 'economic loss' and personal injury is without merit.").

42. *See* Council of Co-Owners Atlantis Condominium, Inc. v. Whiting-Turner Contracting Co., 308 Md. 18, 38, 517 A.2d 336, 344 (1986) (holding limited to cases when negligent construction creates a risk of personal injury); *see also* Oates v. JAG, Inc., 314 N.C. 276, 277-78, 333 S.E.2d 222, 224 (1985) (pleadings indicated that the defect created a dangerous condition).

43. *See, e.g.*, Nastri v. Wood Bros. Homes, Inc., 142 Ariz. 439, 690 P.2d 158 (Ct. App. 1984); Wheeling Trust & Sav. Bank v. Tremco, Inc., 153 Ill. App. 3d 136, 142-43, 505 N.E.2d 1045, 1050 (1987) (to recover economic loss, plaintiff must allege defendant breached a duty of care exhibited by his profession); Dutton v. International Harvester Co., 504 N.E.2d 313, 318 (Ind. Ct. App. 1987) (in absence of personal injury, economic loss could not be recovered for a defective planter); Ellis v. Robert C. Morris, Inc., 128 N.H. 358, 367, 513 A.2d 951, 954-55 (1986) (no tort duty exists with respect to economic loss); Butler v. Caldwell & Cook, 122 A.D.2d 559, 505 N.Y.S.2d 280, 290 (Ct. App. Div. 1986) (economic loss rule barred recovery of defective siding and sheathing).

44. *See* East River S.S. Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 876 (1986) (admiralty claim).

45. *See* Salmon Rivers Sportsman Camps, Inc. v. Cessna Aircraft Co., 97 Idaho 348, 351, 544 P.2d 306, 309 (1975).

have held that in cases of pure economic loss, the purchaser's remedy resides in contract.[46] Thus, purchasers must rely on express and implied warranty actions. The rationale for the economic loss rule rests on judicial reluctance to allow unlimited liability.[47]

The Fourth Circuit, interpreting South Carolina law, disallowed a negligence claim in which the plaintiff sought to recover the repair costs of a defective roof. Instead, the court held that plaintiff's remedy rested solely in contract.[48] In *Terlinde*, however, the South Carolina Supreme Court allowed a subsequent purchaser to sue the builder in tort because of the existence of a latent defect,[49] but did not discuss the economic loss rule. Recently, the South Carolina Court of Appeals held that *Terlinde* did not address or abolish the economic loss rule.[50] Rather, the court of appeals stated *Terlinde* was limited to its facts and upheld the economic loss rule as barring an owners' negligence cause of action.[51]

If the Homebuyers live in one of the increasing number of states adhering to the economic loss rule, a negligence action against Mr. Homebuilder will fail because they have suffered purely economic losses; only their home has been damaged. If the defect had personally injured the Homebuyers or damaged any of their household property, these states may afford them a remedy. In jurisdictions recognizing the economic loss rule, the Homebuyers would have to resort to a contract cause of action. The Indiana Supreme Court recognized the problem with this

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46. *See, e.g.*, Woodward v. Chirco Constr. Co., 141 Ariz. 514, 516, 687 P.2d 1269, 1271 (1984) ("For example, if a fireplace collapses, the purchaser can sue in contract for the cost of remedying the structural defects and sue in tort for damage to personal property or personal injury caused by the collapse.").

47. For a discussion of the problem of allowing purely economic loss in a negligence action, see Perlman, *Interference with Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine*, 49 U. CHI. L. REV. 60 (1982).

48. *See* 2000 Watermark Assocs., Inc. v. Celotex Corp., 784 F.2d 1183, 1187-88 (4th Cir. 1986). The court noted that *Terlinde* was not applicable because the case was concerned with latent defects.

49. *See* Terlinde v. Neely, 275 S.C. 395, 399, 271 S.E.2d 768, 770 (1980).

50. *See* Carolina Winds Owners' Ass'n v. Joe Harden Builder, Inc., 297 S.C. 74, 83, 374 S.E.2d 897, 903 (Ct. App. 1988) ("Unlike the defendants in this case, the builder in *Terlinde* built the house for speculation, not pursuant to a contract for its construction."), *aff'd on rehearing*, No. 25 Davis Adv. Sh. 21 (S.C. Ct. App. Nov. 30, 1988).

51. *See id.* at ___, 374 S.E.2d at 906 (the right to a well-constructed building arises from owner's contract, and thus, the owner's remedy "lies in contract, not negligence").

approach. The court asked: "Does the law penalize those who are alert and prevent injury? Should it not put those who prevent personal injury on the same level as those who fail to anticipate it?"[52]

C. Builder-Vendors: Other Causes of Action

In addition to implied warranty and negligence claims, subsequent purchasers may claim the benefit of an express warranty. If a builder-vendor makes an express warranty to the first purchasers, they undisputably have a valid claim. In Oklahoma an express warranty does not preclude an implied warranty action unless the contract provides for this preclusion in clear and conspicuous language.[53] A subsequent purchaser's lack of privity with the warrantor, however, prevents an action based upon a builder-vendor's express warranty.[54] On the other hand, if a subsequent purchaser was a contemplated beneficiary of the contract, a third-party beneficiary claim may be successful.[55] Such claims rarely have been successful.[56]

Subsequent purchasers may be protected if their builders participated in the Home Owner's Warranty (HOW) program. The builder purchases this warranty, and it is automatically transferred to subsequent purchasers. The warranty extends for a ten-year period during which certain parts of the house are protected for different lengths of time. For instance, minor problems are covered for the first two years, while the structural integrity of the house is covered by a full ten-year warranty. The builder is responsible for defects occurring within the first two

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52. Barnes v. Mac Brown & Co., 264 Ind. 227, 229, 342 N.E.2d 619, 621 (1976) (reasoning that a home buyer should not have to wait until an actual injury occurs to recover his damages).

53. *See* Bridges v. Ferrell, 685 P.2d 409, 410-11 (Okla. Ct. App. 1984).

54. *See* Governors Grove Condominium Ass'n v. Hill Dev. Corp., 36 Conn. Supp. 144, 147, 414 A.2d 1177, 1180 (Super. Ct. 1980) (one not a party to a contract cannot sue to enforce the contract); Butler v. Caldwell & Cook, 122 A.D.2d 559, ___, 505 N.Y.S.2d 280, 290 (Ct. App. Div. 1986) (plaintiff failed to plead that the warranty was intended to benefit third parties).

55. *See Governors Grove Condominium Ass'n*, 36 Conn. Supp. at 147, 414 A.2d at 1180 (recognizing that a party to a contract or a contemplated beneficiary may enforce the contract).

56. *See* Wheeling Trust & Sav. Bank v. Tremco, Inc., 153 Ill. App. 3d 136, 140, 505 N.E.2d 1045, 1048 (1987) (intent to benefit a third party must be established by an express provision in contract).

years; however, the insurer assumes liability should the builder fail to fulfill his obligations. Thus, home purchasers are protected should their builder become insolvent.[57]

Not surprisingly, Mr. T.V. Lawyer discovered that Mr. Homebuilder had not participated in the HOW program. Only twenty-five percent of America's homebuilders participate in this program.[58] He further discovered that neither Mr. Homebuilder nor Vendors Incorporated had made any express warranties. In fact, the real estate contract contained an "as is" disclaimer of all express and implied warranties.[59] Even if the original real estate contract had contained an express warranty, the Homebuyers likely would be unable to enforce the contract because of the improbability of qualifying as third-party beneficiaries.

D. Builder-Nonvendors: Implied Warranty

Few courts have addressed the question of whether a party who builds houses for developers or private parties pursuant to a construction contract (builder-nonvendor) may be sued for breaching an implied warranty. Builder-nonvendors do not build houses and sell them to the general public. The majority of states upholding an implied warranty have done so in the context of builder-vendors or vendors.[60] Therefore, it is unclear whether courts upholding an implied warranty will make a distinction when considering builder-nonvendors.

At least one state, Maryland, has defined "vendor" to include builders, and thus, it is immaterial whether the builder actually sells the home. The Maryland statute, which establishes an implied warranty, defines "vendor" as "any person engaged in the business of erecting or otherwise creating an improvement on realty, *or* to whom a completed improvement has been

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57. *See* Note, *supra* note 6, at 491-92.

58. *See* The Home Buyer's Guide to HOW, 1985 (pamphlet available from local Homeowner's Warranty Corporation).

59. For a discussion of the "as is" disclaimer in the sale of new homes, see Larson, *The "As Is" Disclaimer and the Sale of New Houses*, 13 REAL EST. L.J. 238 (1984).

60. *See* Annotation, *supra* note 2, at 413 ("[T]he courts have taken the view that a *builder-vendor* or other *vendor* of a new dwelling may be held liable for loss, injury, or damage occasioned by a defective condition of the dwelling, on the theory of breach of an implied warranty of habitability or quality." (emphasis added)).

granted for resale in the course of his business."[61] In dicta, the Supreme Court of Illinois indicated that "repair costs should be borne by the responsible builder-vendor *who created the latent defect*."[62] If Illinois follows the rationale of this dicta, builder-nonvendors may be liable for construction defects since as builders they are responsible for creating those defects.[63]

In contrast, South Carolina does not recognize the existence of an implied warranty cause of action against builder-nonvendors. The South Carolina Supreme Court reasoned that "when a new building is sold there is an implied warranty of fitness for its intended use which springs from the sale itself."[64] While recognizing that the seller-nonbuilder's liablility was not founded upon fault, the court held that "because [the seller] has profited by receiving a fair price and, as between [the seller] and an innocent purchaser, the innocent purchaser should be protected from latent defects."[65] The court implied that a builder-nonvendor would not be liable under an implied warranty theory. Several years later in *Arvai v. Shaw*[66] the court clarified its position. The court reasoned that "[h]olding the custom builder liable under an implied warranty, where he is not also involved in the *sale* of the house, would be incompatible with the law of warranty."[67]

The court's holding leaves an anomalous result in South Carolina. As previously discussed, homebuilders may be able to avoid an implied warranty by building houses for intermediate purchasers, such as shell companies, so that the homes are not considered "new" when they are sold to the general public.[68] In addition to this tactic, builders may be able to avoid implied warranty liability to subsequent purchasers by building under

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61. MD. REAL PROP. CODE ANN. § 10-201(e) (Michie 1988) (emphasis added).

62. Redarowicz v. Ohlendorf, 92 Ill. 2d 171, 183, 441 N.E.2d 324, 330 (1982) (emphasis added).

63. For a discussion of South Carolina's misplaced reliance upon *Redarowicz*, see *Property, Annual Survey of South Carolina Law*, 39 S.C.L. REV. 131, 136-37 (1987).

64. Lane v. Trenholm Bldg. Co., 267 S.C. 497, 500, 229 S.E.2d 728, 729 (1976). The court held a nonbuilder-vendor, who did not build the house, liable. The nonbuilder-vendor, however, had undertaken the cloak of a builder by installing a new septic system, and thus, a court may use this factor to distinguish *Lane*.

65. *Id.* at 503, 229 S.E.2d at 731.

66. 289 S.C. 161, 345 S.E.2d 715 (1986).

67. *Id.* at 164, 345 S.E.2d at 717.

68. *See supra* notes 29-32 and accompanying text.

contract exclusively for developers or private individuals rather than building "speculative homes," those to be sold to the general public.

What is to prevent builders from establishing their own shell vendor corporations? Such a possibility would create nightmares for home buyers who would face the difficult task of piercing the corporate veil. In South Carolina, builders must establish proof of financial responsibility or execute a $10,000 bond with an approved surety before they can become licensed residential home builders.[69] Developers and other vendors, however, are not required to be bonded or to establish financial responsibility. What benefit is a bond or a fiscally sound builder when home purchasers may have virtually no recourse against these builders?

Although the South Carolina statute establishing the bond does not expressly confer upon home buyers a private cause of action, in *Watson v. Harmon*[70] the court of appeals recognized a private cause of action, reasoning that the legislative intent was " 'to protect the home buying public from . . . financially irresponsible builders.' "[71] In *Watson*, however, the builder and plaintiff had entered into an oral contract to construct an additional room.[72] Whether the court will extend such a private cause of action to subsequent home purchasers is unclear. Also remaining to be answered is whether private parties will be granted a cause of action against the bond when builders are nonvendors. Given the court's broad conclusion that the bond was intended to benefit the *public*, perhaps courts will be willing to extend the private cause of action.[73] On the other hand, the court's reluctance in *Arvai v. Shaw* to hold builder-nonvendors liable may lead courts to conclude that since builder-nonvendors are not liable, then no action should exist against the bonds that they post.[74]

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69. *See* S.C. CODE ANN. § 40-59-70(b) (Law. Co-op. 1986). For a definition of residential home builder, see *id.* § 40-59-10.

70. 280 S.C. 214, 312 S.E.2d 8 (Ct. App. 1984).

71. *Id.* at 218, 312 S.E.2d at 11 (citing Henderson v. Evans, 268 S.C. 127, 136, 232 S.E.2d 331, 336 (1977) (Gregory, J., dissenting)).

72. *See id.* at 216, 312 S.E.2d at 9.

73. For an excellent discussion of *Watson*, see *Property, Annual Survey of South Carolina Law*, 37 S.C.L. REV. 211 (1985).

74. *See supra* notes 66-69 and accompanying text.

Further, in *Kennedy v. Henderson*[75] when faced with the identical public policy argument, the court recognized that the bond's protection extends only to "those violations falling within the coverage of the particular surety bond provisions."[76] The court continued by noting that the bond was intended to assure the "builder's compliance with certain rules and regulations pertaining to construction standards and health and safety requirements."[77] In *Kennedy* the plaintiff was attempting to recover $11,000, which was advanced to the builder to construct a "dwelling-house type building to be used as a nursery."[78] The builder refused to begin construction and the court denied recovery, stating that the bond is not a "performance bond guaranteeing the completion of the work contracted."[79] The bond's protection is clearly limited in its protective scope.

In any event, $10,000 affords home purchasers very little protection, especially in instances involving major structural damage. Also, if more than one claim is filed against the bond, the money must be divided among the parties filing such claims. Thus, even several relatively minor mistakes by the builder could result in the depletion of the bond. Once the bond is depleted, later claimants will receive nothing.[80]

Whether the Mr. and Mrs. Homebuyer will have an implied warranty claim against Mr. Homebuilder is unclear. In at least one state, Maryland, such a claim could be successful. In South Carolina, however, the Homebuyers would be compelled to seek another remedy. Assuming the courts will not allow an implied warranty claim, they will be equally unlikely to allow an action against the bond. Instead, the Homebuyers would have to recover from the seller, Vendors Incorporated. Unless more states address these questions, other homebuyers will be exposed to expensive litigation to resolve many of these issues.

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75. 289 S.C. 393, 346 S.E.2d 526 (1986).

76. *Id.* at 396, 346 S.E.2d at 528.

77. *Id.*

78. *Id.* at 394, 346 S.E.2d at 527.

79. *Id.* at 396, 346 S.E.2d at 528.

80. The information was obtained from an interview with the Director of the South Carolina Residential Home Builders Commission. At present the Commission has not published formal regulations concerning a claims procedure. This lack of procedure is not surprising considering a private cause of action against the bond was just recently recognized.

E. Builder-Nonvendors: Tort Theory

In negligence claims, the courts apparently have made no distinction between builder-vendors and builder-nonvendors.[81] Since courts that have allowed subsequent purchasers to recover for builder's negligence have held that foreseeability and not privity is determinative, these courts likely will not deny recovery simply because a builder did not sell the house.[82] After all, if the courts are going to allow negligence claims against builder-vendors, harm does not become less foreseeable merely because the builder does not sell also the house. Whether this distinction will affect a home buyer's negligence claim remains to be seen. In any event, the obstacle of the economic loss rule still persists for homebuyers attempting to bring negligence claims.[83]

F. Nonbuilder-Vendors: Implied Warranty

The fact that a vendor did not build a house should not prevent the vendor from being liable based upon an implied warranty.[84] "The vendor agrees to provide a product, and if the product is defective, he should be liable. Of course the ultimate liability may rest with the actual builder, who may be joined as a third-party defendant."[85]

At least two states have indicated that nonbuilder-vendors may be liable on an implied warranty theory. In *Smith v. Old Warson Development Co.*[86] the Missouri court recognized that a vendors' liability is not founded upon negligence, knowledge, or fault. Similarly, in *Lane v. Trenholm Building Co.*[87] the Supreme Court of South Carolina held that "when a new building is sold there is an implied warranty of fitness for its intended

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81. *See* Annotation, *supra* note 8, at 389-93 (cases discussed fail to draw a distinction between builder-vendors and builder-nonvendors).

82. *See* Coburn v. Lenox Homes, Inc., 173 Conn. 567, 575, 378 A.2d 599, 603 (1977) (court reasoned that there was no reason why a builder-vendor should not be liable for his negligence if the effects were foreseeable by a reasonable man).

83. *See supra* notes 44-48 and accompanying text.

84. *See* McNamara, *The Implied Warranty in New-House Construction Revisited*, 3 REAL EST. L.J. 136, 141-42 (1974).

85. *Id.* at 142.

86. 479 S.W.2d 795, 798 (Mo. 1972).

87. 267 S.C. 497, 229 S.E.2d 728 (1976).

use which springs from the sale itself."[88] Although the court recognized that the nonbuilder-vendor's liability is not founded upon fault, the court held that as between a vendor and an innocent purchaser, the vendor will be held liable.[89] Although every state except Georgia recognizes an implied warranty cause of action against vendors of new homes,[90] are purchasers really protected? Assuming these courts will treat nonbuilder-vendors the same as builder-vendors, just how much protection is afforded home purchasers? As previously discussed, many states do not recognize the existence of an implied warranty when subsequent home purchasers sue builder-vendors; therefore, these states probably will not allow an implied warranty theory when subsequent purchasers sue nonbuilder-vendors.[91]

Furthermore, many vendors do not exist several years after a subdivision is complete. "Indeed, the [vendor] may well have been a collapsible corporation which, like Maeterlinck's, ceased to exist when the last house was sold."[92] Thus, states that deem the vendor as the primary source for recovery may have provided home purchasers, whether original or subsequent, with a procedural right devoid of any substantive merit.

Mr. and Mrs. Homebuyer discovered that Mr. Homebuilder formed Vendors, Incorporated for the sole purpose of selling houses that he constructed in the Sinking Sands subdivision. While Connecticut and Maryland[93] probably would protect *original* purchasers from the builder's tactics, in South Carolina it is unclear whether the Homebuyers would be able to recover directly against Mr. Homebuilder, the builder-nonvendor. Also, as

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88. *Id.* at 500, 229 S.E.2d at 729.

89. *See id.* at 503, 229 S.E.2d at 731. Under *Lane*, however, the nonbuilder-vendor assumed the cloak of a builder by undertaking to install a new septic system. *Lane*, therefore, may be limited to its facts. *See supra* note 64.

90. *See supra* notes 1-6 and accompanying text.

91. *See* Vetor v. Shockey, 414 N.E.2d 575 (Ind. Ct. App. 1980):

> Our research, however, has uncovered no Indiana cases expanding this implied warranty concept to the purchaser of a *used* house from a *non* builder-vendor. Those jurisdictions which have been confronted with such factual situations have universally rejected such expansion. The refusal to extend the doctrine is seemingly premised on the idea that in the sale of *used* housing, the vendor usually has no greater expertise in determining the quality of a house than the purchaser.

Id. at 577 (emphasis in original).

92. Roberts, *supra* note 1, at 836.

93. *See supra* note 31 and accompanying text.

subsequent purchasers, many states would deny the Homebuyers an implied warranty cause of action. The implied warranty theory does not provide the Homebuyers with as much protection as it might appear initially.

G. Prior Owners, Real Estate Agents: Fraud

Subsequent home purchasers will find it extremely difficult to establish fraud against prior owners and against their real estate agents, especially if their damages are caused by latent defects. Because fraud requires mental culpability, no fraud can be committed unless the prior owners or real estate agent knew of a defect when the house was sold. Latent defects by their very nature do not manifest themselves until after some period of time has elapsed. Consequently, in the majority of cases prior home owners and real estate agents lack the requisite knowledge to commit fraud. In any event, the difficulty of proving the elements of fraud creates a very difficult road for plaintiffs seeking this avenue of redress.

For example, South Carolina plaintiffs must prove by clear, cogent, and convincing evidence the following nine elements:[94]

> 1) a representation; 2) its falsity; 3) its materiality; 4) knowledge of its falsity or a reckless disregard of its truth or falsity; 5) intent that the representation be acted upon; 6) the hearer's ignorance of its falsity; 7) the hearer's reliance on its truth; 8) the hearer's right to rely thereon; and 9) the hearer's consequent and proximate injury.[95]

If one element is not proven then the fraud cause of action fails.[96]

In *May v. Hopkinson*[97] the court recognized that the buyer has a right "to rely on a seller of a home to disclose latent defects or hidden conditions which are not discoverable on a reasonable examination of the property and of which the seller has

94. *See* Schie v. Gay & Taylor, Inc., 290 S.C. 31, 34, 347 S.E.2d 910, 911 (Ct. App. 1986).

95. Florentine Corp. v. Peda I, Inc., 287 S.C. 382, 385-86, 339 S.E.2d 112, 113-14 (1985).

96. *See id.*

97. 289 S.C. 549, 347 S.E.2d 508 (Ct. App. 1986).

knowledge."[98] Therefore, if the seller has knowledge of the defect, the plaintiff may be able to prove fraud. In *May* the vendor and real estate agent were found liable for fraud. The prior owner had hired someone to conceal rotten areas of the exterior of the house.[99] Additionally, the real estate agent obtained two repair estimates for a window. One estimate contained a warning that the estimate did not include the cost of repairing structural damage, while the other estimate did not contain this warning. The purchaser received only the estimate that made no reference to the structural damage.[100] Knowledge by the owner and real estate agent was, therefore, established.

In rare instances subsequent purchasers may be able to establish fraud against a builder. In *Herz v. Thornwood Acres "D," Inc.*[101] the court held that the builder intended for the subsequent purchaser to rely on his false representations. The court emphasized that the builder filed a "guarantee" for the separate sewage system with the county health department and admitted that he represented to the purchasers and their *successors* that the septic system was properly constructed.[102] Without this filing and representation, the subsequent purchasers probably would not have prevailed. As a general rule, therefore, absent a direct representation to the subsequent purchasers, a builder's indirect representations concerning the quality of a house will not give rise to a successful fraud cause of action.[103]

If Mr. and Mrs. Homebuyer could establish that the prior owners or the real estate agent knew of the structural problems and failed to reveal them, they may be able to recover for fraud. The structural problems, however, did not manifest themselves until well after the Homebuyers had purchased their home. Therefore, at the time the house was sold, the Wesoldits and the Homebuyers' real estate agent had no knowledge of the structural defects. Thus, the nature of latent defects prevents fraud

98. *Id.* at 557, 347 S.E.2d at 513.

99. *See id.* at 555, 347 S.E.2d at 512.

100. *See id.* at 556, 347 S.E.2d at 512.

101. 86 Misc. 2d 53, 381 N.Y.S.2d 761 (1976), *aff'd per curiam*, 91 Misc. 2d 130, 397 N.Y.S.2d 358 (1977) (a two-year express warranty had expired).

102. *See id.* at 56, 59, 381 N.Y.S.2d at 763, 765.

103. *See* Sponseller v. Meltebeke, 280 Or. 361, 364, 570 P.2d 974, 975 (1977) (builder's representation that all inspections required by law had been performed insufficient to confer a fraud cause of action upon a subsequent purchaser).

from being a reliable remedy, especially for subsequent purchasers seeking to hold the builder liable.

H. Lender Liability

Although banks and other lending institutions would provide home purchasers with a deep pocket, the majority of states have refused to hold lenders liable for construction defects.[104] The financing agency "refers to any financing institution which finances the purchaser, the vender, or both."[105] Home purchasers have attempted to argue that when lenders make inspections they have assumed a duty of care to the home buyers. The courts, however, have recognized that lenders may make inspections or monitor the progress of construction for their own protection without exposing themselves to liability for construction defects.[106] If, however, lenders engage in activities ancillary to normal lending practices, liability may be imposed.[107]

In California lenders are not liable to third persons for a borrower's failure to use due care in constructing real property "unless such loss or damage is a result of an act of the lender outside the scope of the activities of a lender of money or unless the lender has been a party to misrepresentations with respect to such real . . . property."[108] In *Connor v. Great Savings & Loan Association*[109] the court held that the lender owed the buyers a duty of care to protect them from structural defects. The lender, however, had assumed control of the development and participated in the financing of plaintiffs' homes. Further, the bank's success directly depended upon its own ability, as

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104. *See* Annotation, *Financing Agency's Liability To Purchaser of New Home or Structure for Consequences of Construction Defects*, 39 A.L.R.3D 247 (1971 & Supp. 1988).

105. *Id.* at 247 n.1.

106. *See* Butts v. Atlanta Fed. Sav. & Loan Ass'n, 152 Ga. App. 40, 42-43, 262 S.E.2d 230, 232-33 (1979) (lender had no legal duty to protect purchasers from defects); Wierzbicki v. Alaska Mut. Sav. Bank, 630 P.2d 998, 1001 (Alaska 1981) (bank not liable for the vendor's nonperformance since loan agreement allowed bank to inspect the progress of construction to protect its own interests).

107. *See* Loyola Fed. Sav. & Loan Ass'n v. Galanes, 33 Md. App. 559, 569, 365 A.2d 580, 586 (1976) (saving and loan was held liable for fraud).

108. CAL. CIV. CODE § 3434 (West 1970) (codifying the holding of Conner v. Great W. Sav. & Loan Ass'n, 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968)).

109. 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968).

well as the developer's ability, to induce persons to purchase the houses.[110] Lenders may, therefore, run the risk of incurring liability if they engage in activities traditionally outside the scope of normal lending practices.

South Carolina follows the majority view and refuses to impose liability on lenders. In *Roundtree Villas Association v. 4701 Kings Corp.*[111] the court, while refusing to hold a lender liable for negligent construction, recognized that if the lender chose to repair any defects, it must exercise due care in making those repairs. The court failed to indicate whether it would recognize an exception similar to the one in effect in California.[112]

Considering the courts' reluctance to hold lenders liable to original purchasers, it seems very unlikely that courts will protect subsequent purchasers. In *Bradler v. Craig*[113] the California Court of Appeals held that the lender was not liable to the subsequent purchasers of a house. The court, however, did distinguish *Connor*, thus suggesting that a lender may be liable to subsequent purchasers if the lender engages in activities apart from its role as lender.[114] The absence of cases holding vendors liable indicates that lenders are not engaging in activities that would expose them to liability. Accordingly, purchasers are unlikely to be successful in recovering damages from vendors.

Vendors Incorporated obtained financing from Greedy National Bank. Greedy was careful to provide contractually for its right to monitor the construction of Sinking Sands before disbursing any money. The contract clearly provides that such inspections are "solely for the benefit of Greedy National Bank and not intended to benefit any purchasers or subsequent purchasers of Sinking Sands homes." The Homebuyers probably

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110. *See id.* at 865-66, 447 P.2d at 617, 73 Cal. Rptr. at 377. In making its determination the court considered:

> [1] the extent to which the transaction was intended to affect the plaintiff, [2] the foreseeability of harm to the plaintiff, [3] the degree of certainty that the plaintiff suffered injury, [4] the closeness of the connection between the defendant's conduct and the injury suffered, [5] the moral blame attached to the defendant's conduct, and [6] the policy of preventing future harm.

Id. (quoting Biakanja v. Irving, 49 Cal. 2d 647, 650, 320 P.2d 16 (1958)).

111. 282 S.C. 415, 321 S.E.2d 46 (1984).

112. For a thorough discussion of *Roundtree Villas*, see *Property, Annual Survey of South Carolina Law*, 37 S.C.L. REV. 208 (1985).

113. 274 Cal. App. 2d 466, 79 Cal. Rptr. 401 (1969).

114. *See Bradler*, 274 Cal. App. 2d at 475-76, 79 Cal. Rptr. at 406.

would be unsuccessful in an attempt to recover from Greedy National Bank.

III. ADEQUACY OF EXISTING REMEDIES

Although this Note is not suggesting that in every state the Homebuyers would be unable to recover their damages, the Homebuyers, as subsequent purchasers, certainly will face a difficult road to recovery. Is the proposed hypothetical a realistic concern or merely an unlikely scenario? The sheer volume of litigation involving home defects demonstrates the true magnitude of the problem. Furthermore, one cannot reasonably deny that many persons purchase "used" homes that are only a few years old. People who buy such houses probably consider these homes to be "new." Assuming a remedy exists, the uncertainty surrounding this area of the law will continue to expose home buyers to expensive litigation. Furthermore, even if home buyers can establish liability in this unsettled area of the law, what are the chances that they will be able to locate a solvent party?

Knowledge of the problems associated with housing defects is apparently disseminating to the home-buying public. Today many home buyers, in an effort to protect themselves from sloppy workmanship, hire private home inspectors to examine homes before they buy.[115] One South Carolina inspector estimates that in his ten years of inspecting Columbia homes, "75 percent are in good condition; 15 percent are going to cost a substantial amount of money to fix; and 10 percent are such that (he doesn't) want anyone to get involved with them."[116] According to his estimates, then, twenty-five percent of home purchasers can expect to incur substantial expenses in repairing their "new" home.

Although private inspectors may prevent some home purchasers from making an expensive mistake, not all purchasers are sophisticated enough to take such precautions. Further, in South Carolina private inspectors are not required to be certified

115. *See* Ivey, *Check Credentials of Home Inspectors*, The State (Columbia, South Carolina), Sept. 10, 1988, at El, col. 4.

116. *Id.* at E3, col. 2 (the inspector, Carlos Frick of Home Inspection Consultants of Columbia Inc., inspected over 400 homes).

or to have any building experience.[117] Consequently, many inspectors actually may provide purchasers little protection. Negligent inspectors, however, may serve as another possible source from which the purchaser may recover their damages. Further, inspectors, like home purchasers, may not be able to discover "latent" defects.

The problem with poor construction practices is not confined to South Carolina. In fact, the problem is clearly national in scope. For example, each year approximately forty builders are removed from the National House-Building Council (NHBC) lists for "persistent failure to meet the NHBC's construction standards, because [NHBC construction standards] effectively force[] the builder out of the new homes market."[118] Members of NHBC pay "one-quarter and one-half of 1 per cent of the sale price of a property to get the NHBC's 10-year guarantee and the builders have to bear the costs of any remedial works in the first three of those years."[119] If a builder is no longer available to settle a claim, NHBC assumes liability, and in 1985 alone, approximately ten percent of the builders were unable to assume responsibility for their full three-year period.[120] If quality construction standards make it difficult for builders to compete, it naturally follows that many successfully competing builders are not producing high quality work.

The Home Builders Association of Maryland, an industry group, has opposed licensing of new home builders, the creation of any state commission, or the creation of a guarantee fund.[121] In Washington, home buyers are discovering that "the most aggravating part of buying a new house isn't arranging financing, but getting a builder to fix defects after they move in."[122]

In addition to the foregoing obstacles, home purchasers face many legal barriers. Courts distinguish between the following: new and used homes; original and remote purchasers; and

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117. *See id.* at E1, col. 5.

118. Brennan, *Property; Builders That Get Struck Off*, The Financial Times Limited; Financial Times, Aug. 9, 1986, at 7.

119. *Id.*

120. *See id.* The article, however, does not clarify whether the discussed builders have gone out of business or merely are no longer members of the NHBC.

121. *See Maryland Assembly Approves Bills for Home Buyers*, The Washington Post, Apr. 25, 1987, at F6.

122. Hankin, *Buyers Battle Builders*, The Washington Post, Sept. 20, 1986, at E1.

builder-vendors, builder-nonvendors, and nonbuilder-vendors. A home buyer's case may turn on one of the distinctions. In addition, the application of the economic loss rule may provide yet another hurdle to overcome. Assuming a purchaser is fortunate enough to overcome these barriers, he has no guarantee that the defendant will be able to pay the home buyer's damages.

Suppose another recession similar to the one that occurred in the early 1970s occurred at approximately the same time Mr. and Mrs. Homebuyer purchased their home from Mr. & Mrs. Glad Wesoldit. As in the 1970s, the high interest rates of the recession priced many would-be homeowners out of the housing market. As a result, many home builders, including Mr. Homebuilder, were caught with houses they could not sell. Consequently, the resulting loss of capital flow forced thousands of home builders out of business. If Mr. Homebuilder becomes bankrupt, the Homebuyers' primary source of recovery disappears. If the builder is also the vendor, the purchaser is doubly deprived. A recession-induced bankruptcy, therefore, could leave the Homebuyers without a viable remedy.

IV. PROPOSED SOLUTION

What steps are needed to avoid the problems encountered by the Homebuyers? Enacting mandatory home warranty laws would be one possible solution. Briefly, such programs should require residential builders to purchase insurance that would insure purchasers — original, as well as subsequent — for a designated period of time. Minor problems would be insured for the first two years while major structural problems, which take more time to manifest themselves, would be covered for a full ten years. Mandatory insurance would improve construction quality and reward conscientious builders with lower rates, thus making the cost of quality homes competitive with shoddy homes. Although home buyers would eventually incur the cost of this program, the benefits outweigh the comparably low cost. The majority of home purchasers, if asked, probably would be unwilling to gamble their home when several hundred dollars of insurance could provide ten years of protection, as well as adequate time for possible latent defects to reveal themselves.

The Home Owners Warranty (HOW) program provides an excellent model from which to construct a mandatory home war-

ranty program. The HOW program divides coverage into three time periods. During each period, specified portions of the house are insured against defects. During the first two years, the builder remains responsible for repairing any defects. If, however, the builder fails to fulfill this obligation, the insurer assumes liability. Furthermore, home owners are responsible for the first $250 of damages; thus, frivolous claims are discouraged.[123] During the first year, builders are liable for a variety of potential minor defects. This liability is limited to those defects *not* due to homeowners' failure to undertake routine maintenance, such as cleaning gutters. For the second year, coverage continues for defective plumbing systems, ventilation systems, and electrical systems. If, however, the problems are due to home owners' negligence, the home owner assumes all repair costs. Major structural defects are covered by a ten-year warranty.

A major structural defect is defined as physical damage to the load-bearing portions of the house so that the house becomes unsafe or unlivable. Load-bearing portions include: foundations, beams, girders, lintels, columns, walls and partitions, floor systems, and roof frames. Purchasers, therefore, are protected from those major defects that may not be revealed for several years. HOW's requirement that the defect must make the house unsafe or unlivable, however, presents the same problem as discussed in regard to the economic loss rule. Arguably, a house should not be required to become unsafe before damages are recoverable. Broader protection needs to be afforded to purchasers so that major defects can be corrected as soon as they are discovered. [124]

This proposed home warranty program is not an entirely novel idea. In fact, New Jersey's New Home Warranty and Builders' Registration Act (Act) is remarkably similar to the HOW program. According to the Act, the house is warranted during the first year against "defects caused by faulty workmanship and defective materials due to noncompliance with the building standards."[125] During the second year, the warranty

123. The information was obtained from a 1987 specimen of the Insurance/Warranty Documents of the Home Owners Warranty Corporation.

124. *See id.*

125. N.J. STAT. ANN. § 46:3B-3(b)(1) (West Supp. 1989). For a discussion of the New

provides that "the dwelling shall be free from defects caused by faulty installation of plumbing, electrical, heating and cooling delivery systems; however, in the case of appliances, no warranty shall exceed the length and scope of the warranty offered by the manufacturer."[126] Major construction defects are covered for a full ten years.[127] Similar to HOW's definition, major construction defect is defined as "actual damage to the load bearing portion of the home."[128]

Rather than operating on an insurance basis, the Act provides that all home builders must participate in the "new home warranty security fund or an approved alternate new home warranty program."[129] The Commissioner of the Department of Community Affairs is responsible for determining the amounts to be paid into the fund. He is also responsible for disbursing the funds when a builder fails to remedy reported defects.[130] Builders, however, are liable only for the original purchase price of the home.[131] Apparently, the Act also protects subsequent purchasers of new homes.[132]

The only significant difference between the Act and the proposed home warranty program is that the Act is administered by the commissioner while the proposed insurance program would be administered largely by private insurance companies with some state supervision. Also, the insurance program would limit builders' liability to two years, rather than ten years; after two years, the insurer assumes liability. The adoption of either program would clearly benefit the home-buying public.

Using the present HOW program as a guide, the estimated

Home Warranty and Builders' Registration Act, see Grand, *supra* note 2, at 53-55.

126. N.J. STAT. ANN. § 46:3B-3(b)(2) (West. Supp. 1989).

127. *See id.* § 46:3B-3(b)(3).

128. *Id.* § 46:3B-2(g).

129. *Id.* § 46:3B-5. The HOW program may qualify as an "approved alternate new home warranty program." *Id.*

130. *See id.* § 46:3B-7. If the commissioner pays funds to an owner, then the commissioner has a right to proceed against the builder in accordance with § 46:3B-6 of the Act. *See id.* § 46:3B-6.

131. *See id.* § 46:3B-4. *See* Kratchman v. Dimedio, 5 N.J.A.R. 202 (1981) (builder liable under the Act for defects in the new home).

132. *See* N.J. STAT. ANN. § 46:3B-2(d)-(e) (West Supp. 1989) (emphasis added). " 'Owner' means any person for whom the new home is built or to whom the home is sold for occupation by him or his family as a home *and his successors in title to the home or mortgagee in possession.* . . . 'New home' means any dwelling not previously occupied, excluding dwelling units constructed solely for lease."). *Id.*

cost of an insurance program would equal approximately .35% of the sale price of new homes. Therefore, a house costing $100,000 could be insured for approximately $360 — less than the cost of automobile insurance. Also, insurance costs may be lower depending upon a builder's experience, number of complaints, years in business, and the cost of the home. Thus, an established quality builder will be rewarded with lower rates and increased competitiveness. Correspondingly, higher risk builders will pay higher rates and become less competitive.[133]

V. CONCLUSION

The transition from *caveat emptor* to *caveat venditor* is not yet complete. Courts have distinguished among new and used homes; original and subsequent purchasers; economic and noneconomic loss; and builder-vendors, builder-nonvendors and nonbuilder-vendors. These distinctions demonstrate that all home purchasers are not afforded adequate protection. Furthermore, the possibility of insolvent defendants poses a serious risk to all home purchasers. These factors coupled with a competitive housing market, in which the ultimate goal is low prices rather than quality, create a climate ripe for noncompensated construction defects.

A mandatory home warranty program, such as the one proposed or one similar to the New Jersey Act, would resolve many of these concerns. Although purchasers ultimately would bear the cost of these programs, they also would reap the benefits. Although the programs certainly will not end all construction defect related litigation, at least prevailing home owners would be assured of recovery. While the courts eventually may address many of these concerns, unless legislative action is undertaken, other Homebuyers may experience the harsh inequities of the current laws.

G. Scott Lutz

133. These cost estimates were obtained from the July 1, 1987, Fee Schedule of HOW. The estimates do not include HOW's initial $200 fee, which is required of all HOW builders.