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New Risk for Agents & Builders Under The Residential Property Disclosure Act

from the desk of David M. Touchstone

Every few years the Courts issue an opinion that has a major impact on the real estate industry here in Louisiana. The latest example is *Stutts v. Melton,* a decision of the Louisiana Supreme Court published on October 15, 2013.

Before reviewing this case, a little background information is in order. In 1986, Louisiana enacted the New Home Warranty Act. In general, this law governs the construction of residential homes and describes the extent of the builder's warranty for such homes. Most importantly, the New Home Warranty Act creates a schedule of time limits (prescription) beyond which the owner may no longer pursue a lawsuit against a builder. The prescriptive schedule is generally connected to the seriousness of the construction defect. For instance, the homeowner must sue within five years of completion of construction if there is a problem with the foundation. If the problem is of a cosmetic nature, the homeowner must sue within one year of completion of construction. With regard to new homes, the New Home Warranty Act replaces other Louisiana law, specifically the law of redhibition (found in Louisiana Civil Code Articles 2520-2548) and the law of construction (found in Civil Code Articles 2756-2777).

Now it is time to get back to the *Stutts* case. In *Stutts,* Chad Melton, a residential contractor built a house in Walker, Louisiana. Chad Melton and his wife, Lauren, moved into the home and resided there for nine months at which time the Meltons sold the house to James Stutts and his wife, Lisa. About two months prior to the sale of the house to the Stutts, the Meltons discovered "color bleeding" on the walls of the house. The Meltons' investigation disclosed that the color bleeding was due to a manufacturer's defect in the roofing materials. The Meltons made a claim against Atlas Roofing Corporation, the manufacturer of the roofing materials, and Atlas paid $13,600 to the Meltons in full settlement of the claim. The Meltons

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cleaned the walls and installed gutters in an attempt to prevent future color bleeding, but did not replace the roof, opting to pocket the $13,600.

Then the Meltons sold the house to the Stutts. Not only did the Meltons fail to disclose to the Stutts the color bleeding problem, they provided the Stutts with a Louisiana Residential Property Disclosure Statement (as required by R.S. 9:3195 et seq.) in which the Meltons *did not disclose* the problem with the roof. About nine months after the Stutts moved into the house, they noticed color bleeding on the walls and discovered that the source of the color bleeding was the manufacturer's defect in the roofing materials. The Stutts made a claim against Atlas Roofing Corporation, and Atlas provided the Stutts with evidence that it had already paid the same claim to the Meltons, and, accordingly, had no further liability.

The Stutts, of course, reviewed their preclosing documents, specifically the Residential Property Disclosure Statement at which time the Stutts discovered that the Meltons had checked the "N" box on the question regarding defects in the roof. This prompted the suit by the Stutts against the Meltons in

which the Stutts claimed that the Meltons had committed a fraud and had also violated the Stutts' rights under the Residential Property Disclosure Act.

The Meltons responded to the Stutts' suit by filing an exception of prescription, a procedural device in Louisiana (similar to a plea under the "statute of limitations" in common law states) by which a defendant seeks to terminate the plaintiff's law suit on the ground that the plaintiff has waited too long to bring the suit. The Meltons argued that inasmuch as Mr. Melton had constructed the house, the New Home Warranty Act preempted all other bodies of law under which the Stutts might otherwise have made a claim. Further, argued the Meltons, this particular type of defect was of the sort for which the New Home Warranty Act provided a one year prescriptive term from completion of construction in which the homeowner must file his suit.

The First Circuit Court of Appeals agreed with the Meltons that the New Home Warranty Act was the exclusive body of law governing this case and that under the New Home Warranty Act, the Stutts' claim had prescribed. The Louisiana Supreme Court decided to review the case and the Supreme Court reversed the holding of the Court of Appeals.

The Louisiana Supreme Court ruled that the act of the Meltons in stating in the Residential Property Disclosure Statement that there was no roof problem constituted a *fraud* on the Stutts and that the Stutts were entitled to recover damages for a new roof and the costs of repair of the walls ($15,503.55), plus attorney fees.

TAKEAWAYS

Lawyers ask themselves when reading an opinion of an appellate court or the Supreme Court: how does this case change or clarify the law? The holding of the Supreme Court in *Stutts v. Melton* represents two major changes in the law, one of great significance for real estate agents and brokers, the other of great significance for residential contractors.

For real estate agents and brokers, *Stutts* announced for the first time since the enactment of the Residential Property Disclosure Act that an intentional incorrect statement by the seller on the residential property disclosure form constitutes a basis for the bringing of a legal action by the buyer against the seller. This would seem to be precluded by the language set forth in R.S. 9:3198(E) in the act which reads as follows:

> E. A seller shall not be liable for any error, inaccuracy, or omission of any information required to be delivered to the purchaser in a property disclosure document if either of the following conditions exists:
>
> (1) The error, inaccuracy, or omission was not a willful misrepresentation according to the best of the seller's information, knowledge, and belief.
>
> (2) The error, inaccuracy, or omission was based on information provided by a public body or by another person with a professional license or special knowledge who provided a written or oral report or opinion that the seller reasonably believed to be correct and which was transmitted by the seller to the purchaser.

The careful reader will take note that Section 9:3198 (E) only pretermits lawsuits when the seller's incorrect disclosure occurs as a result of "error, inaccuracy, or omission" that is not a result of a "willful misrepresentation." The Supreme Court held in *Stutts,* that when the Meltons checked the "N" box on that portion of the statement dealing with roof problems, same amounted to a "willful misrepresentation." Further, the Supreme Court held that such a willful misrepresentation amounted to an act of fraud.

There is another apparent obstacle to a claimant who wishes to bring a lawsuit urging a disclosure violation under the Residential Property Disclosure

Act, specifically the language set forth in R.S. 9:3198 (D) of the Act which reads:

> D.(1) A property disclosure document shall not be considered as a warranty by the seller. The information contained within the property disclosure document is for disclosure purposes only and *is not intended to be a part of any contract between the purchaser and seller.*
>
> (2) The property disclosure document may not be used as a substitute for any inspections or warranties that the purchaser or seller may obtain. Nothing in this Chapter precludes the rights or duties of a purchaser to inspect the physical condition of the property.

The Meltons argued that this provision also barred the Stutts from making a claim under the Residential Property Disclosure Act. The Supreme Court disagreed, holding that the "willful misrepresentation" exception in 9:3198(E) negated the Meltons' invocation of 9:3198(D). In effect, by holding that when the Meltons intentionally checked the "N" box next to roof problems, this "willful misrepresentation" *did become a part of the contract* and constituted fraud.

The bottom line for real estate agents and brokers is that the possibility of law suits being undertaken by buyers who have received incorrect information in a Residential Property Disclosure Statement has been expanded by the *Stutts* case. And while such a claimant will have to prove a "willful misrepresentation," i.e., fraud, the buyer's burden of proof is not that great. For most of Louisiana's history, in order to prove fraud, one had to do so by "clear and convincing" evidence. This standard was very difficult for plaintiffs to meet. However, in 1984 Louisiana amended the Civil Code Articles on fraud and new Article 1957 states:

> 1957. Proof
> Fraud need only be proved by a preponderance of the evidence and may be established by circumstantial evidence.

Preponderance of the evidence is the same standard of proof that a plaintiff has in most every other type of lawsuit. Thus, one who brings a lawsuit under the Residential Property Disclosure Statement will simply have to prove (a) an incorrect representation on the statement and (b) the declarant knew or had to know that the representation was incorrect. Furthermore, as set forth in Article 1957, the claimant can prove the seller's knowledge "by circumstantial evidence." As I set forth above, claimants who successfully prove fraud recover their attorney fees. This heady brew will, no doubt, prove very inviting to the plaintiff's bar when they eventually discover the holding in *Stutts v. Melton*. Now, I'm going to make your skin crawl a little more. Under Article 2032 of the Civil Code, claims based on fraud do not prescribe until five years from the date they are "discovered." Generally, "discovery" occurs when the victim of the fraud becomes aware that he has been harmed. So, potentially, suits making a claim for a "willful misrepresentation" in a Residential Property Disclosure Statement may be brought many years after the sale. This, of course, applies to all houses for which a Disclosure Statement has been given. And we all know what happens when buyers sue sellers for defects in the house. Generally, somebody sues the real estate agents, their brokers, and the brokers' insurers.

If you are a real estate agent or broker, you should show extreme caution when counselling a seller who is filling out the Disclosure Statement. Always urge your seller clients to disclose *everything*, even stuff in the gray zone.

The takeaway here for residential contractors is that they cannot rely on the preemptive provisions of the New Home Warranty Act in those cases in which the contractor has lived in the house and is, thus, required to give a Residential Property Disclosure Statement. Further, residential builders should pay close attention to the peremptive provision in the act, R.S. 9:3150 which reads:

3150. Exclusiveness

This Chapter provides the exclusive remedies, warranties, and peremptive periods as between builder and owner relative to home construction and no other provisions of law relative to warranties and redhibitory vices and defects shall apply. Nothing herein shall be construed as affecting or limiting any warranty of title to land or improvements.

Note the last sentence. Builders are free to expand their warranties beyond the minimum warranties given in the act. In my opinion, if a builder were to give a Residential Property Disclosure Statement, even though he is not required by law to do so, and if it were to be proven that he had made a "willful misrepresentation," then it is likely that under *Stutts v. Melton* he would be held liable for fraud.