Predecessor Landowner Liability: Disclosing Latent Defects

*Mina S. Park**

TABLE OF CONTENTS

INTRODUCTION

Historical lack of environmental regulation during the period of industrialization in early and mid-twentieth century has left a legacy of contaminated properties all over the United States.[1] Recent increase in awareness of the hazards related to toxic waste has led to a dramatic increase in governmental regulations that require private parties to clean up contaminants on their property. Pursuant to these regulations, potentially immense cleanup costs could be imposed on owners of contaminated property, regardless of the particular owner's involvement in the creation of the contamination. Thus, with the regulations came an increase in litigation over the allocation of the cleanup costs.

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* J.D. UCLA, 1995; B.A., UC Berkeley, 1991. I would like to thank Professor Gary Schwartz for his extensive assistance in reading and critiquing drafts of this article.

1. *See generally* SAMUEL EPSTEIN, ET AL., HAZARDOUS WASTE IN AMERICA (1982). It is estimated that America's chemical industry was producing more than 170 million pounds of synthetic-organic chemicals by 1938. CHRISTOPHER HARRIS, ET AL., HAZARDOUS WASTE: CONFRONTING THE CHALLENGE 5 (1987).

This comment examines whether a predecessor landowner should be held liable against the current landowner for damages arising from the environmental contamination that the predecessor landowner created on the property sold. The discussion is limited to the situations where both the seller and the buyer are sophisticated commercial entities that are likely to be savvy in the art of negotiation.

Part I studies the common law tort claims in the area of environmental litigation that are often used despite the existence of statutory regulations. Part II examines the existing case laws that reach conflicting results regarding the liability of predecessor landowners under common law tort claims and notes that the existence of liability is primarily determined by the state law's definition of a particular tort cause of action. Part III recommends that the liability should be imposed on the predecessor landowner based a disclosure theory, shifting the focus of the factual inquiry toward the knowledge of the contracting parties. This section asserts that a result that is dependent on the knowledge of the parties reaches a fairer result, and also creates positive incentives for the sellers to disclose any relevant information to the buyers. Part IV explores how a court should interpret the language in a real estate sales contract. Part V examines the existing law on a seller's duty to disclose latent defects and concludes that the seller's duty to disclose latent defects should encompass the duty to disclose existing environmental contamination. Lastly, Part VI examines modern statutory regulations that require sellers of industrial property to disclose to the buyer the existence of any contaminants prior to sale.

I.
STATUTORY REGULATIONS VERSUS TORT CLAIMS

Statutory regulations dealing with environmental contamination define the liabilities of the parties to a large extent.[2] Such

2. The primary federal regulation that deals with cleanup of hazardous substance releases is the Comprehensive Environmental Response, Compensation and Liability Act of 1980 ("CERCLA"), 42 U.S.C.A. §§ 9601-75 (West 1983 & Supp. 1991). CERCLA imposes strict liability upon four categories of "potentially responsible parties" to clean up hazardous substances: 1) the present owner and operator of facilities; 2) owner or operator of facilities at the time of disposal; 3) anyone who arranged for disposal or treatment, or transported for disposal or treatment; and 4) anyone who accepted any hazardous substances. *Id.* § 9607(A)(1)-(4). CERCLA holds the defendants jointly and severally liable under § 9601(32) unless a defendant can demonstrate that the harm it caused is divisible from the harm caused by others.

regulations provide private causes of action for the responsible parties to allocate the financial burden among themselves.[3] In addition to seeking relief under statutory provisions, plaintiffs that have purchased contaminated property are increasingly relying on common law tort claims such as negligence,[4] trespass,[5] private and public nuisance,[6] and strict liability based on ultrahazardous activity[7] in order to recover costs arising from the existence of the hazardous substances from the original contaminator of the property.

There are several reasons for this increasing reliance on common law tort claim. First, tort causes of action generally allow greater recovery of damages than the regulatory provisions.[8] For instance, unlike most statutory remedies that are limited to the recovery of cleanup costs, tort causes of action have been used by plaintiffs to recover damages arising from economic losses or

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United States v. Alcan Aluminum Corp., 36 E.R.C. (BNA) 1321 (2d Cir. 1993). The Resource Conservation and Recovery Act of 1976 ("RCRA"), 42 U.S.C.A. §§ 6901-91 (West 1983 & Supp. 1991) which mainly regulates active solid waste facilities also requires cleanup by landowners.

3. *See e.g.,* CERCLA Section 107, 42 U.S.C. § 9607 (private cost recovery actions); Clean Water Act Section 505, 33 U.S.C. § 1365 (citizen suits against persons in violation); RCRA, Section 7002, 42 U.S.C. § 6972(a)(1)(A) (citizen suit against persons in violation of RCRA). For an overview of private actions and contribution actions available under CERCLA, see Michael B. Hingerty, *Property Owner Liability for Environmental Contamination in California*, 22 U.S.F. L. REV. 31, 53-60 (1987).

4. To recover under the theory of negligence, the plaintiff must prove that the defendant breached a duty that the plaintiff owed. *See e.g.,* Kulas v. Public Serv. Elec. & Gas Co., 196 A.2d 769, 772 (N.J. 1964), Donley v. Amerada Petroleum Corp., 106 P.2d 652, 655-56 (Kan. 1940).

5. Plaintiff can recover under the trespass doctrine by proving that the defendant invaded his interest in exclusive possession of the property. W. PROSSER, HANDBOOK OF THE LAW OF TORTS, § 89, at 594 (4th ed. 1971); RESTATEMENT (SECOND) OF TORTS § 160 (1965). *See also* Ralph D. Harris, *Trespassing Pollutants: Use of Trespass in Environmental Litigation*, 29-Dec ARIZ. ATT'Y 13 (1992).

6. Private nuisance is defined as an unreasonable or substantial interference with the use and enjoyment of land. PROSSER, *supra* note 5, at 591. Public nuisance is an action which causes damage to the public in the exercise of common public rights. *Id.* at §§ 88-89.

7. Strict liability is imposed on landowners for escaping substances that cause harm on neighboring properties if the landowner was engaging in high risk activities. *See* RESTATEMENT OF TORTS §§ 519 - 520 (1976). This doctrine was first established in Rylands v. Fletcher, 1 L.R. Ex. 165 (1868), *aff'd* 3 L.R. E. & I. App. 330 (1868) where the doctrine was limited to situations where the defendant engaged in "non-natural" uses of his land. *Id.,* at 338. For uses of strict liability doctrine in a toxic waste case, *see, e.g.,* City of Bridgeton v. B.P. Oil, Inc., 369 A.2d 49 (N.J. 1976).

8. "Among the salient features of statutory liability for hazardous waste cleanup costs [is]... the preference for compelling cleanups over recovery of damages as the primary remedy." Hingerty, *supra* note 3, at 35.

personal injuries.[9] Second, statutory regulations are governed by strict guidelines where a plaintiff may be prohibited from recovery simply for failing to meet certain procedural requirements.[10] Lastly, the scope of a particular regulation may not provide relief for a certain category of activities. For example, CERCLA explicitly excludes petroleum and natural gas from its definition of a hazardous substance.[11]

Because visible signs of contamination may not surface for many years, the party that originally created the contamination often no longer owns or uses the property. However, environmental regulations such as CERCLA generally hold the current owner responsible for cleanup costs even a prior owner of the land created the contamination.[12] Therefore, many landowners that have purchased land burdened with toxic contaminants found themselves responsible for costs of cleaning up a hazardous waste site that they did not create.[13] Many of them have turned to tort remedies to attempt to recover the costs from the predecessor owners that created the contamination.[14] However, some courts have refused to grant relief to these plaintiffs because the opposing parties were in a contractual relationship.[15] Recovery was denied because the parties already had an opportunity during the negotiation process to allocate all the risks associated with the ownership of the land, including the costs arising from the contamination.[16]

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9. *See e.g.*, Werlein v. United States, 746 F.Supp. 887 (D.Minn. 1990)(denying recovery of medical monitoring expenses under CERCLA but upholding a common law claim for the same expenses); Artesian Water Co. v. Gov't of New Castle County, 659 F. Supp. 1269, 1285 (D. Del. 1987) ("Congress in enacting CERCLA clearly manifested an intent not to provide compensation for economic losses or for personal injury resulting from the release of hazardous substances."); Varjabedian v. City of Madera, 572 P.2d 4349-50 (Cal. 1977) (depreciation of property value and loss of advantageous loan allowed in nuisance action).

10. *See, e.g.*, County Line Inv. Co. v. Tinney, 933 F.2d 1508, 1512-15 (10th Cir. 1991) (denying landfill owners' summary judgment motion on a contribution claim under CERCLA because of claimants' failure to provide for public comment on response actions as required); Channel Master Satellite Sys., Inc. v. JFD Elecs. Corp., 748 F. Supp. 373, 389-90 (E.D.N.C. 1990).

11. CERCLA, 42 U.S.C.A. § 9601(14)(West 1983 & Supp. 1988).

12. *See e.g.*, CERCLA, § 107(a), 42 U.S.C.A. § 9607(a)(1) (West 1983 & Supp. 1988)

13. *See* New York v. Shore Realty Corp., 759 F.2d 1032, 1037 (2d Cir. 1985).

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

15. *See infra* note 19 and accompanying text.

16. This comment only focuses on the problem of predecessor liability in the context of common law tort claims where the statutes do not govern. However, the question of whether the seller should be liable to the purchaser also arises in cases

II.
CONFLICTING CASE LAW ON PREDECESSOR LANDOWNER LIABILITY

Tort law traditionally has not provided relief for a successor in title, mainly resolving conflicts between neighboring, contemporaneous land uses.[17] Under the traditional doctrine of caveat emptor,[18] a vendor of real property was generally not liable to the vendee for the conditions of the land existing at the time of transfer. Under this doctrine, some courts have held that the successor owner could not hold the predecessor landowner liable for damages resulting from the contamination.[19] However, other courts have been reluctant to leave an innocent purchaser of contaminated land without any remedy and have expanded common law doctrines to allow the purchaser to recover the costs from the predecessor landowner.[20]

The main rationale behind denying recovery to the current owner is that the contracting parties had an opportunity to nego-

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where the recovery was based on statutory regulations. Although contractual arrangements apportioning liabilities between parties cannot alter the underlying liability under CERCLA, it can change who ultimately pays that liability. Mardan Corp. v. C.G.C. Music, Ltd., 804 F.2d 1454, 1459 (9th Cir. 1986). Under CERCLA, the court is authorized to "allocate response costs among liable parties using such equitable factors as the Court determines are appropriate." 42 U.S.C. § 9613(f)(1). The courts have considered different factors in the case in order to allocate the costs of clean up among the "potentially responsible parties". PVO International Inc. v. Drew Chemical Corp., 16 Chem. Waste Lit. Rep. 669 (D.N.J. 1989) (considering the possible increases in value of the burdened property arising from a cleanup in allocating response costs between a seller and a purchaser); United States v. Sterling Steel Treating, Civ. No. C84-29D (W.D. Wash. Sept. 26, 1986) (holding that while neither caveat emptor nor the "as is" sale is a defense to CERCLA liability, they may be used to allocate costs). For a general discussion on cases that deal with government regulation in allocating costs of environmental torts, see Mindy H. Stern, Note, *Successor Landowner Liability for Environmental Torts: Robbing Peter to Pay Paul?*, 13 RUTGERS L.J. 329 (1982).

17. *See e.g.*, Essick v. Shillam, 347 Pa. 373, 376 (1943) ("An owner has a right, barring malice and negligence, to any use of his property, unless by its continuous use he prevents his neighbors from enjoying the use of their property to their damage.") (quoting Pennsylvania Co. v. Sun. Co., 290 Pa. 404, 408).

18. "Under the ancient doctrine of caveat emptor, the original rule was that, in the absence of express agreement, the vendor of land was not liable to his vendee, or a fortiori to any other person, for the condition of the land existing at the time of transfer.... The vendee is required to make his own inspection of the premises, and the vendor is not responsible to him for their defective condition, existing at the time of transfer." RESTATEMENT (SECOND) OF TORTS, § 352, cmt. a (1977).

19. *See e.g.*, Wilson Auto Enterprises, Inc. v. Mobil Oil Corp., 778 F.Supp. 101 (D.R.I. 1991); Wellesley Hills Realty Trust v. Mobil Oil Corp., 747 F.Supp. 93 (D. Mass. 1990); PBS Coals, Inc. v. Burnham Coal Co., 558 A.2d 562 (Pa. 1989).

20. *See infra* note 30 and accompanying text.

tiate with one another in order to allocate the risks associated with the property during the bargaining process. Therefore, the purchaser could have ensured at the time of purchase that the price of the land was reduced to reflect the effects of the contamination. Under this rationale, the court in *Philadelphia Electric Co. v. Hercules, Inc.*[21] held that a nuisance claim could not be brought against the predecessor landowner.

In *Philadelphia Electric*, the plaintiff, Philadelphia Electric Company ("PECO"), brought a suit claiming private nuisance against Hercules, Inc. ("Hercules"), a successor corporation of Pennsylvania Industrial Chemical Corporation ("PICCO"). Prior to 1971, PICCO owned a piece of property ("the site") abutting the Delaware River in Chester, Pennsylvania where it deposited or buried various resins and their by-products. In 1971, PICCO sold the site to Gould, Inc. ("Gould"). In mid-1973, PECO purchased the site from Gould. In 1981, PECO was required by the Philadelphia Department of Environmental Resources to remove the resinous material at the site for violation of state environmental laws. PECO filed a suit against Hercules in order to recover costs related to cleanup of the contamination.[22]

The Third Circuit in *Philadelphia Electric* applied the doctrine of caveat emptor and held that Hercules was not liable to PECO under private nuisance for conditions existing on the land transferred.[23] Although the court assumed for the purposes of the decision that Hercules had created a nuisance,[24] it held that a purchaser of real property could not recover from the seller for conditions existing on the very land transferred at the time of sale, absent fraud or concealment. The holding was based on the rationale that the judicial system should not disrupt the market process.

> [A]llowing a vendee a cause of action for private nuisance for conditions existing on the land transferred - where there has been no fraudulent concealment - would in effect negate the market's allocations of resources and risks, and subject vendors who may have

21. 762 F.2d 303 (3d Cir. 1985)(hereinafter *Philadelphia Electric*).

22. *Id.* at 306-307.

23. "[W]here, as here, corporations of roughly equal resources contract for the sale of an industrial property, and especially where the dispute is over a condition on the land rather than a structure, caveat emptor remains the rule." *Id.* at 313 (interpreting the reasoning of the Pennsylvania Supreme Court's opinion in Elderkin v. Gaster, 288 A.2d 771, 774-75 (Pa. 1972)).

24. *Id.* at 313.

originally sold their land at appropriately discounted prices to unbargained-for liability to remote vendees.[25]

Because both parties to the transaction were sophisticated commercial entities and PECO had a chance to inspect the site carefully prior to purchase, the court found it "inconceivable that the price [PECO] offered Gould did not reflect the possibility of environmental risks, even if the exact condition giving rise to this suit was not discovered."[26] Therefore, if the court were to order the seller to pay for the costs of cleanup, the buyer would get a windfall by paying less for a property.

Other courts have relied on similar rationale to find that the successor landowner was prohibited from recovering damages from the vendor.[27] For example, a Florida court in *Futura Realty v. Lone Star Building Centers, Inc.* held the doctrine of caveat emptor prohibited a commercial purchaser of land from recovering against the vendor who sold a piece of property that was contaminated through the operation of a wood treatment plant.[28] Even though the contamination on the property was not readily observable through casual inspection, the court held that "[t]he commercial property vendor owe[d] no duty for damage to the land to its vendee because the vendee can protect itself in a number of ways, including careful inspection and price negotiation. This is the vital legal and practical distinction between the duty owed a neighbor and the duty owed a successor in title . . . ."[29]

In contrast, other courts have rejected this rule because it would deny any remedies to the successor owners. Accordingly, another line of cases has been developing where the courts have expanded the scope of the traditional tort law to provide relief for innocent purchasers of contaminated land.[30] Encountered

25. *Id.* at 314-15.

26. *Id.* at 314.

27. *See supra* note 19, 364-65 and accompanying text.

28. 578 So. 2d 363, 364-65 (Fla. Dist. Ct. App. 1991).

29. *Id.* at 365.

30. *See e.g.,* Newhall Land & Farming Co. v. Superior Court, 23 Cal. Rptr. 2d 377 (1993)(hereinafter *Newhall*)(holding that the plaintiff has stated causes of action against the predecessor owners for nuisance, trespass and negligence based on breach of the duty to disclose); Westwood Pharmaceuticals, Inc. v. National Fuel Gas Distrib. Corp., 737 F.Supp. 1272, 1281-82 (W.D.N.Y. 1990)(*aff'd on other grounds*, 964 F.2d 85 (2d Cir. 1992))(recognizing a public nuisance claim between consecutive landowners); Hanlin Group, Inc. v. Int'l Mineral & Chemical Corp., 795 F. Supp. 925, 933 (D.Me. 1990) (holding that a claim for strict liability for an abnormally dangerous activity was not barred to a purchaser of contaminated land).

with the issue of predecessor owner liability arising from a dispute surrounding a site contaminated with radium, the New Jersey Supreme Court in *T & E Industries, Inc. v. Safety Light Corp.*[31] explicitly rejected the doctrine of caveat emptor applied in *Philadelphia Electric.* The court held that, under strict liability for abnormally dangerous activity, a predecessor in title that is responsible for the contamination was liable for damages to a successor owner of the contaminated land.

In this case, the plaintiff T & E Industries ("T & E"), sued the successor corporation of United States Radium Corporation ("USRC") for damages that resulted from contamination created by USRC when it had owned the land. Between 1917 and 1926, USRC processed radium for manufacturing purposes and disposed unprocessed radium tailings in the lot. USRC sold the land in 1943 to Arpin.[32] Although Arpin was aware of the presence of the radium tailings in the land,[33] it did not realize the dangers and built a structure over the area where the tailings were buried. Since 1943, the property had been sold several times, and was ultimately sold to T & E in 1974. When the problem of elevated radiation levels was discovered in 1979 by the New Jersey Department of Environmental Protection, T & E was advised to either decontaminate or abandon the site. T & E moved its operations to another location and sued for damages arising from the contamination including indemnification for future cleanup costs.[34]

Finding that defendant's business constituted abnormally-dangerous activity[35], the court held that a property owner can assert

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31. 587 A.2d 1249 (N.J. 1991)(hereinafter *T & E*).

32. *Id.* at 1253.

33. T & E Industries, Inc. v. Safety Light Corp., 680 F. Supp. 696, 698 (D.N.J. 1988).

34. *T & E*, 587 A.2d at 1261-1262.

35. Restatement (Second) of Torts gives six factors that should be considered in determining if an activity is abnormally dangerous:

"(a) existence of a high degree of risk of some harm to the person, land or chattels of others;

(b) likelihood that the harm that results from it will be great;

(c) inability to eliminate the risk by the exercise of reasonable care;

(d) extent to which the activity is not a matter of common usage;

(e) inappropriateness of the activity to the place where it is carried on; and

(f) extent to which its value to the community is outweighed by its dangerous attributes." RESTATEMENT (SECOND) OF TORTS, § 520 (1977).

For an overview of the doctrine, see Jon G. Anderson, Comment, *The Rylands v. Fletcher Doctrine in America: Abnormally Dangerous, Ultrahazardous, or Absolute Nuisance?*, 1978 ARIZ. ST. L.J. 99.

a cause of action sounding in strict liability for abnormally-dangerous activity against a predecessor in title. Furthermore, the New Jersey Supreme Court rejected the defendant's argument that T & E assumed the risks of contamination by purchasing the land. Although the property was purchased pursuant to an "as is" contract, the court found that T & E did not assume the risks that arose from USRC's activities. Reiterating the rationale behind the abnormally dangerous activity doctrine, the court noted that "allowing a buyer to recover would place liability on the party responsible for creating the hazardous condition and marketing the contaminated land. . . [C]ertain enterprises should bear the costs attributable to their activities."[36]

The *T & E* court also rejected the defendant's contention that holding a predecessor in title strictly liable would destroy the real estate market. Stating that a buyer can knowingly and voluntarily assume the risk of harm, the court found that the liability could be assumed by explicitly stating such understanding in the contract.[37] Absent explicit language in the contract, however, the seller would remain liable to the buyer. "A real-estate contract that does not disclose the abnormally dangerous condition or activity does not shield from liability the seller who created that condition or engaged in that activity."[38]

The case law regarding predecessor liability appear to reach a completely opposite result in Pennsylvania and in New Jersey: the *T & E* court held that a seller who contaminates his land remains strictly liable to the successor owner, while the *Philadelphia Electric* court held that the successor owner is not allowed to bring a claim based on private nuisance against the seller. However, a close examination of these opinions show that both courts have left some room for flexibility where the application of the general rule would clearly result in unfair allocation of the losses. Although strict liability was imposed on a predecessor owner, the New Jersey Supreme Court noted that the seller can contract out of this liability by clearly indicating in the contract language the fact that the buyer knowingly and voluntarily accepted the dangerous conditions on the land.[39] The *Philadelphia Electric* court's

36. *T & E*, 587 A.2d at 1258.

37. *Id.* at 1258-59 ("A buyer can assume the risk of harm from an abnormally-dangerous activity. To do so a buyer need only knowingly and voluntarily encounter the risk").

38. *Id.*

39. *See supra* note 37 and accompanying text.

opinion indicates that, if there is fraud or misrepresentation on the part of the seller, the doctrine of caveat emptor would not apply and the seller would be held liable.[40] Therefore, the holding in both *T & E* and in *Philadelphia Electric* lead to the conclusion that a buyer who explicitly assumes the risks in the sales contract will not be able to recover against the predecessor owner, while a contaminator who fraudulently conceals the dangerous condition to a buyer will not be able to escape liability.

Although both courts leave an exception for extreme cases where the rational allocation of the damages seems clear, the courts adopt opposite initial assumptions regarding the knowledge of the buyer: The holding in *Philadelphia Electric* presupposes that a commercial buyer has knowledge of materially relevant conditions on the property, and thereby assumes the possible risks associated with any defective conditions. In contrast, the rule set by the *T & E* court presupposes that, without an explicit contract stating otherwise, the buyer has not assumed the risk of loss associated with the property.[41] In addition, the cases appear to tie the liability of the predecessor owner to the particular state's definition of the relevant tort cause of action. For example, the *T & E* court reached its decision based on the historical rationale behind strict liability and found the predecessor owner liable under the theory of strict liability for ultrahazardous activity, but not under public nuisance.[42]

III.
FOCUSING ON KNOWLEDGE OF THE PARTIES

Both *T & E* and *Philadelphia Electric* courts set up a bright line test which is based on the state law definition of the particular tort. However, this bright line test can reach unsatisfactory results. In establishing a law, a court should keep in mind the following considerations. First and foremost, the holding should reach a fair result for the parties at hand. Second, the court

40. " 'Generally speaking, the rule is that *in the absence of fraud or misrepresentation* a vendor is responsible for the quality of property being sold by him only to the extent for which he expressly agrees to be responsible.' " *Philadelphia Electric*, 762 F.2d at 312 (3d Cir. 1985) (emphasis added) (quoting Elderkin v. Gaster, 447 Pa. 118, 124 (1972)).

41. *See supra* note 37 and accompanying text.

42. Amland Properties Corp. v. Aluminum Co. of Am., 711 F. Supp. 784, 801-09 (D.N.J. 1989)(declining to give plaintiff standing to sue for a public nuisance but allowing plaintiff's claim under strict liability); Jersey City Redev. Auth. v. PPG Indus., 655 F.Supp. 1257, 1265-66 (D.N.J. 1987).

should try to establish a rule that will set clear guidelines for future cases so that future litigants will be able to predict the outcome and reach an efficient result by settling the dispute without going to trial.[43] This comment argues that these goals can be better achieved by a fact intensive test that focuses on the knowledge of the parties, rather than through a bright line test.

A. *Fairness*

An examination of the *T & E* case shows that, although holding all predecessor landowners strictly liable may be a simpler way of determining liability, it does not always reach a fair result between the parties. The court in *T & E* set a bright line rule by stating that the risk of harm will not be assumed by the buyer unless the contract expressly discloses the abnormally-dangerous condition or activity.[44] If the goal of the court is to fairly allocate the losses that have already occurred, however, the specific disclosure requirement of *T & E* seems too restrictive to deal with the different fact patterns that may come to the court's attention.[45]

It is true that "a party[ ] ignorant of the presence of an abnormally dangerous condition [cannot] be held to have contractually assumed the risk posed by that condition merely by signing an 'as is' purchase contract."[46] However, it should be equally true that the party cannot be presumed to not have assumed the risk merely because the contract failed to disclose the abnormally-dangerous condition. Because some of the sales contracts may have been formed with the understanding of both the buyer and the seller that all liabilities arising from the property will pass on to the buyer, the parties may not have found it necessary to mention the allocation of liability in the language of the sales contract. One can imagine a situation where the price of the land would have reflected the risk of loss to the buyer even though the terms of the contract failed to explicitly mention the dangerous activity, especially if the terms were an "as is" contract where the implicit understanding was that the buyer would bear all risks of

43. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29 (1972)(examining behavior-guiding considerations in tort law).

44. *T & E*, 587 A.2d at 1256-57.

45. For a discussion of the problems relating to retroactive application of law, see Gary T. Schwartz, *New Products, Old Products, Evolving Law, Retroactive Law*, 58 N.Y.U. L. REV. 796 (1983).

46. *T & E*, 587 A.2d at 1259 (quoting *Amland Properties*, 711 F. Supp. at 803 n.20)

loss.[47] In order to deal with such situations, the main focus of the inquiry should be on the actual expectations of the parties at the time of the contract formation rather than focusing merely on the language of the contract.

Instead of examining the actual expectations of the parties, the *T & E* court holds the predecessor landowner strictly liable based on the doctrine of ultrahazardous activity. The court states that, unlike nuisance or trespass which historically pertained to activities on the defendant's property that indirectly interfered with the plaintiff's property rights, the development of liability for ultrahazardous activity did not rest on notions of property right.[48] Rather, the doctrine emphasized the dangerousness and inappropriateness of the activity and imposed strict liability because of economic policy considerations.[49] Then, the court concluded that the expansion of the ultrahazardous activity doctrine to cover the vendor-vendee relationship will further the goal of internalizing the costs of the business[50] because "allowing a buyer to recover would place liability on the party responsible for creating the hazardous condition and marketing the contaminated land."[51] Although internalization of business costs would be achieved by holding the contaminator strictly liable, it is important to recognize that this internalization will occur only if the buyer has *not* "knowingly and voluntarily" assumed the risk of harm.

A goal behind the imposition of strict liability is to reduce negative externalities that are created whenever a decision regarding the use of some resource is made without considering the costs associated with the activity.[52] For example, if an owner of the property contaminates his land, knowing that he can sell the land in the future without disclosing the contamination to the buyer, the owner will not bear the full costs associated with the contaminating activity. The owner expects to get a certain amount of

47. In such a situation, the buyer as well as the seller of the property may have fully expected any risk of loss to be placed on the buyer.

48. *T & E*, 587 A.2d at 1258.

49. Holding the business that engage in ultrahazardous activity strictly liable will "serve[ ] to induce certain businesses to 'internalize' the external costs of business" and "shift a seemingly-inevitable loss onto the party deemed best able to shoulder it." *Id.* at 387.

50. These are the classic rationales behind imposing strict liability. WILLIAM H. RODGERS, JR. 1 ENVIRONMENTAL LAW § 2.81 (1986).

51. *T & E*, 587 A.2d at 1263.

52. For a discussion of externalities, *see generally*, R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960); Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347-357 (1967).

benefit from the activity. He will only engage in this activity if the costs he must bear are less than the benefit. The costs may include many elements such as raw material, labor and depreciation of the property value that results from the activity. If the harmful effects arising from that activity are not disclosed to the buyer, the sales price will not reflect the actual damage to the property. Therefore, the contaminator would be insufficiently discouraged from engaging in the activity because overall cost that he bears himself will be less than then actual total costs that the activity generates. Therefore, he may engage in the contaminating activity even though the total cost of the activity to the society as a whole may be greater than the benefit that he obtains.

Negative externalities can result between two contracting parties if the negotiation process fails to take full account of the possible harms arising from the contamination. Even if the contracting parties negotiate over the sales price, the costs of the activity will not be internalized unless the bargaining process between the parties take into consideration the possible harms created by the seller's activities.

On the other hand, if the negotiated sales price fully accounted for the possibility of contamination, the price of the land will be lowered to reflect the cost of the risk. In this way, the vender of the contaminated property will fully internalize the costs associated with his activity by accepting a lower price for the land.[53] Therefore, if the buyer and the seller actually bargained to allocate the liability associated with the contamination, the court should simply enforce the actual expectations of the parties.

The question of liability, therefore, should depend on the actual allocation of the risk of damage arising from the contamination written in the contract. Rather than setting a liability rule based on the court's definition of the applicable tort cause of action, the allocation of the costs should be determined primarily through the interpretation of the contract language.[54]

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53. Of course, the price reduction that the seller had to give in order to pass on the future cost arising from the contamination is unlikely to exactly equal the actual cost that the buyer incurs when the contamination creates damages on the property, mainly because neither parties can accurately predict what the exact cost would be.

54. "It is a commonplace that, absent some overriding public policy, courts are to enforce contracts in accordance with the 'expectations of the parties.' Usually the parties will have aided the court by expressing at least some of these expectations in contract language, oral or written." E. Allan Farnsworth, *Disputes Over Omission in Contracts*, 68 COLUM. L. REV. 860, 860 (1968).

B. *Creating Incentives*

In addition to resolving the present conflict between the litigating parties, a judicial decision also sets a precedent for future possible litigants to consider in setting their possible course of action. Therefore, it is important to examine what kind of incentives are created by a law.

A judicial case law that focuses on the knowledge of the parties in determining liability can affect the seller's incentives to disclose any information regarding the property. A test based on actual expectation of parties essentially establishes a disclosure requirement because the only way that the seller can ensure nonliability is by thoroughly disclosing all relevant information to the buyer.

If placing the liability on the seller of the property will produce a more fair and economically efficient result, the courts should set a rule imposing a duty to disclose the facts regarding the contaminating activity. The considerations of economic efficiency indicate that the seller should have a duty to disclose latent defects on the property, including possible contamination. In his discussion of disclosure rules, Anthony Kronman concludes that requiring the seller to disclose any latent defects will make good sense because it will be more expensive for the buyer to discover the defects through his own investigation.[55] "Where the seller actually knows of the defect, and the buyer does not, the seller is clearly the party best able to avoid the buyer's mistake at least cost,"[56] and the seller should be required to disclose the defect to the buyer in order to reach a more efficient result.

Of course, the seller as well as the buyer may need to make an investment in order to acquire information regarding a particular defect. For example, a contaminator who suspects that his activity may have contaminated the groundwater may not be able to discover the extent of harm without an expensive environmental investigation. However, the contaminator can discover the extent of damage at a much lower cost than the buyer because he has superior knowledge regarding the property and the existence of potential damages. He is likely to be aware of the potential

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

56. *Id.* at 25.

location of the hazardous waste deposit and be able to predict the extent of damages.[57]

Therefore, the considerations of economic efficiency indicate that the seller should have a duty to disclose latent defects on the property including possible contamination.

It is important to note that the issue regarding liability of predecessor landowner often arises when the contract had been formed in the past. Therefore, a disclosure rule that is being applied retroactively cannot change the actions that have already occurred.[58] However, the original contaminator may still be in a better position to mitigate the harms arising from the contaminants because he has superior knowledge regarding the scope of the activity that resulted in contamination. By notifying the current owner of the potential location of the contamination, the original contaminator may be able to ensure that the harm is not aggravated.

Interestingly, the original contaminator is in a better position to mitigate the harm even if he did not realize the dangers associated with his activity at the time of sale. For example, a contaminator may have sold a property at a time when he did not actually realize that his activity has produced toxic substances and contaminated the land.[59] If the harmful effects of the activity become well known to the public many years later, the original contaminator who now realizes the effects of his activity should have an incentive to warn the present owner in order to mitigate

57. It is important to recognize that the question deals with the knowledge of the parties at the time of transfer. Although the original owner's knowledge of the danger at the time that he engages in the activity may be relevant in determining whether the act constituted a nuisance or ultrahazardous activity, it is not relevant in determining whether or not the purchaser of the land should be able to bring a claim against the original owner who has contaminated.

58. Schwartz, *supra* note 45 (noting that retroactively applied law cannot influence behavior).

59. The effects of the contaminating activity may have been such that the contaminator could not have discovered the harmful effects at the time of the sale because the scientific knowledge was not available. In such cases the defendant may be able to assert the "state of art technology" defense which provides that if the risk of activity was scientifically unknowable when undertaken, the actor should not be held liable in tort as a result of activity's consequences. *See generally*, Christine M. Beggs, Comment, *As Time Goes By: The Effect of Knowledge and the Passage of Time on the Abnormally Dangerous Activity Doctrine*, 21 HOFSTRA L. REV. 205 (1992). The *T & E* court leaves the issue unresolved. *T & E*, 587 A.2d at 1260. The state of art technology defense would be effective against third parties such as adjoining landowners as well as successor landowners. *But see* Beshada v. Johns-Manville Prods. Corp., 447 A.2d 539, 546-47 (N.J. 1982)(rejecting "state of art" defense in asbestos case).

the amount of damages. Without the warning, the present owner who was not aware of the previous owner's activities may aggravate the harm. If the contaminator is under a duty to disclose, he will have an incentive to warn in order to reduce his potential liability.

In addition to the efficiency arguments, the notions of fairness also indicate that the seller should have a duty to disclose defects on the property. Professor Keeton wrote that a disclosure rule should "impose on parties to the transaction a duty to speak whenever justice, equity, and fair dealing demand it."[60] It seems fair to require the seller to disclose the existence of contamination on the property sold, especially because the contamination may create health and safety risks to people who are exposed to it.[61] Even though the seller may have an incentive to remain silent in order to get a higher price for the property sold, he may feel morally bound to reveal the existence of contamination. This is especially true if the buyer is not likely to discover the danger during his use of the property and, through his ignorance, may unwittingly expose the persons on the land to health hazards.[62] Such moral arguments support the notion that the seller who knows about a material defect on his property should have to disclose such a fact to the buyer, especially if the buyer did not have equal access to the relevant information.[63]

IV.
INTERPRETATION OF THE SALES CONTRACT

If a court were to adopt a rule that places liability based on the actual expectations of the contracting parties, the court must determine how much disclosure of information was sufficient for the seller to avoid liability. A sales contract for a contaminated piece of real property can be placed in two distinct categories. First, the contract may reflect the fact that the parties have formed certain expectations regarding the allocation of costs associated with the contamination either through express language

60. W. Page Keeton, *Fraud - Concealment and Non-Disclosure*, 15 TEX. L. REV. 1, 31 (1936).

61. *See infra* notes 94-95 and accompanying text.

62. Professor Keeton suggests a duty to disclose could be determined through the standard of "what the man of ordinary moral sensibilities would have done; would he have disclosed the information or would he have remained silent?" Keeton, *supra* note 60 at 32.

63. *Id.* at 34-37 (delineating factors that are important in determining existence of a duty to disclose).

in the contract or though an implicit understanding between the parties. A second category of contracts may have omitted any mention of the contamination due to the fact that the parties have failed to consider the issue. For example, if the buyer did not have notice of the contamination and, therefore, did not have a chance to negotiate with regards to its effects, the contract will fit in the second category.

The holdings in both *T & E* and *Philadelphia Electric* indicate that, if the sales contract expressly allocates the costs associated with the contamination, the terms of the contract should be enforced. If the actual expectations of the parties are stated in the contract, the court should follow the language of the contract because such expectations were formed as a result of a fair bargaining process.[64] Therefore, if the buyer expressly assumes liability in the contract, that clause should be enforced by the courts.

However, some contracts omit the terms regarding the contamination. These are the cases where the courts are split as to whether the vendor of the land should be held liable to the vendee. There can be two different explanations for the contract's silence regarding the costs arising from the contaminating activity.[65] First, the parties could have negotiated the risks associated with the activity or at least had an understanding as to the allocation of the losses, but simply failed to explicitly mention the terms in the contract. Second, the parties may not have foreseen the possibilities of the losses arising from the activity and, therefore, simply have not provided for the situation.[66] If the contract falls under the first category, the actual expectation of the parties should be enforced just as in situations where the liability was expressly allocated in the contract itself.

Absent explicit language in the contract, however, the courts must look at the particular facts of the case to determine if the buyer had actually negotiated to accept the risk of loss from contamination in exchange for a reduction in price of the land. For example, the facts of the case may show that the parties have negotiated with one another regarding the effects of contamina-

64. Farnsworth, *supra* note 54 at 876 ("If it can be established that [the parties] shared a common expectation, that expectation will control the result.").

65. Glanville Williams divides omissions of contract terms into three categories: first, terms the parties probably had in mind but failed to state; second, the terms that the parties would have stated if it had been brought to their attention; and third, terms that are implied by the court because of its view of fairness or policy. Glanville Williams, *Language and the Law*, 61 L.Q. REV. 384, 401 (1945).

66. *See generally* Farnsworth, *supra* note 54.

tion but failed to expressly allocate the costs in the contract. This is especially likely to be the case if the buyer has actual knowledge of the contamination and its dangers and the contract contains "as is" language.[67] The parties may have assumed that the "as is" language of the contract or the omission of any terms regarding the allocation of liability has placed the risk of loss on to the purchaser. If that is the case, the court should interpret the contract so that the expectation of the parties will be enforced.[68]

The risk of harm passes from the vendor to the vendee when the vendor discloses sufficient information about the potential dangers associated with the land for the vendee to have taken the risks into consideration when bargaining for the purchase of the land. In essence, the sales price of the land reflect two distinguishable components: (1) the value of the land without any contamination; and, (2) the present value of the risk that the activities on the land would result in future harm. The second component, the risk of future harm, will only be a component of the sales price if the vendee was aware of the existence of the risk.

At minimum, the buyer must at least be aware of the contamination in order for the risk of harm to be reflected in the sales price. When the buyer has some notice of the contaminants but the contract fails to mention the allocation of the costs, the courts should engage in a case by case analysis of the facts to determine if the buyer's knowledge was sufficient to place liability on him. Seen in retrospect, the actual damages suffered by the present owner may be much larger than the reduction in the price of the land that was negotiated, and it may seem unfair to place the heavy loss solely on the current owner. However, it is important to remember that the reduction in price only reflects the risk of harm which was contingent on many factors that both the seller and the buyer may not have accurately predicted at the time of conveyance, especially if the transaction took place at a time when people were less aware of environmental issues. First, the actual reduction in price would only reflect the present value of a loss that may occur in the future.[69] Second, it may be that the

67. *See generally*, Laura M. Schleich, Note, *An 'As Is' Provision in a Commerical Property Contract: Should it be Left As Is When Assessing Liability for Environmental Torts?*, 51 U. PITT. L. REV. 995 (1990).

68. "If it can be established that they shared a common expectation, that expectation will control the result." Farnsworth, *supra* note 54, at 876.

69. For example, ignoring the effects of inflation, the present value of $1 discounted at interest rate of 10% for fifty years is .0085. Therefore, if a purchaser of

both seller and the buyer did not fully appreciate the exact extent of harm and expected the chance of substantial harm to be small. There are many factors that the parties may not have accurately predicted. For example, the scientific knowledge at the time may not have been sufficient to predict the extent of the harm, even if the dangers were well known. Also, the amount of monetary harm suffered may be greater than anticipated due to changes in the law.[70]

However, absent fraud or misrepresentation by the seller, the tort law should not be used to compensate the purchaser from the loss that turned out to be greater than what they had anticipated. In determining the enforceability of the terms of a contract, the adequacy of the consideration is usually not relevant.[71] Therefore, if the trier of fact determines that both the buyer and seller have considered the potential risks involved with contaminants on the property, the actual expectations of the party regarding liability should be enforced.

Exactly how much information would the buyer have to be aware of in order for the risk of loss to pass on to the buyer? The knowledge should be sufficient for the buyer to have considered the contamination as a factor when negotiating the price. Absent an explicit clause in the contract, the allocation of the costs should be determined through a highly factual inquiry into the subjective knowledge of the parties. Therefore, the court would need to consider factors such as (1) obviousness of the danger, (2) the language of the contract, such as an "as is" clause, (3) thoroughness of inspection by the buyer, and (4) the buyer's familiarity with the seller's activities.[72]

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land in 1940 knew that the contamination on the property would result in loss in 1990 in the amount of $10,000, the purchaser would assume the future loss if the price is reduced by more than $85.

70. One obvious cost that the enactment of regulations have imposed on the present owner is that the land may have become inalienable. Even if the cost of cleanup may be less than the value of the land without the contaminations, the uncertainty regarding the legal obligations may make it extremely difficult to find a buyer for the land. C855 ALI-ABA 485, 488, Daniel Riesel (June 21, 1993).

71. If the consideration rests on an unlikely contingency, the disparity between the price and the actual income may be great. However, the contract is still enforceable.

72. One obvious draw back of such a factual inquiry is that the litigation cost will increase greatly. Because parties cannot predict what the outcome will be, they are more likely to litigate and possibility of a settlement may become smaller. Furthermore, the discovery may expand in scope and the litigation time may increase. Although such a multi-factor test may be impractical in cases where the dispute is over a small amount of money, most of the toxic tort claims involve cases where the

In cases where the buyer had no knowledge of the contamination, the sales price fails to reflect the risks associated with the contamination. In such situations where the omission in the contract regarding the allocation of liability is due to the fact that the parties have not considered the issue, there is no actual expectation of the parties to enforce.[73] Since environmental contaminations often involve conditions that the buyer could not have discovered through casual inspection of the land, it is likely that without the seller's disclosure regarding the existence of contamination, the contract negotiation will have failed to take the issue into consideration at all. When the parties do not address the issue of contamination, there is a gap in the contract because the parties have failed to actually assign the risk, explicitly or implicitly. Consequently, the seller did not reduce the sales price to reflect the amount of the damage that exists on the property. In such cases, the seller has not assumed all the costs associated with creating the contamination and negative externalities are created.[74] Therefore, placing the liability on the seller who has failed to make any disclosure will reach a fair result.

V.
A DUTY TO DISCLOSE LATENT DEFECTS

An examination of the cases supports a legal doctrine that focuses its inquiry on the knowledge of the buyer. Even in cases where the court did not base its decision on the actual knowledge of the parties, a close study of the facts show that the expectations of the parties may have affected the court's holding. For

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amount of damages is large enough to make the litigation cost effective. For example, a study of California sites show that cleanup will cost an average of $800,000 per site, and twice that if groundwater contamination is also discovered. 2 CALIFORNIA GOVERNOR'S TASK FORCE ON TOXICS, WASTE AND TECHNOLOGY 83 (1986); *see also*, U.S. OFFICE OF TECHNOLOGY, SUPERFUND STRATEGY 3 (Apr. 1985) ("costs to Superfund could easily be $100 billion").

73. Even if the contract contains "as is" language, the clause may simply have been inserted without any consideration of the contamination if the buyer did not have any knowledge of the defects. In such cases, there would be no actual expectation of the parties to enforce.

74. Farnsworth, *supra* note 54, at 876-881. Farnsworth notes that the court may also choose a result "on the basis of a convenient rule of thumb or because it will discourage litigation by promoting certainty." *Id.* The court may also try to interpret the contract through hypothetical reactions of the party. *Id.* at 879. However, if the parties have not actually formed expectations regarding a certain factor in the contract, the basic principles of fairness, justice, or efficiency should be used for the court to interpret what the hypothetical reactions of the parties would have been. *Id.* at 881.

example, the holding in *Philadelphia Electric* may have been partially based on the court's finding that the negotiated sales price must have reflected costs of the contamination. The court held that the doctrine of caveat emptor applied in the context of sale of land and that the seller should not remain liable against the buyer. However, the court reached this conclusion because it found that, given the facts of the case, it seemed "inconceivable that the price [PECO] offered Gould did not reflect the possibility of environmental risks, even if the exact condition giving rise to this suit was not discovered."[75] Unlike in *T & E* where the buyer was truly unaware of the existence of environmental problems, PECO appears to have had knowledge of the environmental risks on the property. The facts of the case show that PECO inquired into the past uses of the site and inspected it carefully.[76] Furthermore, when PECO obtained the option to purchase the property from Gould in 1973, PECO was operating a plant on an adjoining piece of land.[77] Given that PECO was an adjacent landowner near the time when PICCO was the owner of the site, it seems highly unlikely that PECO was totally unaware of the fact that PICCO was engaged in activities that created the environmental contamination.

Although the facts in *Philadelphia Electric* show that the buyer probably was aware of the contaminants at the time of purchase, the court did not limit its holding to cases where the buyer had knowledge. In contrast, the recent California case of *Newhall Land Farming Co. v. Superior Court*[78] focused its inquiry to the knowledge of the buyer and held that the current owner who was ignorant of the contamination at the time of purchase has a cause of action based on negligence against the predecessor owner. The facts of the case show that the defendants discharged hazardous substances into the ground knowing that the substances would pollute the soil and the ground water. The defendants sold the property to third parties without disclosing the existence of the contamination. The plaintiff acquired the property from

75. *Philadelphia Electric*, 762 F.2d at 314.

76. "[A] PECO representative inspected the site on more than one occasion, including walking tours along the banks of the Delaware River and the banks of the PICCO pond. PECO learned that Gould's tenant, ABM, had caused a number of spills on the site, including oil spills in the pond area, and was informed that ABM was a 'sloppy tenant.'" *Id.* at 306.

77. *Id.*

78. *Newhall*, 23 Cal. Rptr. 2d at 377.

third parties without any knowledge or suspicion of the contamination on the property.[79]

Reversing the trial court's holding that the doctrine of caveat emptor precluded the plaintiff from stating a cause of action based on failure to disclose a material defect,[80] the *Newhall* court pointed out that, although the damage to the property *could* have been factored into the term of the purchase, if was not actually taken into consideration because the defendants failed to disclose the contamination.[81] Therefore the court held that the plaintiff has stated a negligence cause of action against the defendants for failure to disclose.[82] In so holding, the court explicitly limited its decision to situations where the defendants "illegally discharged hazardous substances onto the ground knowing these substances would pollute the soil and enter the ground water and then failed to disclose the existence of the contamination when the property was sold."[83] Therefore, the court left open the possibility that if the plaintiff knew of the hazardous substances on the property at the time of purchase, the defendants may not be held liable.

The view that a landowner who is selling his property has a duty to disclose latent defects on the property which involve unreasonable risk of harm is not a new one, and there is much legal support for a disclosure rule.[84] This duty to disclose has developed an exception to the doctrine of caveat emptor which generally states that the vendor of land is not liable to his vendee for the condition of the land existing at the time of transfer.[85] The latent defect exception is defined in section 353 of Restatement (Second) of Torts as the following:

> "(1) A vendor of land who conceals or fails to disclose to his vendee any condition, whether natural or artificial, which involves un-

79. *Id.* at 380.

80. *Id.* at 385.

81. "[The defendants] did not disclose the existence of the contamination when the property was sold. Consequently, the effect of [the defendants'] unlawful discharge of hazardous materials into the soil could not be considered when the purchase was negotiated." *Id.* at 382.

82. *Id.* at 387. The court also found that the plaintiff had stated causes of action in nuisance and trespass.

83. *Id.*

84. Belote v. Memphis Development Co., 346 S.W.2d 441 (Tenn. 1961); Derby v. Public Service Co., 119 A.2d 235 (N.H. 1955); Herzog v. Capital Co., 164 P.2d 8 (Cal. 1945); Mincy v. Crisler, 96 So. 162 (Miss. 1923); Weikel v. Sterns, 134 S.W. 908 (Ky. 1911).

85. *See supra* note 18 and accompanying text.

> reasonable risk to persons on the land, is subject to liability to the vendee and others upon the land with the consent of the vendee or his subvendee for physical harm caused by the condition after the vendee has taken possession, if
> (a) the vendee does not know or have reason to know the condition or the risk involved, and
> (b) the vendor knows or has reason to know of the condition, and realizes or should realize the risk involved, and has reason to believe that the vendee will not discover the condition or realize the risk."[86]

Under the Restatement's view, the liability is imposed on the vendor if he fails to disclose a defect that involves unreasonable risk of physical harm if the vendee could not have discovered the defect through casual inspection. The application of this exception is appropriate in conditions involving environmental contamination because the effects of the contamination are exactly the kind of conditions that "an inspection by the vendee would not discover or, although the condition would be so discovered, the vendor realizes the risk involved therein and has reason to believe that his vendee will not realize it."[87] Furthermore, the existence of contaminants involves "unreasonable risk to the persons on the land" because the toxic substances can cause health and safety problems to persons who become exposed.

Cases that impose a duty to disclose latent defects emphasize that the defect was such that the vendee could not have easily discovered through casual inspection.[88]

> "[I]n the case of a vendor of realty most courts are inclined to impose on him a rather strict duty of disclosure of *latent* defects in the property.... The most emphasized point is the difficulty or impossibility of the purchaser's discovering the defect himself. That is to say, the duty of discovery is not cast upon the purchaser although he could, presumably, learn of the defect if he paid for a thorough, expert investigation."[89]

Environmental contaminations fall under this definition of latent defects because the contamination is often not discoverable

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86. RESTATEMENT (SECOND) OF TORTS, § 353(1) (1977); *see also*, 4 American Law of Property (A. James Casner ed. 1952) § 11.20.

87. RESTATEMENT (SECOND) OF TORTS, § 353, comment on subsection (1)(d) (1977).

88. *See, e.g.,* Clauser v. Taylor, 122 P.2d 661 (Cal. 1941) (emphasizing purchaser's ignorance and the inaccessibility of facts); Greenberg v. Glickman, 50 N.Y.S. 2d 489 (1944) *modified*, 268 A.D. 882 (1944), *appeal denied*, 268 A.D. 987 (1945).

89. William B. Goldfarb, *Fraud and Nondisclosure in the Vendor-Purchaser Relations*, 8 W. RESERVE L.REV. 5, 19 (emphasis in original).

through casual inspection of the land.[90] In fact, the determination of the exact extent of damage may require expensive environmental investigation.[91]

Another element to the latent defect exception to caveat emptor is the requirement that the defect involve unreasonable risk of harm to persons on the land. Cases have found the defect to involve unreasonable risk if nondisclosure of the defect would create health and safety problems.[92] This requirement is also met because nondisclosure of toxic contaminants can lead to health or safety hazards. Although environmental cases mostly arise where the plaintiff is attempting to recover economic losses associated with cleanup rather than damages from physical injuries, often the cleanup is required because the contaminants create health and safety problems.[93] Statutory regulations generally require landowners to remove contaminants that may create health hazards upon exposure. For example, CERCLA defines "pollutants or contaminants" that need to be cleaned up as substances which can cause bodily injury upon exposure to living organisms.[94]

Although environmental cases often involve contamination that could lead to diseases upon prolonged exposure, the health hazards may not be severe or imminent in some cases. In such cases, the only recognizable damage to the owner of the property may be the diminution in the value of the land. Even if the latent defect only affects the value of the property, the general trend of the law has been to expand the scope of the exception to require

90. *See, e.g., Newhall*, 23 Cal. Rptr. 2d at 380 (no visible evidence of the discharged hazardous substances); *T & E*, 587 A.2d 1249 (N.J. 1991) (radium tailings buried under a building).

91. *See, e.g.,* PVO Int'l, Inc., v. Drew Chemical Corp., 19 Envtl. L. Rep. 20077, 20078 (D.N.J. 1988)

92. Goldfarb, *supra* note 89, at 16 ("Where the conditions affect personal health and safety the vendor's duty is greater than where they merely affect the value of the property."); *see, e.g.,* Quashnock v. Frost, 445 A.2d 121, 126 n.4 (Pa. 1982) (pointing out that the latent defect has to be dangerous in order for the duty of disclosure to exist); Mincey v. Crisler, 96 So. 162 (Miss. 1923) (emphasizing the health and safety factor).

93. Many environmental claims indicate that there are substantial injuries involved with toxic exposure. Rodgers, *supra* note 50, at 407.

94. "The term 'pollutant or contaminant' shall include . . . any element . . . which after release into the environment and upon exposure, ingestion, inhalation, or assimilation into any organism, either directly from the environment or indirectly by ingestion through food chains, will or may reasonably be anticipated to cause death, disease, behavioral abnormalities, cancer, genetic mutation, physiological malfactions (including malfactions in reproduction) or physical deformations, in such organisms or their offspring." CERCLA, § 103, 42 U.S.C.A. § 9601(33) (West 1993).

disclosure in such situations.[95] In fact, the court in *Newhall* found that the latent defect exception to the doctrine of caveat emptor did apply in situations involving environmental contamination, and held that the vendor did have a duty to disclose.[96] Citing the Restatement's view on predecessor landowners' liability for latent defects with approval, the court held that the vendor's duty to disclose was not limited to personal injury cases, but extended to cases where the facts affected the value of the property itself.[97]

In contrast, other courts have stated that the latent defect exception was not applicable in the context of environmental tort claims. In *Philadelphia Electric*, the court addressed the applicability of the latent defect exception to the caveat emptor but dismissed the issue, merely stating that PECO conceded that the exception did not apply in this case.[98] The court's opinion is unclear as to why the exception did not apply in this case. However, even if the court had found that the exception did apply, the vendor still may not have been held liable because the facts seem to show that the buyer probably knew of the risks on the land.[99]

The lower court's opinion in *Philadelphia Electric* shows that it felt that the both the doctrine of the caveat emptor and its latent defect exception did not apply because these rules "address a vendor's liability for physical harm to persons on the land

95. "[T]here has been a rather amorphous tendency on the part of most courts to find a duty of disclosure in cases where the defendant has special knowledge, or means of knowledge, not open to the plaintiff, and is aware that the plaintiff is acting under a misapprehension as to facts which would be of importance to him, and would probably affect his decision. This tendency . . . has been most manifest in cases involving latent dangerous physical conditions of land or chattels . . . . This has now generally been extended to any facts or conditions basic to the transaction, even though they are of a kind likely to cause only pecuniary loss." PROSSER, LAW OF TORTS, § 106 at 697-98 (4th ed. 1971)(footnotes omitted).

96. *See supra* notes 80-82 and accompanying text.

97. The court noted that in context of real estate transactions, "[i]t is now settled in California that where the seller knows of facts materially affecting the value or desirability of the property . . . and also knows that such facts are not known to or within the reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer." *Newhall*, 23 Cal. Rptr. 2d at 386 (citing Barnhouse v. City of Pinole, 133 Cal.App.3d, 171, 187-88 (1982)).

98. *Philadelphia Electric*, 762 F.2d at 313.

99. Although the court did not explicitly find that the buyer had knowledge of the contaminants, the court found it inconceivable that the price did not reflect the possibility of environmental risks. *Id.* at 314. This shows that the court felt that the buyer did have at least some knowledge of the environmental problems on the property.

whereas the instant case involves a claim for costs of abating a nuisance."[100] However, Pennsylvania cases that addressed the issue of latent defect exception to caveat emptor have not limited the vendor's liability to cases involving physical harms to persons on the land.

For example, in *Quashnock v. Frost*,[101] the purchasers of a house brought an action against the seller claiming as damages the costs of exterminating termites in repairing their home. The court found that the seller was liable to the purchaser of the house for failing to disclose the existence of termite infestation because "[a] seller has a duty to disclose conditions that are dangerous to the purchaser."[102] Noting that the traditional view of caveat emptor would have imposed no liability absent active concealment or material misrepresentation, the court adopted the modern view that "where there is a serious and dangerous latent defect known to exist by the seller, then he must disclose such defect to the unknowing buyer or suffer liability for his failure to do so."[103]

The applicability of the latent exception in the context of an environmental tort claim was also addressed in *Wellesley Hills Realty Trust v. Mobil Oil Corp.*[104] The action involved a dispute over liability for the contamination of real property that the defendant has created during its operation of a gasoline service station on the property. The facts of the case show that the plaintiff was aware of the existence of contaminants on the property prior to purchase.[105] Dismissing the plaintiff's assertion of a negligence claim, the court held that the vendor is not liable for harm resulting to the vendee from defects existing at the time of transfer.[106] In reaching this decision, the court considered the applicability of the latent defect exception to this general rule which would impose a duty to disclose to the vendee any hidden defects. The court stated that the latent defect exception probably does not apply because there was an intermediate owner be-

100. Philadelphia Electric Co. v. Hercules, Inc., 587 F.Supp. 144, 154 (E.D.Pa. 1984), *rev'd* 762 F.2d 303 (3d Cir. 1985).

101. 445 A.2d 121 (Pa. 1982).

102. *Id.* at 124 (citing Shane v. Hoffman, 324 A.2d 644 (Pa. 1958)); *See*, RESTATEMENT (SECOND) OF TORTS, § 353.

103. Quashnock, *supra* note 102 at 125.

104. 747 F.Supp. 93 (D.Mass. 1990) (hereinafter *Wellesley Hills*).

105. The results of an environmental assessment of the site prior to the closing revealed "severe contamination of the site by 'benzene, toluene, enthylbenzene and xylene, all of which are components of gasoline.' " *Id.* at 94.

106. *Id.* at 100.

tween the parties.[107] However, the court stated in dicta that even if the latent defect exception did apply, the plaintiff's claim under negligence would ultimately fail because the facts show that the plaintiff was aware of the risks. "[T]he undisputed facts are that an environmental assessment was conducted prior to the sale and that [plaintiff] therefore knew of the contaminated condition of the property when the sale was consummated."[108]

The *Wellesley Hills* opinion raises the following question: How long should the seller of the property be liable to the purchaser for failure to disclose latent defects? A vendor's duty to disclose latent defect should not end merely because the purchaser has subsequently sold the property to a third party. "No sound reason exists for relieving [defendants] from liability for their alleged breach of disclosure merely because of the fortuitous event of intervening sales. Thus, the lack of privity does not bar [plaintiff's] claim."[109] Therefore, the liability on the vendor should continue until the time where the vendee or a subvendee discovers the harm.[110]

VI.
STATUTORY DISCLOSURE REQUIREMENTS

In dealing with real property transactions in the future, the law should encourage sellers and buyers to explicitly allocate the risks in the language of the contract in order to minimize any uncertainty that could lead to litigation. The goal of tort law should be to create incentives for the seller to disclose material defects on the land so that the negotiation process will take account of the contamination. However, the case law should be

107. *Id.* at 100-10. However, The Restatement's view is that the liability extends to "not only those who are there by the consent of the vendee as his licensees but any person to whom he subsequently sells or leases the land . . . ." RESTATEMENT (SECOND) OF TORTS, Comment on subsection (1) (1977); *see also Newhall*, 23 Cal. Rptr. 2d 377 (1993) (holding that the privity of title if not a prerequisite to recovery in an action for negligence based on breach of the duty to disclose).

108. *Wellesley Hills*, 747 F. Supp at 100.

109. *Newhall*, 23 Cal. Rptr. 2d at 387.

110. The Restatement's view is that the vendor's liability will end when the vendee discovers the harm or has an opportunity to discover the harm. However, "[a] very latent defect, not likely to be discovered in the course of normal inspection or use of the land, may make the vendor liable for a considerable length of time after he surrenders possession . . . ." RESTATEMENT (SECOND) OF TORTS, § 353, cmt. g (1977).

analyzed in conjunction with legislation which may be much more effective in setting clear guideline for parties' behaviors.[111]

Industrial real estate transactions are heavily regulated through government and state agencies which set specific requirements for environmental audits and disclosures of activities.[112] The *T & E* court acknowledged that "almost without exception any conveyance of industrial property today would be made not in a vacuum but in full appreciation of regulatory requirements .... [The regulations] will surely alter the equities in respect of any claim of benefit-of-the-bargain damages by a successor in the chain."[113]

The disclosure requirements should establish detailed guidelines for the contracting parties in order to increase the predictability of the rights of the parties. Such specific regulation is much more easily achieved through legislation than through case law which can only set general rules based on the particular fact patterns that have come to the attention of the court.[114]

Recently, federal and state legislatures have adopted regulations to deal with problems arising from environmental contamination.[115] Some states and the federal government have adopted transfer laws to define the appropriate levels of environmental due diligence and cleanup before certain industrial properties can be sold.[116] In addition to the disclosure requirement set for conveyance of federal real estate which has been exposed to haz-

111. For a general discussion on the advantages and disadvantages of establishing specific statutory criteria for imposing liability to prior or successor landowners, see Stern, *supra* note 16, at 352-356. The note concludes that "[a]lthough a clearer judicial standard may provide a short-term solution to the problem, direct government regulation is the best way to allocate the costs of environmental torts committed by prior landowners." *Id.* at 355; *see also* CARL F. CRANOR, REGULATING TOXIC SUBSTANCES: A PHILOSOPHY OF SCIENCE AND THE LAW 99-102 (1993).

112. "The incentives in the environmental laws ... should eventually make some level of environmental assessment a part of almost every property transaction. This process should also help reduce the numbers of unwitting owners of contaminated land." *Id.* at 86.

113. *T & E*, 587 A.2d at 1264-65.

114. CRANOR, *supra* note 116, at 99 (noting that the regulatory law allows greater degree of specificity than criminal or tort law).

115. "[W]ith a gradually developing consensus that courts and common law rules could not adequately address widespread environmental pollution, citizens and their elected representatives endeavored to find legislative solutions. The results by 1986 comprise a vast and complex network of federal and state statutes and regulations ...." HARRIS, *supra* note 1, at 55.

116. *See generally*, I. LEO MOTIUK, ET. AL., PRACTICING LAW INSTITUTE ORDER NO. B4-7026: THE IMPACT OF ENVIRONMENTAL REGULATIONS ON BUSINESS TRANSACTIONS AND OPERATIONS (1992).

ardous substances under CERCLA Section 120(h)[117], states such as New Jersey[118], Connecticut[119], Illinois[120], Indiana[121], California[122], Missouri[123], Iowa[124] and Pennsylvania[125] have adopted property transfer laws that private parties must follow when dealing with property that may contain hazardous contaminants. These statutes allow the transferee to recover damages from the transferor for violation of the law. In conjuction with such statutes that set specific guidelines for disclosure of contamination, the common law that requires the seller of a contaminated property to disclose the defects to the buyer will encourage the parties to discuss the issue of liability during the negotiation process and to explicitly allocate the risks in the contract language.

CONCLUSION

Allocating liability between the seller and the buyer of a contaminated land has frequently become a major issue in environmental cases dealing with industrial property. Although this Comment limits its discussion to the allocation of damages between two commercial parties who are likely to retain full awareness of the ramifications of contract negotiation process, it is important to recognize that different policy considerations may come into plan if the litigation involves a contaminated residential property.[126] Furthermore, toxic tort claims should be considered in conjunction with complex web of federal and state regulations that exist in the area of environmental litigation.

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117. 42 U.S.C. § 9620(h).

118. N.J. STAT. ANN. § 13:1K-6 et seq. (West 1991 & Supp. 1994).

119. CONN. GEN. STAT. ANN. § 22a-454(b) (West 1985 & Supp. 1994) (requiring the transferor of certain industrial property to deliver to the transferee a notarized certification that there has been no discharge of hazardous waste on the site, or that any such discharge has been cleaned up in accordance with state law).

120. 765 ILL. COMP. STAT. ANN. 90/1 (requiring transferor to provide a disclosure statement to a transferee and the state regulatory agency).

121. IND. CODE ANN. § 13-7-22.5-1 *et seq* (Burns 1990 & Supp. 1994).

122. CAL. HEALTH & SAFETY CODE § 25359.7 (West 1992).

123. MO. ANN. STAT. § 260.465 (Vernon 1990).

124. IOWA CODE ANN. § 455B.430 (West 1990).

125. Pennsylvania Solid Waste Management Act, PA. STAT. ANN. tit. 35 § 6018.405; Pennsylvania Hazardous Sites Cleanup Act, PA. STAT. ANN. tit. 35 § 6020.512.

126. Courts have articulated a public policy hostile to disclaimers of habitability in the area of residential property. *See* David L. Abney, *Disclaiming the Implied Real Estate Common-Law Warranties*, 17 REAL EST. L.J. 141 (1988). There may be borderline cases as well. For example, the purchaser of a contaminated property may be a small scale farmer who may or may not have the resources available to a commercial entity.

Even though the environmental regulations play a large role in guiding behavior of parties that are involved in real estate transactions, tort laws complement the statutes by providing flexible remedies for particular conflicts and filling any gaps that legislative schemes may leave open. If the parties have allocated the liability through an arms length negotiation process, the enforcement of the contract terms will lead to an equitable result. However, the courts need to consider a liability rule for situations where such negotiation process did not occur. Efficiency and fairness arguments show that a seller of the property should be required to disclose to the buyer the existence of any contamination on the property. Therefore, the seller who fails to disclose the hazardous conditions should be held liable against the purchaser.