

## Commentary

### **"AS-IS" PROVISION: NOT A WAY AROUND A SELLER'S DISCLOSURE OBLIGATIONS**

*by Shirley S. Lu*

One of the most widely held misconceptions about the effect of an "as-is" provision in a sales contract is that it completely relieves the seller of its duty to disclose defects in the property to the buyer. Under California law, however, even with an "as-is" provision, a seller must nevertheless disclose known facts which materially and adversely affect the value and desirability of the property, which facts are not known or readily ascertainable by the buyer. An "as-is" provision simply means that a buyer is purchasing the property in the physical condition that is visible and observable by that buyer.

The circumstances under which a seller must disclose known defects, despite the existence of an "as-is" provision, are varied and inexhaustible. For example, the courts have decided that a seller need not disclose to a buyer an obviously dilapidated stairway, but would need to disclose the existence of a subterranean creek in the backyard, or an unexploded bomb buried in a basement. One court held a seller liable for its failure to disclose that the property had been the scene of gruesome multiple murders ten years earlier. Another court found a seller liable for fraud when the seller knew that the buyer was purchasing the property for development, and the seller still failed to disclose that the government was considering condemning the site.

Criminal and even successor liability may attach to sellers for failing to disclose important defects in the property. For example, in one case a seller was held criminally liable where that seller had failed to disclose to the buyer that a faulty boiler in the house had leaked poison gas and had previously injured the seller's family, the buyer's family died of carbon monoxide poisoning from the gas leak three months after the close of escrow.

In another case, an oil company was found liable to a successor owner for failure to disclose the presence of environmental contamination placed on the property by the seller, despite the lack of privity between the oil company and the successor owner. The court reasoned that the oil company should not be relieved of liability merely because of the fortuitous event that the original purchaser had transferred the property without knowledge or disclosure of the contamination on the property.

Each situation must be analyzed on a case-by-case basis to determine whether disclosure of a known defect is required of the seller. To be safe, sellers should err on the side of over-disclosure. A good rule of thumb for sellers to follow is that "if you have to ask, then disclose" because probably the matter would also be worthy of the buyer's consideration.

To avoid liability for failure to disclose, prudent sellers should disclose in writing all known defects as early as possible in the transaction. This practice has several advantages: First, when all known defects are brought to the open by a seller, the seller can make an early determination as to the buyer's level of commitment to the transaction and avoid wasting time with a buyer who is not serious; second, the buyer will be deterred from claiming an element of "surprise" and attempting to "re-negotiate" the price later; and third, in the event a suit is filed against the seller, one of the seller's defenses is its written disclosure to the buyer of the existence of the defects in question.

Where the seller has complied with the rules of disclosure, a property crafted "as-is" provision can serve as a useful tool to reduce the seller's liability. For example, in one case, two seasoned buyers, after having conducted their own thorough investigation of the property, purchased a property which was adjacent to a freeway off-ramp. The sales contract contained an "as-is" provision and the seller had verbally warned the buyer that

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the property was "a dog, in bad shape, dilapidated and dangerous." A few months after the close of escrow, the property was condemned by the city for code violations and the buyers sued for rescission. In ruling for the seller, the court reasoned not only that the seller had sufficiently disclosed all material defects to the buyers, but that the buyers were sophisticated businessmen who unjustifiably sought to renege on a transaction by relying upon certain alleged inadequacies of an "as-is" provision in the contract.

A comprehensive "as-is" provision should provide that the seller has not made any representations and warranties, except as specifically set forth in the agreement, and that the buyer is purchasing the property with all defects, whether known or unknown. A seller should include a "sophisticated buyer" clause, where the buyer represents that it is experienced in real property transactions, that it will have had the opportunity to, and will have in fact conducted (or elected not to conduct at the buyer's own risk) a thorough investigation of each aspect of the property, and that the buyer is relying on their own investigation of the property.

A seller can increase the protection of an "as-is" provision by including a general release clause where the buyer releases the seller from liability for damages arising from the condition of the property. A general release clause, however, releases a seller from "known" claims related to the property. Therefore, the seller may consider obtaining the buyer's release of any "unknown" claims and an express waiver of statutory provisions relating to release of "unknown" claims. In light of the high liability associated with environmental issues today, a seller should obtain specific releases from a buyer for damages arising from the environmental condition of the property.

A seller should be mindful that regardless of how well an "as-is" provision is drafted and how comprehensive it may be, an "as-is" provision will not relieve the seller of the duty to disclose all material information to the buyer.

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