

ADOPTING THE IMPLIED WARRANTY OF HABITABILITY TO DEFINE SUBSTANTIAL PERFORMANCE IN THE SALE OF NEW HOMES

In the last three decades, more than twenty jurisdictions have established some form of implied warranty of habitability on new houses purchased from builder-vendors.¹ This warranty affords house buyers remedies for latent defects in the construction of their new homes.² The definition and application of this implied warranty varies widely from state to state. In *Petersen v. Hubschman Construction Co.*,³ the Illinois Supreme Court definitively established that

1. See, e.g., *Vanderschrier v. Aaron*, 103 Ohio App. 340, 140 N.E.2d 819 (1957). *Vanderschrier* is the landmark American case in house warranty law. The Ohio court recognized an implied warranty for latent defects causing basement flooding when the buyer purchased the house before completion of construction.

Since *Vanderschrier*, the following jurisdictions have recognized an implied warranty by either judicial caveat or legislation. By case law: *Cochran v. Keeton*, 287 Ala. 439, 242 So. 2d 313 (1971); *Wawak v. Stewart*, 247 Ark. 1093, 449 S.W.2d 922 (1970); *Pollard v. Saxe & Yolles Dev. Co.*, 12 Cal. 3d 344, 525 P.2d 88, 155 Cal. Rptr. 648 (1974); *Carpenter v. Donohoe*, 154 Colo. 78, 388 P.2d 399 (1964); *Brennan v. Watergate West*, 391 A.2d 1351 (D.C. 1978); *Bethlahmy v. Bechtel*, 91 Idaho 55, 415 P.2d 698 (1966); *Barnes v. Mac Brown and Co.*, 264 Ind. 141, 342 N.E.2d 611 (1976); *Crawley v. Turhune*, 437 S.W.2d 743 (Ky. 1969); *Weeks v. Slavick Builders, Inc.*, 24 Mich. App. 621, 180 N.W.2d 503 (1970); *O'Dell v. Custom Builders, Inc.*, 560 S.W.2d 862 (Mo. 1978); *Henggeler v. Jindra*, 191 Neb. 317, 214 N.W.2d 925 (1974); *Norton v. Burleaud*, 115 N.H. 435, 342 A.2d 629 (1975); *Dobler v. Malloy*, 214 N.W.2d 510 (N.D. 1973); *Hartley v. Ballou*, 286 N.C. 51, 209 S.E.2d 776 (1974); *Jones v. Gatewood*, 381 P.2d 158 (Okla. 1963); *Yepsen v. Burgess*, 269 Or. 520, 525 P.2d 1019 (1974); *Elderkin v. Gaster*, 447 Pa. 118, 288 A.2d 771 (1972); *Padula v. J. J. Deb-Cin Homes, Inc.*, 111 R.I. 29, 298 A.2d 529 (1973); *Rutledge v. Dodenhoff*, 254 S.C. 407, 175 S.E.2d 792 (1970); *Waggoner v. Midwestern Dev., Inc.*, 83 S.D. 57, 154 N.W.2d 803 (1967); *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968); *Bolkum v. Staab*, 133 Vt. 467, 346 A.2d 210 (1975); *House v. Thornton*, 76 Wash. 2d 428, 457 P.2d 199 (1969); *Tavares v. Horstman*, 542 P.2d 1275 (Wyo. 1975). By statute: CONN. GEN. STAT. §§ 47-116 to 120 (1979); FLA. STAT. ANN. § 718.203 (West Supp. 1981) (condominiums only); MD. REAL PROP. CODE ANN. §§ 10-203 (Michie Supp. 1980); N.J. STAT. ANN. § 46:3B-1 to 12 (West 1980).

2. See notes 19 & 26 and accompanying text *infra*.

3. 76 Ill. 2d 31, 389 N.E.2d 1154 (1979).

such an implied warranty exists and by analogy adopted the warranty provisions of the Uniform Commercial Code⁴ (UCC) to define the rights of builders and buyers under this warranty. The court not only ratified the implied warranty as an independent cause of action but also held the warranty to be an element of substantial performance.⁵

Plaintiffs in *Petersen* contracted with a commercial builder-vendor⁶ for the purchase of a residential lot and construction of a house thereon.⁷ The purchasers objected to the defendant builder's continued inadequate construction⁸ and refused to close the transaction.⁹ In response, the defendant invoked a contract forfeiture clause and retained the Petersens' down payment.¹⁰ The builder-vendor argued that he had substantially performed the contract because the house was habitable under the Illinois definition of implied warranty of habitability.¹¹ Although agreeing that the warranty was an ele-

4. ILL. ANN. STAT. ch. 26 (Smith-Hurd 1977) [hereinafter cited as UCC] (Illinois adopted the Uniform Commercial Code in 1961).

5. When the Petersens repudiated the contract, it was executory; substantial performance by the builder-vendor, including the implied warranty, was a constructive condition to performance by plaintiffs. 76 Ill. 2d at 43-44, 389 N.E.2d at 1159.

6. *Id.* at 40, 389 N.E.2d at 1158. The court labeled builder-vendor as a person "who is in the business of building and selling houses." *Id.* This definition is common. Frequently, however, implied warranty cases arise where the builder is also the developer, selling both the house and the land. *See, e.g.,* Hoye v. Century Builders, 52 Wash. 2d 830, 329 P.2d 474 (1958). *See generally* Annot., 25 A.L.R.3d 383 (1969).

7. 76 Ill. 2d at 35, 389 N.E.2d at 1155.

8. The plaintiffs complained of various flaws in defendant's construction as follows: a basement floor improperly pitched away from the drains; a defective window; defective installation of, and materials for the front doorway; drywall cracks; and nail popping. Defendant agreed to repair the listed items, but failed to do so. To promote performance, plaintiff requested \$1,000 be held in escrow until proper completion of the home. Defendant rejected this idea. *Id.* at 36, 389 N.E.2d at 1156.

9. The term "closing" connotes both the final payment for the land and house and the transfer of ownership. Generally, a closing is a meeting between the parties arranged to adjust final sales figures, taxes, and other incidentals. *See* A. AXELROD, C. BERGER, AND Q. JOHNSTONE, *LAND TRANSFER AND FINANCE* 1122 (3rd ed. 1978).

10. 76 Ill. 2d at 36, 389 N.E.2d at 1156. Defendant also refused to compensate the vendees for the labor and materials they supplied for the house pursuant to an agreement whereby Mr. Petersen, a plumber, would do the plumbing and heating work on the house. In return, he would receive an abatement on the purchase price. Mr. Petersen provided labor and materials valued at \$9,000 by the trial court. *Id.*, 389 N.E.2d at 1155.

11. The trial court rejected the defendant's argument and found for the plaintiffs, holding that the Petersens' repudiation was justifiable. The court ordered the defendant to return the \$10,000 earnest money and pay the fair value of the labor and materials that plaintiffs expended on the house. The defendant asserted, as his defense, that

ment of substantial performance, the Illinois Supreme Court differed with the builder's definition.¹² Applying the UCC by analogy, the court held that substantial performance of a building contract requires compliance with the implied warranty of habitability.¹³

The application of an implied warranty to new house sales is a recent legal development altering the established doctrines of *caveat emptor* and merger, which formerly governed builder liability in the sale of real property. *Caveat emptor*¹⁴ is a judicially-created doctrine premised on the buyer's presumed inspection of property and arm's-length negotiations with the seller.¹⁵ Under this theory, once the

the house was habitable, irrespective of defects, and thus he substantially performed. This defense is unusual as it is commonly the purchaser, not the builder, who relies on the implied warranty. The appellate court, however, rejected the defense. 53 Ill. App. 3d 626, 368 N.E.2d 1044 (1977).

12. 76 Ill. 2d at 41, 389 N.E.2d at 1158. The defendant relied upon *Goggin v. Fox Valley Constr. Corp.*, 48 Ill. App. 3d 103, 365 N.E.2d 509 (1977), which stated:

The primary function of a new home is to shelter its inhabitants from the elements. If a new home does not keep out the elements because of a substantial defect of construction, such a home is not habitable within the meaning of the implied warranty of habitability. . . . Another function of a new home is to provide its inhabitants with a reasonably safe place to live. . . . If the home is not structurally sound . . . [.] such a home is not habitable.

Id. at 106, 365 N.E.2d at 511.

The *Petersen* court rejected this reasoning and noted "[t]he use of the term habitability is perhaps unfortunate. Because of its imprecise meaning it is susceptible of [sic] misconstruction." 76 Ill. 2d at 41, 389 N.E.2d at 1158.

13. 76 Ill. 2d at 42, 389 N.E.2d at 1159.

14. Loosely translated this means "let the buyer beware." BLACK'S LAW DICTIONARY 202 (5th ed. 1965).

15. See Hamilton, *The Ancient Maxim Caveat Emptor*, 40 YALE L.J. 1133 (1931). This article provides the classic discussion of the origin and development of the *caveat emptor* doctrine. The following articles provide a comprehensive background in the doctrine of *caveat emptor* as it applies to real property. They postulate that continued reliance on *caveat emptor* is inequitable under modern marketing practices, and articulate theories presently applied by some courts. Bearman, *Caveat Emptor in Sales of Realty—Recent Assaults upon the Rule*, 14 VAND. L. REV. 541 (1961); Dunham, *Vendor's Obligation as to Fitness of Land for a Particular Purpose*, 37 MINN. L. REV. 108 (1953); Haskell, *The Case for Implied Warranty of Quality in Sales of Real Property*, 53 GEO. L.J. 633 (1965); Jaeger, *The Warranty of Habitability* (pt. II.), 47 CHI.-KENT L. REV. 1 (1970); Roberts, *The Case of the Unwary Home Buyer: The Housing Merchant Did It*, 52 CORNELL L.Q. 835 (1967).

More recent sources describe the erosion of *caveat emptor*, noting the specific tendencies of courts as they apply the implied warranty of habitability to new houses. See Bixby, *Let the Seller Beware: Remedies for the Purchaser of a Defective Home*, 49 J. URB. L. 533 (1971); Jaeger, *Apartments and Houses: The Warranty of Habitability*, 12 AKRON L. REV. 373 (1979); Jaeger, *An Emerging Concept: Consumer Protection in Statutory Regulation, Products Liability and the Sale of New Homes*, 11 VAL. L.

buyer has had an opportunity to examine the house and has purchased it, he can no longer hold the seller liable for defects.¹⁶

According to the doctrine of merger, when the purchaser accepts a deed, the contract, including all its obligations, merges into it. Thus, if problems with the house appear after delivery of the deed, its provisions, rather than those of the contract, govern the builder-vendor's liability.¹⁷ Since deeds usually do not contain specific contractual covenants regarding house warranties,¹⁸ merger, like *caveat emptor*, in effect leaves the purchaser without remedy for defects discovered after the sale. Currently, courts are invalidating both doctrines using various legal theories, the most important being the implied warranty of habitability.¹⁹

REV. 335 (1977); Maldonado, *Builder Beware: Strict Tort Liability for Mass-Produced Housing*, 7 REAL EST. L.J. 283 (1979); Roeser, *The Implied Warranty of Habitability in the Sale of New Housing: The Trend in Illinois*, 1978 S. ILL. U. L.J. 178; Schwartz, *Defective Housing, The Fall of Caveat Emptor*, 33 J. AM. LAW. A. 122 (1970); Note, *Products Liability: Implied Warranty in the Sale of New Homes*, 38 MO. L. REV. 315 (1973); Note, Elderkin v. Gaster—*The Pennsylvania Experience with Implied Warranties in Sales of New Homes*, 47 TEMP. L.Q. 172 (1973); Note, *Developments in Actions for Breach of Implied Warranties of Habitability in the Sale of New Houses*, 10 TULSA L.J. 445 (1975); Note, *Implied Warranties on New House Construction: Caveat Ohio Purchasers*, 46 U. CIN. L. REV. 207 (1977); Note, *Expansion of Consumer Protection in the Purchase of New Homes*, 3 WEST. ST. U. L. REV. 106 (1975); Comment, *Home Sales—A Crack in the Caveat Emptor Shield*, 29 MERCER L. REV. 493 (1978); Comment, *Extension of Implied Warranties to Developer-Vendors of Completed New Homes*, 11 URBAN L. ANN. 257 (1976).

16. *E.g.*, *Druid Homes, Inc. v. Cooper*, 272 Ala. 415, 131 So. 2d 884 (1961); *Levy v. C. Young Constr. Co.*, 46 N.J. Super. 293, 134 A.2d 717 (App. Div. 1957), *aff'd on other grounds*, 26 N.J. 330, 139 A.2d 738 (1958). *See also* note 19 *supra*.

17. *See, e.g.*, *Weber v. Aluminum Ore Co.*, 304 Ill. 273, 136 N.E. 685 (1922) (plaintiff's acceptance of the deed merged all prior conversations and agreements in reference to the subject property). *Contra*, *Glisan v. Smolenske*, 153 Colo. 274, 387 P.2d 260 (1963) (since the home was incomplete at the date of closing, no merger occurred, and unperformed agreements remained obligatory; the warranty of habitability remained an obligation on the builder).

18. *See generally* Roeser, *supra* note 15.

19. Formerly, the common law grounds for suits against builders-vendors by purchasers were: fraud, deceit, misrepresentation, lack of substantial performance, and breach of express warranty. These theories focused on the builder's behavior, so that courts imposed liability only when the purchaser proved defendant's bad faith or breach of contract.

Until the advent of the implied warranty of habitability, buyers also resorted to negligence claims. As Dean Prosser noted, house buyers were often frustrated since negligence was difficult to prove. In addition, other problems with the negligence theory developed because defects frequently resulted without fault. To resolve these problems, courts have looked to products liability cases and the theories of strict lia-

By 1937, two English cases had established that builder-vendors impliedly warrant a house sold during the course of construction.²⁰ This warranty provided for completion of the house in a workmanlike manner. Initially, courts implied this warranty only to unfinished houses because of the buyer's forced reliance on the builder's skill and expertise.²¹ According to the two English courts, the purchaser of a completed home was better able to inspect the house before purchasing, and thus did not require similar protection.²²

Some courts noted the unfairness of according an implied warranty of habitability to purchasers of houses under construction while denying purchasers of completed new homes a similar remedy.²³ In *Carpenter v. Donohoe*,²⁴ the Colorado Supreme Court found this distinction artificial.²⁵ The court therefore eliminated the discrepancy in remedies by permitting purchasers of completed new houses to recover for latent defects on the implied warranty theory.

bility and implied warranty. See PROSSER, TORTS § 97 (4th ed. 1971). See also McNamara, *The Implied Warranty in New-House Construction: Has the Doctrine of Caveat Emptor Been Abolished?*, 1 REAL EST. L.J. 43 (1972).

20. *Miller v. Cannon Hill Est., Ltd.*, [1931] 2 K.B. 113. In *Miller*, the plaintiff purchased a home during the course of its construction. After taking possession, the purchaser abandoned the house when latent defects caused excessive dampness, rendering it uninhabitable. Although the court predicated plaintiff's recovery on an express warranty, dicta suggested that in a house purchased during construction, there is an implied warranty that it will be completed in a workmanlike manner.

In *Perry v. Sharon Dev. Co.*, [1937] 4 All E.R. 390 (C.A.), the court expressly applied the *Miller* dicta where the buyer purchased the home during the process of construction. The court held the builder liable for the breach of implied warranty.

21. Courts presumed that buyers purchasing incomplete homes were unable to inspect them, and thus were at the mercy of builders. Hence, courts formulated an implied warranty that a builder would perform as promised and in a workmanlike manner. The same courts, on the other hand, found that in purchases of completed homes, the buyer, who had not relied on the builder, could inspect the new home to discover the defects. See *Jones v. Gatewood*, 381 P.2d 158 (Okla. 1963). See also note 15 *supra*.

22. See note 20 and accompanying text *supra*.

23. See generally Haskell, *supra* note 15. Noting the improbability of a house purchaser negotiating and obtaining express warranties, Haskell argues that this legal fiction operates as a hardship on buyers. *Id.* at 633.

24. 154 Colo. 78, 388 P.2d 399 (1964).

25. *Id.* at 83, 388 P.2d at 402.

That a different rule should apply to the purchaser of a house which is near completion than would apply to one who purchases a new house seems incongruous. To say that the former may rely on an implied warranty and the latter cannot is recognizing a distinction without a reasonable basis for it.

Id.

With the emergence of the implied warranty of habitability²⁶ for new houses, courts have departed from the traditional body of contract law for builders,²⁷ applying instead the law of sales.²⁸ Some of

26. As the law of implied warranty developed, constants appeared. First, courts found a notice requirement under the implied warranty of habitability which provided the builder-vendor with an opportunity to repair defects. *E.g.*, *Matulunas v. Baker*, 569 S.W.2d 791 (Mo. App. 1978) (recovery possible after the builder-vendor had an opportunity to observe the defect and failed to correct it). *Accord*, *Wawak v. Stewart*, 247 Ark. 1093, 449 S.W.2d 922 (1970) (buyer recovered for defective installation of air conditioning and heating elements; buyer's notification to builder with opportunity to repair sufficiently mitigated damages). *Cf.* *Pollard v. Saxe & Yolles Dev. Co.*, 12 Cal. 3d 374, 525 P.2d 88, 115 Cal. Rptr. 648 (1974) (California court adopted the UCC notice requirement, but since buyer failed to provide proper and timely notice to the builder, he was denied any recovery for latent defects in the building).

Second, the right of action under this implied warranty arose only after delivery of the deed. *See, e.g.*, *Hartley v. Ballou*, 286 N.C. 51, 209 S.E.2d 776 (1974) (purchaser recovered damages for flooded basement after deed passed and possession taken).

Finally, courts found implied warranties only under limited circumstances. One such circumstance was the failure of a house to protect its inhabitants from the elements. *See, e.g.*, *Utz v. Moss*, 31 Colo. App. 475, 503 P.2d 365 (1972) (water damage caused by rain because of improper grading); *Crawley v. Terhune*, 437 S.W.2d 743 (Ky. 1969) (structural defects caused basement flooding); *Weeks v. Slavick Builders, Inc.*, 24 Mich. App. 621, 180 N.W.2d 503 (1970) (court found implied warranty that roof would protect home's inhabitants); *Hartley v. Ballou*, 286 N.C. 51, 209 S.E.2d 776 (1974) (basement flooding due to inclement weather). Other problems constituting breach of warranty include structural conditions which render the house dangerous, and latent defects in the utilities. For cases dealing with structural damage, *see, e.g.*, *Cochran v. Keeton*, 287 Ala. 439, 252 So. 2d 313 (1971) (fire damage); *Carpenter v. Donohoe*, 154 Colo. 78, 388 P.2d 399 (1964) (structural defects caused cave-in of walls to such an extent that purchasers had to move out); *Wright v. Creative Corp.*, 30 Colo. App. 575, 498 P.2d 1179 (1972) (failure to install safety glass caused injury to infant); *Vernali v. Centrella*, 28 Conn. Supp. 476, 266 A.2d 200 (1970) (use of flammable material to construct fireplace); *Centrella v. Holland Constr. Co.*, 82 Misc. 2d 537, 370 N.Y.S.2d 832 (Suffolk County Dist. Ct. 1975) (oak floors buckled); *Humber v. Morton*, 426 S.W.2d 554 (Tex. 1968) (fire burned house down due to defective construction); *Klos v. Gockel*, 87 Wash. 2d 567, 554 P.2d 1349 (1976) (requiring structural defect which rendered house uninhabitable).

For cases on defective utilities, *see, e.g.*, *Wawak v. Stewart*, 247 Ark. 1093, 449 S.W.2d 922 (1970) (liability imposed for defective construction of ductwork with impeded heating and air conditioning); *Kriegler v. Eichler Homes, Inc.*, 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (Dist. Ct. App. 1969) (defective construction of heating system); *Elderkin v. Gaster*, 447 Pa. 118, 288 A.2d 771 (1972) (builder's failure to provide potable water constituted breach of implied warranty of habitability); *Tavares v. Horstman*, 542 P.2d 1275 (Wyo. 1975) (builder installed defective septic tank causing raw sewage flow into open trench near house).

27. Under common law analysis, the construction of a home on real property was merely the creation of an appurtenance. Thus, the emphasis of the courts was on the realty, not the building. The buyer had only the limited remedy of resorting to substantial performance for defective construction. *See* notes 40-45 *infra*. Modern courts

these courts have noted the injustice of treating realty and personalty differently.²⁹ Refusing to regard house sales solely as sales of land, they consider the mass-produced house³⁰ a product inviting application of the UCC. Courts applying the UCC by analogy³¹ have employed the warranty provisions of Article Two,³² noting similarities

have recognized that the purchase of a house is an end in itself. They have noted that the transactions are two-tiered: a contract to build and a contract to convey property. *Cf.* *Pollard v. Saxe & Yolles Dev. Co.*, 12 Cal. 3d 374, 525 P.2d 88, 115 Cal. Rptr. 648 (1974) (California Supreme Court rejected this trend, noting that a house bears the same relationship to manufacturing as it does to real property).

28. *See* *Schipper v. Levitt & Sons, Inc.*, 44 N.J. 70, 207 A.2d 314 (1965). *Schipper*, an early warranty case involving a completed house, addressed the policy considerations supporting builder liability. Examining the marketing of mass-produced homes, the court noted that form contracts precluded actual negotiations for warranties. Under the court's analysis, the house purchasers were deemed victims of one-sided agreements since they were unable to reasonably inspect their new houses. The court concluded that retaining *caveat emptor* for real property, when that doctrine was no longer applicable to goods, was anachronistic and contrary to public policy. *Id.* at 82, 207 A.2d at 321. Drawing from strict liability cases, such as *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69 (1960), the court found that the strict liability theory imposed on manufacturers was also applicable to builders. *Id.* at 89-91, 207 A.2d at 324-25. *See also* *Wawak v. Stewart*, 247 Ark. 1093, 1095, 449 S.W.2d 922, 923 (1970) ("The contrast between the rules of law applicable to the sale of personal property and those applicable to the sale of real property [is] so great as to be indefensible.").

29. *See* note 28 *supra*.

30. *See* *Haskell*, *supra* note 15. Mass-produced homes are defined as those built from builder-supplied plans, *O'Dell v. Custom Builders*, 560 S.W.2d 862 (Mo. 1978), or in the builder-vendor's development, *Schipper v. Levitt & Sons, Inc.*, 44 N.J. 70, 207 A.2d 314 (1965). Purchasing under such circumstances, the buyer usually is not in the proper economic position to negotiate for warranties. Presumably, the builder's liability in a home designed on behalf of, or by the owner would be different; the purchaser is in a better bargaining position and may negotiate for warranties.

31. *See, e.g.*, *Pollard v. Saxe & Yolles Dev. Co.*, 12 Cal.3d 374, 525 P.2d 88, 115 Cal. Rptr. 648 (1974) (applying the UCC to an apartment building); *O'Dell v. Custom Builders*, 560 S.W.2d 862 (Mo. 1978) (UCC applied to defective house plans which resulted in the construction of a dangerous home); *Smith v. Old Warson Dev. Co.*, 479 S.W.2d 795 (Mo. 1972) (defective installation of floor slabs); *Casavant v. Campopiano*, 114 R.I. 24, 327 A.2d 831 (1974) (defective construction of roof); *Bolkum v. Staab*, 133 Vt. 467, 346 A.2d 210 (1975) (applied UCC to a commercial vendor who contracted out to construct homes).

32. UCC § 2-102 provides that the Code does not directly apply to realty. *Cf.* *Gable v. Silver*, 258 So. 2d 11 (Fla. 1972) (holding UCC inapplicable because a condominium is not a good within its meaning). *See also* *Gallegos v. Graff*, 32 Colo. App. 213, 508 P.2d 798 (1973). *Gallegos* examines the Article Two definitional section, § 2-105, which distinguishes goods from realty. The court took notice of the language in the official comments to § 2-304 that "[his Article . . . do[es] not affect

between a house and a good.³³ In each instance, the consumer needs protection from defective manufacturing.³⁴

the transfer of realty . . . since [it] fall[s] outside the scope of this Article [and] is left to the courts and other legislation." *Id.* at 214, 508 P.2d at 799.

Although the UCC precludes its own application, courts have adopted it by analogy. This application of Article Two to areas other than sales is not unusual. For example, one commentator dealing with the analogy problem notes that the use of Article Two is desirable because it provides for uniformity of treatment. Comment, *The Extension of Article 2 of the Uniform Commercial Code to Leases of Goods*, 12 TULSA L.J. 556 (1977). Furthermore, under this rationale, the specific application of the UCC by analogy to real property does not seem strained. The propriety of the analogy is especially evident when the UCC is compared with the UNIFORM LAND TRANSACTION ACT (West 1975) [hereinafter cited as U.L.T.A.]:

UCC § 2-314 IMPLIED WARRANTY; MERCHANTABILITY; USAGE OF TRADE:

- 1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. . . .
- 2) Goods to be merchantable must be at least such as
 - a) pass without objection in the trade under the contract description; and
 -
 - c) are fit for the ordinary purposes for which such goods are used. . . .

U.L.T.A. § 2-309 IMPLIED WARRANTY OF QUALITY:

- b) A seller, . . . in the business of selling real estate impliedly warrants that the real estate is suitable for the ordinary uses of real estate of its type and that any improvement made or contracted for by him will be:
 - 1) free from defective materials; and
 - 2) constructed in accordance with applicable law, according to sound engineering and construction standards. . . .

While the U.L.T.A. has not been adopted, a brief examination of the statute reveals that its drafters found the UCC an appropriate model for a real property statute. The language of the statute reflects the recognition of the similarity of the sale of houses and goods.

Judicial applications of the UCC to real property reveal at least two clear problems. First, it is difficult to determine whether the courts have applied all or only part of Article Two in response to legislative inaction regarding house purchaser protection. Frequently, where courts announce, as in *Pollard*, that they are applying the warranty provisions they do not clarify whether other related provisions also apply. This is particularly important in regard to § 2-316, which provides for disclaimers. *See, e.g., Griffin v. Wheeler-Leonard & Co.*, 290 N.C. 185, 225 S.E.2d 557 (1976) (court addressed the disclaimer problem, stating that a builder may disclaim if he complies with UCC notice requirement). Further, the courts have not clearly stated which UCC warranty provisions they are using. This omission leaves the warranty standard undefined. *See also* note 66 *infra*.

33. *See* note 31 *supra*.

34. This erratic development of the implied warranty of habitability has raised some analytical problems for the courts. The most perplexing problem is whether to characterize the warranty action as contract or tort. For instance, in *Smith v. Old Warson Dev. Co.*, 479 S.W.2d 795 (Mo. 1972), the Missouri Supreme Court, while

Illinois appellate decisions exemplify the conflict between the implied warranty of habitability and the older doctrines of *caveat emptor* and merger. In 1962, the court in *Weck v. A:M Construction Co.*³⁵ found an implied warranty of habitability on a new house purchased from a builder-vendor. The court followed the English Rule³⁶ because the house was purchased during construction.³⁷ A year later, however, when the same issue arose in *Coutrakon v. Adams*,³⁸ an appellate court of another district rejected *Weck*, relying instead upon the principle of *caveat emptor*. The Illinois Supreme Court granted leave to appeal *Coutrakon* on the implied warranty issue, but avoided that issue by affirming the lower court on other

looking to the UCC, concluded that the implied warranty is a hybrid of contract and tort. *Id.* at 798. Thus, this case has been cited frequently both for applying the UCC and obscuring the nature of the implied warranty of habitability.

If the court classifies a warranty as tort, the doctrine of merger would not be a bar to recovery. Since merger is concerned solely with contractual obligations, the implied warranty would, in effect, survive delivery of the deed. Furthermore, a court's classification of warranty under tort theory would circumvent the privity requirement that is indigenous to contract. See *Kriegler v. Eichler Homes, Inc.*, 269 Cal. App. 2d 224, 74 Cal. Rptr. 749 (Dist. Ct. App. 1969) (granting recovery to a purchaser who had no privity with the builder-vendor). But see *Utz v. Moss*, 31 Colo. App. 475, 503 P.2d 365 (1972) (the court upheld the privity requirement except where builder-vendor sold to a realtor for resale).

The statute of limitations problem is similar. States have different statutes of limitations for negligence, strict liability, other torts, and contracts. *E.g.*, CONN. GEN. STAT. § 52-573 to 598 (1979). (§ 52-577 for tort—3 years; § 52-584 for negligence—2 years from date injury sustained is discovered, but no more than 3 years from act or omission; § 52-577(a) for strict liability—8 years maximum; § 52-576 for contract—6 years). The problem is further complicated by analogies to UCC § 2-725, the statute of limitations provision, which provides four years. Thus, the classification of warranty as tort or contract creates various analytical complications. See generally Comment, *Implied Warranty of Habitability—Contract or Tort*, 31 BAYLOR L. REV. 207 (1979).

35. 36 Ill. App. 2d 383, 184 N.E.2d 728 (1st Dist. 1962).

36. *Id.* at 390, 184 N.E.2d at 731-32. See note 20 and accompanying text *supra* for an explanation of the English Rule and its rationale.

37. The *Weck* court had to resolve a hotly contested issue. Even if the defendant conceded an implied warranty, the builder contended that the house was complete when purchased. The court found otherwise. *Id.* at 388, 184 N.E.2d at 729.

Two years later, the same court faced a similar implied warranty case also dealing with the merger problem. In *Brownell v. Quinn*, 47 Ill. App. 2d 206, 197 N.E.2d 721 (1st Dist. 1964), the court followed the *Weck* decision. Because some work was performed after delivery of the deed, the court found there was no merger.

38. 39 Ill. App. 2d 290, 188 N.E.2d 780 (3rd Dist. 1964), *aff'd on other grounds*, 31 Ill. 2d 189, 201 N.E.2d 100 (1964).

grounds.³⁹ Such action left the status of the warranty uncertain. Consequently, some purchasers who discovered defects in their new houses brought suits on a theory of substantial performance⁴⁰ rather than implied warranty.⁴¹

Under contract law, the doctrine of substantial performance prevents a house buyer from avoiding a building contract when the builder delivers a house in *substantial* compliance with the agreement.⁴² An Illinois builder need not deliver a perfect house to substantially perform; he must only act in good faith and in a workmanlike manner.⁴³ Despite acceptance of the theory, however, the doctrine has met with difficulties in its application. As there is no formal rule defining what constitutes substantial performance, the trier of fact faces the difficult problem of determining whether the

39. 31 Ill. 2d 189, 201 N.E.2d 100 (1964). The court avoided the issue of implied warranty. Instead, it found the evidence was insufficient to support the jury verdict. *Id.* at 191-92, 201 N.E.2d at 101.

In *Coutrakon*, the purchaser sued, alleging that the builder improperly installed a boiler, resulting in fire damage. *Id.* at 190, 201 N.E.2d at 101. In absence of affirmative proof of the builder's negligent conduct, the court would not impose liability. *Id.* at 191, 201 N.E.2d at 101.

40. *See, e.g.*, *Broncata v. Timbercrest Est., Inc.*, 100 Ill. App. 2d 49, 241 N.E.2d 569 (1st Dist. 1968). Under warranty type facts, the court permitted the purchasers to recover for deficiencies in construction. *Id.* at 55, 241 N.E.2d at 572-73. *Cf.* *Ehard v. Pistakee Builders, Inc.*, 111 Ill. App. 2d 227, 250 N.E.2d 1 (2d Dist. 1969). The buyer based this action on implied warranty. The builder constructed the heating system improperly. The appellate court, criticizing the supreme court for avoiding the warranty issue, decided the case by construing the contract language to provide for the requested relief, likewise avoiding the warranty issue. *Id.* at 232-33, 250 N.E.2d at 3-4.

41. In the five years following *Coutrakon*, only one suit under the implied warranty theory reached the appellate level. That case, *Narup v. Higgins*, 51 Ill. App. 2d 102, 200 N.E.2d 922 (5th Dist. 1964) (abstract opinion), followed *Coutrakon* in denying the existence of the warranty on the sale of a new home.

42. *See* *Watson Lumber v. Mouser*, 30 Ill. App. 3d 100, 333 N.E.2d 19 (5th Dist. 1975). If the owner received substantially what he bargained for, he must pay for it. The builder must: 1) not willfully depart from the contract, and 2) make a good faith performance. The buyer's duty to pay arises when the builder-vendor delivers the house, even if there are technical, unimportant defects. *Id.* at 105, 333 N.E.2d at 24. *Cf.* *Brewer v. Custom Builders Corp.*, 42 Ill. App. 3d 668, 356 N.E.2d 565 (5th Dist. 1976) (substantial performance requires enjoyment of benefits by the buyer). *See generally* 3 A. CORBIN, CONTRACTS §§ 700-12 (1960); S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 842 (3rd ed. 1962). *See also* *Nordin Constr. Co. v. City of Nome*, 489 P.2d 455 (Alaska 1971) (action to recover damage for alleged failure of substantial performance); *Collyer, Building Contracts and Substantial Performance in New York*, 18 INTRA. L. REV. OF N.Y.U. 103 (1963).

43. *See* note 40 *supra*.

builder has met this standard.⁴⁴ Further, the need for an implied warranty of habitability arose to protect buyers after they had accepted their houses because the substantial performance doctrine was inapplicable after acceptance.

Illinois law first acknowledged an implied warranty of habitability in real property in 1922. In that year, the Illinois Supreme Court found an implied warranty of habitability on apartments, basing its decision on consumer protection grounds.⁴⁵ All but one of the appellate districts that have since confronted the implied warranty issue on new houses have recognized that such a warranty exists.⁴⁶ Prior to *Petersen*, however, they failed to articulate the substance and limits of the warranty.⁴⁷

44. *Brewer v. Custom Builders Corp.*, 42 Ill. App. 3d 668, 673, 356 N.E.2d 565, 570 (5th Dist. 1976). See *Butkovich & Sons, Inc. v. State Bank of St. Charles*, 62 Ill. App. 3d 810, 379 N.E.2d 837 (2d Dist. 1978) (suit to foreclose mechanic's lien); *Watson Lumber Co. v. Guennewig*, 79 Ill. App. 2d 377, 226 N.E.2d 270 (5th Dist. 1967) (action by contractor for unpaid balance due); *Dittmer v. Nokleberg*, 219 N.W.2d 201 (N.D. 1974) (action to recover damages from contractor for breach of contract). See also Comment, *Substantial Performance: A Legal Breach of Duty*, 9 LINCOLN L. REV. 275 (1974-75).

Where the jury finds substantial performance, the builder is entitled to receive the contract price less damages for deficiencies. If the jury finds inadequate performance, under certain circumstances the buyer may rescind. See generally 3 A. CORBIN, CONTRACTS §§ 707-12 (1960). See also D. DOBBS, REMEDIES § 12.14 (1973).

Courts have distinguished cases involving construction on the builder's property from those involving property of the buyer. In the former case, as in *Petersen*, courts are likely to grant rescission. The builder has not lost his labor and materials. In the latter case, granting rescission would often operate as a hardship on the builder and unjustly enrich the property owner. This situation is more difficult, and the result turns on the specific facts. See S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 842, p. 167 n.4 (3d ed. 1962); D. DOBBS, LAW OF REMEDIES § 12.23 (1973). See also Collyer, *supra* note 42.

45. *Jack Spring, Inc. v. Little*, 50 Ill. 2d 351, 280 N.E.2d 200 (1972).

46. After *Narup v. Higgins*, 51 Ill. App. 2d 102, 200 N.E.2d 922 (5th Dist. 1964) (discussed in note 41 *supra*), every Illinois court that addressed the implied warranty issue found such a warranty. Even the third district, which decided *Coutrakon*, found an implied warranty of habitability in *Hanavan v. Dye*, 4 Ill. App. 2d 576, 281 N.E.2d 398 (1972). Yet the *Hanavan* court refused to overrule *Coutrakon*. In a rather remarkable piece of legal thinking, the court distinguished the earlier case on geographical grounds. Since *Coutrakon*, there was a redistricting of appellate courts. As a result, the *Hanavan* property, formerly in another district, was not subject to the earlier decision. See also *Conyers v. Molloy*, 50 Ill. App. 3d 17, 364 N.E.2d 986 (4th Dist. 1977); *Goggin v. Fox Valley Constr. Co.*, 48 Ill. App. 3d 103, 365 N.E.2d 509 (1st Dist. 1977); *Elmore v. Blume*, 31 Ill. App. 3d 643, 304 N.E.2d 431 (3rd Dist. 1975); *Garcia v. Hynes & Howe Real Estate, Inc.*, 29 Ill. App. 3d 479 (3d Dist. 1975).

47. See, e.g., note 12 *supra*.

In *Petersen v. Hubschman Construction Co.*, the Illinois Supreme Court faced the dual issues of implied warranty of habitability and substantial performance. The court, following the modern trend, explicitly found an implied warranty in the sale of new houses to individual purchasers, irrespective of the extent of completion.⁴⁸ Noting that the lower courts had difficulties in defining this warranty,⁴⁹ the court resolved the definitional problem by adopting the warranty language of the UCC.⁵⁰ The court recognized implicitly the UCC's effectiveness in the law of sales and therefore felt its application to mass-produced houses would also be advantageous.

Once defined, the *Petersen* court uniquely applied the implied warranty. Other courts had traditionally found an implied warranty of habitability cause of action only when defects appeared following completion of the house and passing of title.⁵¹ Under the *Petersen* analysis, however, the implied warranty is not simply a curative cause of action, but also serves as a condition precedent of an executory contract.⁵² To prove substantial performance, a builder-vendor must prove he has fulfilled the requirements of the implied warranty.

The *Petersen* court's combination of substantial performance and the implied warranty of habitability creates a significant innovation in building contract law.⁵³ In previous substantial performance suits, courts were unable to clearly articulate a standard of performance; decisions turned solely on the facts of each case.⁵⁴ By making the implied warranty an element of substantial performance, the Illinois Supreme Court has delineated a workable standard of proof for substantial performance. If the builder-vendor complies with the war-

48. 76 Ill. 2d 31, 42, 389 N.E.2d 1154, 1159 (1979). See notes 23-25 and accompanying text *supra*.

49. The court held that the implied warranty was limited to latent defects which would interfere with its intended use. The court would not apply the warranty for cosmetic defects. 76 Ill. 2d at 42, 389 N.E.2d at 1159. See note 12 *supra*.

50. The court referred to UCC § 2-314 and 2-315, but its use of the UCC analog, "a warranty that the house . . . would be reasonably suited for its intended use," could be construed to make either section applicable. 76 Ill. 2d at 41-42, 389 N.E.2d at 1158-59. But see note 55 *infra*, for a criticism of the court's lack of clarity.

51. See note 26 *supra*.

52. 76 Ill. 2d at 42, 389 N.E.2d at 1159.

53. No other decision recognizes the implied warranty of habitability before the transfer of title. The *Petersen* case thus ties together the law of implied warranty and substantial performance, making equivalent defects discovered before and after transfer of title.

54. See notes 42-44 and accompanying text *supra*.

ranty provisions of Article Two, there is substantial performance and the buyer cannot rescind.⁵⁵ The court, in effect, has established guidelines to govern the builder's conduct.

The *Petersen* decision logically and justifiably extends the implied warranty of habitability to the doctrine of substantial performance. By using the UCC the court objectified a standard once considered problematic.⁵⁶ *Petersen* realistically reflects the similarity between mass-produced houses and goods, ignoring irrelevant, technical distinctions.⁵⁷ The opinion, however, neglects to identify the applicable UCC warranty provision.⁵⁸ This omission may cause problems in the harder cases because the standards of the relevant provisions differ.⁵⁹ Nevertheless, the use of any UCC standard to define warranty

55. 76 Ill.2d at 43, 389 N.E.2d at 1160. The court noted the limit of its decision. The Petersens agreed to purchase a home built on Hubschman's land. The court expressly declined to decide whether the same remedy would apply on land provided by the purchaser. In light of the broad implications of the decision, the court's refusal to resolve the problem suggests that it might decide against the purchaser in that instance. Yet, such a conclusion may undermine the essence of the decision. A house built on the buyer's land is no easier to inspect than one built on land of the seller. The sole justification for the court's choice of remedy may be the prevention of unjust enrichment. Thus, where a builder constructs on the buyer's land and fails to substantially perform, the court might provide only damages. See notes 42-44 and accompanying text *supra*.

56. See notes 42-44 and accompanying text *supra*.

57. 76 Ill.2d at 40-41, 389 N.E.2d at 1157-58.

58. See note 50 *supra*.

59. The relevant provisions are as follows:

§ 2-314. IMPLIED WARRANTY; MERCHANTABILITY; USAGE OF TRADE

1) Unless excluded or modified (Section 2-316), a warranty that the goods shall be merchantable is implied in a contract for their sale if the seller is a merchant with respect to goods of that kind. Under this section the serving for value of food or drink to be consumed either on the premises or elsewhere is a sale.

2) Goods to be merchantable must be at least such as

- a) pass without objection in the trade under the contract description; and
- b) in the case of fungible goods, are of fair average quality within the description; and
- c) are fit for the ordinary purpose for which such goods are used; and
- d) run, within the variations permitted by the agreement, of even kind, quality and quantity within each unit and among all units involved; and
- e) are adequately contained, packaged, and labeled as the agreement may require; and
- f) conform to the promises or affirmations of fact made on the container or label if any.

§ 2-315. IMPLIED WARRANTY; FITNESS FOR PARTICULAR PURPOSE

Where the seller at the time of contracting has reason to know any particular

and substantial performance will clarify the rights and liabilities of both builders-vendors and purchasers.⁶⁰

The *Petersen* court advanced the trend of affording greater consumer protection for the new house purchaser. In finding a warranty of habitability, and using it as an element of substantial performance, the court extended the protection provided the purchaser both before and after delivery of the deed. The court, moreover, by merging the two theories and looking to the UCC, clarified the responsibilities of the concerned parties. For other jurisdictions, *Petersen* is an example of a case whereby future litigants, both builders and buyers, will benefit.

Mark Fogel

purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is, unless excluded or modified under the next section, an implied warranty that the goods shall be fit for such purpose.

The § 2-314 provision prescribes an objective test. If, for example, a house would "pass in trade," a court might reject a claim of warranty. Under § 2-315, however, a litigant must prove reliance or lack thereof. If the § 2-315 requirement applies, the builder would have an added defense if the purchaser is knowledgeable or in the trade. Thus, if the buyer was knowledgeable regarding the building trade, a court might have a difficult time determining which standard to apply. The standard selected is crucial in determining substantial performance.

60. *Petersen* was followed in *Posner v. Davis*, 76 Ill. App. 3d 638, 395 N.E.2d 133 (1979).