Case 3: Caveat Emptor? The Consideration of Economic, Ethical, and Biblical Perspectives in Determining Legal Alternatives

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Introduction

Attorney Liz Ryan reviewed the file on her desk in her Denver office. She had a scheduled meeting with John and Susan Jacobson in an hour to review their legal options regarding the faulty construction of their home. This April meeting was a follow-up to the initial meeting held in January 2002. The Jacobsons wanted a solution that would preserve their long-term financial security and honor their Christian values.

Background

The Jacobsons were newcomers to Denver, having relocated in January 2001 when John took early retirement from the large Midwest university where he had taught strategic planning and marketing. In addition to John's teaching career, John and Susan offered strategic planning and marketing services through a consulting business they owned.

Before John's retirement, the Jacobsons began working with a Christian nonprofit organization in Denver to develop a strategic plan for the ministry. After 18 years with one product, the ministry was in the process of launching three new products and entering into additional foreign markets. John and Susan had traveled to Denver multiple times over the period of a year and spent six weeks during the summer of 2000 finalizing the plan for the nonprofit and beginning the implementation process. During those six weeks, Mike and Shelia Brown, co-founders of the ministry, asked John and Susan to join the ministry's staff to lead the implementation process. The Jacobsons agreed to accept the position as full-time volunteers beginning January 1, 2001.

Purchasing A Home

The previous summer, August 2000, John and Susan started looking for a home to purchase. Upon Mike Brown's recommendation, they used Shawn Rook, a realtor from a major national firm, as a real estate agent. Shawn had completed a course with the nonprofit ministry, and his wife had worked for the ministry. During their discussions of housing needs, Shawn stressed that the one concern in the southwestern suburbs of Denver was bentonite in the soil, but he also stressed that he knew the area intimately and would make sure they found a house with no problems.

After looking at a variety of homes, the Jacobsons found a beautiful one-year-old townhouse just two miles from the offices of the nonprofit. It was a one-story home with a basement, and except for a bathroom, the basement was unfinished.

A Home Inspection

Having bought many houses in the past, the Jacobsons had the house inspected prior to purchase. The purpose of a home inspection is to make sure a home and its systems (such as plumbing and electrical) are structurally sound. Upon the recommendation of Shawn, John and Susan retained a licensed home inspector, Dallas Johnson, to evaluate the condition of the house. Shawn stressed that some real estate agents did not like Dallas because he tended to find too many problems that stopped sales.

During the August 2000 inspection, John and Susan visited, and Dallas reported that he carried a $1,000,000 malpractice insurance policy. He also invited the Jacobsons to try his church when they arrived in Denver. His inspection determined that the clearance under the basement floor was 15 inches less than it should be, but he checked with zoning and reported that it was legal. Since the sale was conditional on the home inspection and there was a five-day window to complete the inspection, a verbal report was given to the Jacobsons. As Dallas shared his findings, he stated that there were no serious flaws in the house, so the Jacobsons paid $225,000 for the property and closed in early September 2000. Several weeks later his written report arrived, but since the Jacobsons already owned the house, they did not bother to read it.

The Bentonite Issue

Houses across the United States are built on land that contains different types of soils. All soils expand, contract, and move over time in response to moisture changes or freezing and thawing. This leads to differences in construction practices for different regions of the United States. In Denver, areas of the city have soil with high levels of bentonite. This is an important consideration because bentonite is extremely expansive and moves more than other soils (bentonite is the clay used to make clumping cat litter).

Therefore, houses built on bentonite soil employ a unique basement and foundation design. First, a number of cement columns are sunk to bedrock, many feet below the ground's surface. Then the concrete basement walls are suspended on the columns. By city building code, there must be eight inches of air below the basement walls to allow the bentonite to expand.

Unlike the concrete basement floors of the Midwest, basement floors over bentonite are similar to the first floor of a two-story house. The basement floor consists of stringers fastened to the basement walls and covered with plywood. They do not rest on the ground below them, and in fact, by code, there is supposed to be an 18-inch void below the floor to provide room for the bentonite to expand. If the home is wide, there is also an I-beam to support the middle of the basement floor similar to upper-floor supports. In summary, the city building code requires an eight-inch gap below the basement walls and an 18-inch gap below the basement floor, which is attached to the walls.

Problems at Home

Hints of a Problem

For the four-month period from September through December 2000 before the Jacobsons moved to Denver, a couple from the nonprofit ministry house-sat. When the Jacobsons arrived at their new home on January 1, 2001, the housesitters told them that the basement toilet was not working because it had risen off the floor. To solve the problem, a few floorboards were removed and the dirt that was pushing the toilet off the floor was removed.

By May 2001, the Jacobsons started noticing a few cracks appearing in the walls throughout the house. By fall, more cracks appeared and the existing cracks got larger. Further, the corner beads on the sheet rock

were shifting, creating hairline cracks along all of the corners in some of the rooms. Cement work also showed signs of shifting as both the garage floor and the sidewalks were buckling. All of the interior and exterior doors started sticking. In fact, before long Susan wasn't strong enough to open or close the front door.

The Jacobsons were not the only owners in the townhouse association with sticking doors. They learned that a neighbor suffering chest pains received delayed medical help because when paramedics arrived, they could not get the front door open because of the pressure from the house moving. The paramedics couldn't enter the house through the garage entrance because they couldn't get their equipment through the sharp turn inside the door. In the end, to provide medical attention, the medics were forced to call the fire department to go through the front door with fire axes.

An Existing Class-Action Lawsuit

At the Fourth of July party that summer, the Jacobsons were startled when neighbors asked if they had joined the class-action lawsuit. A class-action lawsuit against the primary contractor had been filed in September 1999, almost a year before the Jacobsons purchased their home.

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The neighbors told them that during the fall of 2000, the four months they owned but did not occupy the home, everyone in the townhouse association had been notified by mail of a class-action lawsuit against the developer who designed and built the homes. The law firm that sent the notice had inspected a number of the townhouses. They suspected that the developer had not designed or constructed the townhouses to take bentonite into account. The professional engineer they hired had found, among other flaws, that the houses had not been designed nor built to withstand the pressure of expanding soil, and this was causing serious problems to a number of homes and would eventually cause problems to all the homes. The law firm indicated that the townhouses did not meet building code requirements or sound engineering specifications. In the law firm's mailing, townhouse homeowners were advised they had three alternatives concerning the class actions:

1) if damage to their home was significant, they could become named plaintiffs and would have an opportunity to collect a significant amount towards their actual damages;

2) they could remain members of the class but not become named plaintiffs, in which case they would share in the award, but the amount would be smaller and would probably total between $3,000 to $8,000 for each class member; or

3) those individuals who felt they had no damages could opt out of the case entirely and collect nothing.

However, by the time the Jacobsons learned of the lawsuit, the closing date for becoming named plaintiffs had passed. Only option 2, remaining in the suit as class members, was available, unless they decided to hire a lawyer to petition the court to be allowed to join the lawsuit. Almost 100 homes were involved in the class-action suit, and damage estimates totaled more than $8 million.

The Extent of the Problem

In March 2002, the Jacobsons hired a professional engineer who inspected their home and found significant damage. He reported that inadequate drainage allowed too much water into the soil around and under the house. As the soil became saturated, the bentonite soil expanded by moving upward into the voids under the floor and inward by placing additional pressures on the exterior basement walls.

A few of the engineer's recommendations to solve the problem included: building counterfort walls to support the basement walls and keep them from collapsing ($45,000); excavating under the basement floor to remove dirt that was forcing the floor upward ($65,000); removing sidewalks and the garage floor to level them and to install proper drainage under them ($35,000); repairing sheet rock and other cosmetic applications ($10,000); and repairing the deck and putting columns under it ($8,000). The estimate for the repairs totaled $200,000.

Later in early April, Susan woke to a loud cracking sound in the middle of the night. She thought a wall had collapsed and got out of bed to check. Finding no problem upstairs, she went back to bed.

About a week later, another engineer inspected the house and, after a minute in the basement, called the Jacobsons down. When they joined him in the basement, they were alarmed by what they saw. A steel post supporting the I-beam had been pushed up by the rising floor, and its top had twisted like a candy cane. This caused the I-beam supporting the middle of the main floor of the home to twist more than 30 degrees, making it resemble a licorice twist.

The professional engineer employed by the Jacobsons immediately called a reconstruction company and asked them to make emergency repairs. John and Susan could only hear his end of the conservation, in which he told the reconstruction company, "You're not hearing me. I want you here now – tomorrow morning is not good enough." At that point, John and Susan were not concerned only about a wall collapsing but rather about their entire house falling into the basement.

Emergency repairs were completed that evening, and a few days later, emergency excavation of the basement started. When the basement floorboards were removed, the contractor discovered that the entire area that was supposed to be empty was filled with bentonite, which was pushing the floor up. There was no 18-inch void as required by law. It was clear that the contractor had not followed the city building code pertaining to bentonite. The I-beam under the basement floor had been pushed up 1.25 inches off the cement columns. It had in turn driven the steel post between the floors up, causing it to bend over at the top, twisting the upper I-beam.

Two days into the project, the foreman immediately stopped work when he found raw sewage from the basement toilet. The sewer line had been crushed between the bentonite and the floor. Later the crew returned with bio-security equipment to ensure they were not infected by the raw sewage. The reconstruction company also found evidence of earlier repairs to the sewer pipe, and it appeared that the flooring had been removed to facilitate the repairs. This indicated that the previous owners of the townhouse had knowledge of the problems the house was facing but did not reveal it in their homeowners' disclosure.

At this time, John and Susan read the home inspection report, and it contained several statements that Dallas never shared with them in his verbal report when they purchased the house. One was a recommendation that they hire a professional engineer to inspect the basement. Hiring an engineer would take time, and Dallas knew the timeline on the Jacobsons' purchase agreement. It appeared that he didn't want them to know this until after the house closed.

At this point, the Jacobsons contacted Attorney Liz Ryan for legal advice for a follow-up meeting. Liz did not work for the firm bringing the class-action lawsuit.

A Biblical Perspective

Property Rights

The Bible clearly identifies the concept of property rights (private ownership to enjoy the use and benefit of an item). Individuals can own their homes, land, the fruits of their land, and livestock. When a neighbor damages or steals another's property, the neighbor is held accountable. Exodus 22 establishes this accountability as punishment by restitution rather than vengeance. Leviticus 6:1-5 creates a general guideline for restitution for ill-gotten gain. Anything acquired through theft, extortion, or lying must be returned to the owner with an addition of a fifth of the value of the item.

Exodus 22 establishes specific restitution guidelines for agricultural property stolen or damaged. If a man steals an ox or a sheep and slaughters it or sells it, he must pay back five head of cattle for the ox and four sheep for the sheep. If the stolen animal is found alive in his possession – whether an ox or donkey or sheep – he must pay back double. If a man's grazing livestock strays into another man's field or vineyard, he must make restitution from the best of his own field or vineyard. If a man starts a fire that damages another's property, he must make restitution. Through Old Testament law, a property owner could expect restitution for possessions damaged or stolen.

A Code of Conduct for Believers

Concerning lawsuits, the Bible distinguishes between believers and non-believers. In Matthew 18:15-20, Jesus lays out the procedure for settling a dispute between two believers. This process involves several steps, ceasing at the point that the injuring party listens to the complaint. The courses of action are:

1) Approach the other party privately and show him his fault.

2) Return with one or two others as witnesses, as every matter may be established by the testimony of two to three witnesses.

3) Tell it to the church.

4) If the injuring party refuses to listen throughout the process, then he will lose the protection of being a believer and is to be treated as a non-believer.

In I Corinthians 6:1-7, Paul admonishes the Corinthians for taking their personal disputes to the courts of unbelievers. It is useful to understand the situation that led to this letter by Paul. Clarke (1993) suggests that the secular leadership customs in the city of Corinth had influenced the perceptions and practices of leadership in the Christian community. This secular type of leadership valued status, patronage, and benefaction. It resulted in contests of eloquence and practices of gift-giving to cultivate and maintain friendships.

More specifically, individuals of high social standing were using the secular legal system to elevate their own status and reputation in the community. Chow (1992) suggests that those involved in the lawsuits were more interested in material gain than spiritual maturity. These individuals were using the courts to their own purpose and gain, neglecting the more important matters of the law – justice, mercy, and faithfulness. Jesus warns against this in Matthew 23:23. Leviticus 19:15 warns believers not to pervert justice but to judge our neighbors fairly.

So, the Corinthians were guilty of using the legal system for their own personal gain and not following the process God set for settling disputes.

Another resource available to the Christian community is Peacemakers Ministries. This organization's mission is equipping and assisting Christians and their churches to respond to conflict biblically. The Institute for Christian Conciliation, a division of Peacemaker Ministries, provides formal mediation and arbitration for Christians through certified mediators and arbitrators.

Recourse When Issues Cannot Be Settled In the Church

Examining history, it is found that religion, the church, and church policy can be and has been greatly influenced by outside economic forces. More specifically, business institutions can and have impacted church policy (Pope, 1965). Out of fear of losing their congregation and/or financial support, churches have supported management in management/labor disputes, opposed racial integration, and even justified racial segregation.

When we look at justice within the church, the above suggests that when the church resolves inner conflicts, it does so in a traditional manner. These results may be at the expense of the weak/poor, if the person in the wrong is financially important to the church.

Injustices are not always the result of economic motivation. In addition, the church may have strategies to deal with misdeeds that are different than how the legal system would proceed. Not that the church condones illegal behavior. For example, to strengthen and heal a family, a pastor might use counseling to deal with a situation of abuse, whereas the legal system might remove a family member from the home.

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Taking a wrong to court can speed up justice and sometimes help move/update the church's position on an issue. Exodus 22 states that when two parties have a dispute that can't be settled and a wrong has been committed, the parties should take the case to a judge.

When this is the case, we are instructed as to how to behave in court. Exodus 23:1-2 suggests that we are not to help a wicked man by being a malicious witness, and we are not to pervert justice by siding with the crowd. In addition, we must present truthful testimony.

Alice Curtis (2001) suggests that Christian lawsuits should be rare and should only proceed after taking the following steps:

1) Prayerful self-examination that is not tainted by anger over the other party's actions

2) Counsel from a trusted and neutral advisor

3) Genuine attempts at resolution using the principles laid out in Matthew 18

4) A determination that the lawsuit can be handled with integrity and will not tarnish one's Christian witness

Possible Legal Recourse

Who Is Liable?

As John and Susan relaxed on their crooked deck drinking coffee, they recognized that they faced a very serious legal problem. The $200,000 to repair their home was a big loss that would cut into their life savings significantly. They had a number of decisions to make. They discussed the alternative courses of action that Liz Ryan had suggested.

In hindsight, the purchase of the townhouse was almost a comedy of errors. The Jacobsons recognized they might have been careless in several decisions. Further, they thought they had been too slow to recognize the problem. They asked themselves, "How much of the loss is our responsibility?" They also thought about Shawn and Dallas, who were both Christians but belonged to churches, as did the Jacobsons, that did not participate in formal conflict resolution as the Peacemakers offered.

In addition, there seemed to be problems with most of the parties who had been involved with the sales transactions or with the townhouse itself. Examining liability, there were several parties who might be held responsible:

1) The previous homeowners. Two seemingly sweet, elderly widows on fixed incomes sold them the townhouse. While they seemed very nice, the Jacobsons wondered why they had not told them about problems with townhouses in the association. Surely they knew about the lawsuit and were legally required to disclose the class action lawsuit on the homeowners' disclosure form. They hadn't done so. And the Jacobsons also knew that the widows had repaired the basement already. The Jacobsons were advised that their out-of-pocket costs were likely to total $25,000 for expert witnesses and other costs. They wondered if they could win and, if they won, how much the sisters could pay.

2) The home inspector. While Dallas, the home inspector, probably had not intentionally misled them, the Jacobsons felt that he had not disclosed a very critical recommendation during the verbal portion of his report. In fact, John had called Dallas three times to specifically check on his recommendations regarding the space between the soil and the basement floor. Not once did he suggest a problem. John was very frustrated by the difference between the oral and written reports. Liz had advised the Jacobsons that they would have to sue Dallas and that his insurance company would defend him and pay any judgment up to the policy limits. While the insurance ensured that a judgment could be paid, insurance coverage cannot be disclosed during a trial. Liz had advised them that the out-of-pocket costs of bringing the suit were likely to total about $25,000.

3) The real estate agency. The realtor, Shawn, failed to deliver on his promise to help them find a house with "no problems." While his promise may have been only sales talk, surely he knew about the bentonite problem in the development. If not, a few quick phone calls should have revealed the problem. Had Shawn done his job? Surely he could have discovered the class action lawsuit underway in the development. The Jacobsons wondered if Shawn had insurance. Again, they had been advised that the out-of-pocket costs to sue the realtor would be about $25,000.

4) The builder. The developer who designed and built the townhouses seemed to have made a number of mistakes in designing and constructing the townhouse. The home had inadequate drainage, and the basement was not built to city code for a home built on bentonite. If the Jacobsons were to sue the builder, they had two options:

a) Joining the class action suit as named defendants. After contacting the attorneys handling the class action lawsuit, Liz found out that it looked likely that the case would be delayed, thus allowing the Jacobsons to file an appeal to become named plaintiffs. However, this would be expensive and without any guarantee that the judge would grant their petition. The petition and expert witnesses were anticipated to cost $6,000. (The plaintiff's law firm had provided much of the money to pay the up-front costs).

b) Bring an independent suit. The Jacobsons could pursue the case on their own through their own lawyer, and Liz indicated her willingness to work with them. If they pursued this alternative and they either won or settled their lawsuit before the class-action suit, their judgment or settlement would be first in line against the contractor's assets. However, they would be responsible for the cost of trial, including expert witnesses, which could run to $25,000.

What Should be the Jacobson's Goal?

The Jacobsons thought about their goal. What was the purpose of the lawsuit? Should they attempt to get back what they had paid for the home ($225,000)? Housing in Denver had appreciated substantially during the intervening two years, and their home was now worth about $265,000.

- Should their goal be to break even and get the $225,000 they had paid for their home?
- Should they focus on trying to get a fair market value for their home?
- Should they seek damages for the stress and anxiety that the situation has inflicted on them?
- Should they seek punitive damages to teach the builder a lesson?
- Should they attempt to get as much money as possible to help them retire?

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APPENDIX A
Possible Legal Issues

Colorado Consumer Protection Act (CCPA)

The purpose of the CCPA is to control deceptive trade practices in order to prevent fraud against consumers. Its provisions apply to the sale of real estate to consumers. The CCPA provides (actual language of the statute):

A person engages in a deceptive trade practice when, in the course of his business, vocation, or occupation, he:

a) Knowingly makes a false representation as to the source, sponsorship, approval, or certification of goods, services, or property.

b) Knowingly makes a false representation as to the characteristics … of services or property …

c) Represents that goods, food, services, or property are of a particular standard, quality, or grade … if he knows or should know that they are other.

d) Fails to disclose material information concerning goods, services, or property which information was known at the time of an advertisement or sale if such failure to disclose was intended to induce the consumer to enter a transaction.

The CCPA provides that a person found to have engaged in deceptive trade practices will be liable for actual damages or $500. The judge may award treble damages if the defendant engaged in "bad faith" conduct.

False Representation

False representation, which is called misrepresentation or fraudulent misrepresentation in some states, is an intentional tort. Intentional torts are civil, as opposed to criminal, wrongs. The person committing the tortuous act must have *intended* to commit the act. In other words, (s)he must know with substantial certainty what the consequences of the action will be.

A false representation of a material fact may be made orally, in writing, by conduct, or in a combination of words and conduct. A representation is falsely made when the person making the representation knows that it is false or makes it with reckless disregard for the truth. A person may also be liable for a false representation if (s)he fails to disclose material facts if (s)he has a duty to disclose those facts. Facts are material if they are important to the parties to whom they are being made. The party misrepresenting a material fact must do so with the intent that the other party will rely on the misrepresentation or omission. If the deceived party relies on the misrepresentation, the reliance must be justified. In other words, was it reasonable for this person to rely on the misrepresentation? The person must suffer damages as a result of relying on the misrepresentation, and the misrepresentation must cause the injuries.

Plaintiffs who can prove a case of false representation are entitled to damages to cover the injuries they have suffered. Because false representation is an intentional tort, courts are allowed to impose punitive damages. Punitive damages are imposed to punish the wrongdoer and to deter others from similar actions.

Negligence

Unlike intentional torts, negligence doesn't require proof that the person committing an act wishes to bring about the consequences of the act. To prove negligence, a plaintiff will have to prove the following:

1) The person committing the tort, the defendant, owed a duty of care to the plaintiff. The idea is that people may act as they wish as long as the actions don't infringe on others' interests. The typical standard is that of a *reasonable person*. The reasonable person is society's judgment of how an ordinary, prudent person would act. This person is careful, even-tempered, and honest. If the defendant is a skilled professional, the standard will be the reasonable professional in the same profession and geographical area.

2) The plaintiff will have to show that the defendant breached his or her duty.

3) The plaintiff will also have to prove that the defendant's breach of duty caused his or her injuries and that it could have been foreseen that the breach would cause the injuries.

4) Finally, the plaintiff has to show that the law recognizes the injury. These injuries include damage to person or property.

A plaintiff injured by a defendant's negligence is entitled to damages to compensate for his or her injuries. If the plaintiff has been negligent and his or her negligence is partially responsible for the injuries, the damages may be reduced. Punitive damages are not appropriate in negligence cases.

Negligent Misrepresentation

Negligent misrepresentation is another tort. Like negligence actions, it requires proof of a duty, a breach of duty, causation, and injury. In this case, the plaintiff has to prove that the defendant negligently misrepresented a material fact. As with the intentional tort of fraudulent misrepresentation or false representation, omitting material information can be a misrepresentation. Therefore, a defendant may be liable for negligently misrepresenting or omitting material facts. Colorado recognizes a tort of negligent misrepresentation in two circumstances: 1) where negligently supplying false information harms the plaintiff or his/her property; and 2) when negligently providing false information during a business transaction causes financial loss.

Breach of Fiduciary Duty and Agency

An agent is someone who agrees to act on behalf of another person, the principal. When an agency relationship is formed, the agent becomes a *fiduciary* with heightened obligations. The *fiduciary duty* has been defined as "the duty of finest loyalty." Many forms of conduct that might otherwise be appropriate are forbidden to those with fiduciary responsibility. In addition, the fiduciary duty includes a duty to act with due care (including a duty to avoid intentional or negligent mistakes). Some states require that the agent act with the level of care (s)he would use for her/his own affairs. An agent who breaches a fiduciary duty owed to a principal will be liable for damages.

Agency relationships are one of the most common in the business world. Employees may act as agents of their employers. Corporations act through their officers and directors. Through the legal doctrine of *respondiate superior*, in certain circumstances principals, such as employers and corporations, may be held responsible for acts of agents. This includes both negligent and intentional acts.