

LETTER OPINION
2001-L-51

November 28, 2001

Mr. Dennis Schulz
Secretary-Treasurer
North Dakota Real Estate Commission
PO Box 727
Bismarck, ND 58502-0727

Dear Mr. Schulz:

Thank you for your letter asking whether state or federal law requires real estate agents to reveal to a prospective buyer of a home that the home has been used as a methamphetamine (meth) lab. I will answer your question in the context of assisting you in giving guidance to real estate brokers concerning their responsibilities to make disclosure in the context of potential disciplinary actions against licensees under N.D.C.C. § 43-23-11.1. Real estate brokers should contact private attorneys concerning specific questions about the duty to make disclosure about specific defects on specific properties.

With regard to a property upon which a meth lab has been located, there are two potential issues. First, because meth labs involve the use of hazardous materials, there is the possibility that the property is contaminated. Second, there is the issue of the psychological impact on the value of the property because a meth lab was located there. There are few North Dakota cases dealing with the responsibility of a real estate broker to disclose defects in real property.

Generally, the common law rule is that while a real estate broker must act as a professional and will be held to a standard of reasonable care, in the absence of any statutory provision to the contrary a real estate agent or broker has no duty to make an independent investigation for hidden defects in a property. 12 Am.Jur.2d *Brokers* § 146 (1999). However, the common law doctrine of caveat emptor has been eroded considerably during the past few decades, and both courts and legislatures of other states have imposed affirmative duties on sellers of land to disclose matters materially affecting the value of property. See generally Colin Campbell, *Liability of Vendor or Real Estate Broker for Failure to Disclose Information Concerning Off-Site Conditions Affecting Value of Property*, 41 A.L.R.5th 57 (1996). Generally, when a real estate

agent or broker is aware of a physical defect in the property, there is a fiduciary relationship between the broker and his client or clients imposing a duty to disclose the defect. See generally Diane M. Allen, *Real-Estate Broker's Liability to Purchaser for Misrepresentation or Nondisclosure of Physical Defects in Property Sold*, 46 A.L.R.4th 546 (1986).

In North Dakota, an agency relationship is created when one person, the principal, authorizes another, the agent, to act for him or her in dealing with third persons. Auction Effertz, Ltd. v. Schecher, 2000 ND 109, ¶ 9, 611 N.W.2d 173. An authorization for a party to sell the property of another creates an agency relationship. Id., citing Coldwell Banker First Realty, Inc. v. Kane, 491 N.W.2d 716, 718-19 (N.D. 1992). The existence and scope of a fiduciary duty depends upon the terms of the parties' agreement. Schecher, supra, at ¶ 9. However, the agreement, if expressed in general terms, "does not authorize an agent . . . [t]o do any act which a trustee is forbidden to do by the provisions of sections 59-01-09 to 59-01-19, inclusive." Id. at ¶ 9. Schecher goes on to say:

Under N.D.C.C. Ch. 59-01, a trustee must act with the highest good faith toward the beneficiary and not obtain any advantage over the beneficiary by the slightest concealment . . . and a trustee must not take part in any transaction adverse to the beneficiary without obtaining the beneficiary's permission after full disclosure of all facts which might affect the beneficiary's own decision.

Id.

In addition, the 2001 Legislature passed the following law protecting purchasers of property from liability for cleanup of hazardous wastes if they have made "all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability." N.D.C.C. § 23-20.3-11(2).

1. Notwithstanding any other provision of law and except as expressly provided by federal law, a person who acquires property is not liable for any existing hazardous waste or substance on the property if (a) the person acquired the property after the disposal or placement of the hazardous waste or substance on, in, or at the property, and at the time the person acquired the property that person did not know and had no reason to know that any hazardous waste or substance was disposed of on, in, or at the property, (b) the person is a governmental entity that acquired the

property by escheat, by tax sale, foreclosure, or through any other involuntary transfer or acquisition, or through the exercise of eminent domain authority by purchase or condemnation, or (c) the person acquired the property by inheritance or bequest and that person did not know and had no reason to know that any hazardous waste or substance was disposed of on, in, or at the property.

2. To establish that the person had no reason to know, the person must have undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice in an effort to minimize liability. For purposes of this requirement, a court shall take into account any specialized knowledge or experience on the part of the person, the relationship of the purchase price to the value of the property as uncontaminated, commonly known or reasonably ascertainable information about the property, the obviousness of the presence or likely presence of contamination at the property, and the ability to detect the contamination by appropriate inspection.
3. A person who has acquired real property may establish a rebuttable presumption that that person has made all appropriate inquiry if that person establishes that, immediately before or at the time of acquisition, that person performed an investigation of the property, conducted by an environmental professional, to determine or discover the obviousness of the presence or likely presence of a release or threatened release of hazardous waste or substances on the property.
4. The presumption does not arise unless the person has maintained a compilation of the information reviewed in the course of the investigation.
5. This section does not diminish the liability of any previous owner or operator of the property who would otherwise be liable under this chapter and nothing in this section affects the liability under this chapter of a person who, by any act or omission, caused or contributed to the release or threatened release of a hazardous waste or substance that is the subject of the action relating to the property.

6. As used in this section, environmental professional means an individual, or entity managed or controlled by an individual, who, through academic training, occupational experience, and reputation, such as engineers, environmental consultants, and attorneys, can objectively conduct one or more aspects of an environmental investigation.

N.D.C.C. § 23-20.3-11.

Because of the danger that a meth lab has contaminated the property with hazardous waste, based upon the above fiduciary duty of the agent, and the release of liability under the law for a purchaser who has performed an investigation of the property to determine the presence of a hazardous waste or substances, under N.D.C.C. § 23-20.3-11, it is my opinion that the real estate brokers should disclose to any potential purchasers that the lab was present so that the purchasers may take appropriate action to protect themselves from potential liability. A seller may also elect to make the appropriate inquiry if, for example, it was a rental property where the renter established the meth lab on the property, to assist the buyer in making the appropriate "compilation of information" under N.D.C.C. § 23-20.3-11(4).

Sellers of real estate and their real estate agents may also have a duty to disclose the prior existence of a meth lab under more general law. Section 70-02-01-20 of the North Dakota Administrative Code states:

The fact that a parcel of real property, or any building or structure thereon, may be psychologically impacted, or may be in close proximity to a psychologically impacted property, is not a material or substantial fact that is required to be disclosed in a sale, lease, exchange, or other transfer of real estate. Licensees are not required to inform a prospective purchaser that certain real property is psychologically impacted real property. However, if the prospective purchaser asks whether the real property may be psychologically impacted, the licensee is required to inquire of the owner whether there are any facts or suspicions that the property is [sic] fact psychologically impacted, and to advise the prospective purchaser of the owner's response. If the owner refuses to answer the inquiry, the prospective purchaser must be so advised.

Section 70-02-01-19, N.D.A.C., defines "psychologically impacted properties" as follows:

As used in this section, the term “psychologically impacted properties” means any real property within this state that is known to be, or is suspected to have been, the site of a suicide, homicide, or other felony, or there are other circumstances, suspicions, or facts which may cause emotional or psychological disturbance or concerns to a prospective purchaser or lessee that have the potential of influencing whether that individual will purchase or lease the property. “Psychologically impacted property” does not mean the fact or suspicion that any present or past occupant is, or has been, infected with or died from human immunodeficiency virus or acquired immune deficiency syndrome or any other disease which has been determined by medical evidence to be highly unlikely to be transmitted through the occupancy of real property.

It is a felony to manufacture meth. See N.D.C.C. § 19-03.1-23(1). The prior existence of a meth lab in a property may also cause a prospective purchaser emotional or psychological disturbance or concerns that could potentially influence whether the prospective purchaser will purchase the property. Thus, the prior existence of a meth lab probably would make a property psychologically impacted, and require a real estate agent to respond to an inquiry in the manner provided in N.D.A.C. § 70-02-01-20. If a licensee violated that rule, he or she may be subject to disciplinary action. See N.D.C.C. § 43-23-11.1(p).

A licensee may also be subject to disciplinary action for fraudulent conduct. See N.D.C.C. § 43-23-11.1(v). “Constructive fraud” is “any breach of duty which, without actual fraudulent intent, gains an advantage to the person in fault or anyone claiming under him, by misleading another to his prejudice or to the prejudice of anyone claiming under him.” N.D.C.C. § 9-03-09(1). Constructive fraud does not require the making of a false statement. Holcomb v. Zinke, 365 N.W.2d 507, 512 (N.D. 1985). The Holcomb court said:

[I]n cases of passive concealment by the seller of defective real property, there is an exception to the rule of caveat emptor, applicable to this case, which imposes a duty on the seller to disclose material facts which are known or should be known to the seller and which would not be discoverable by the buyer’s exercise of ordinary care and diligence.

Id.

As a result, if the prior existence of a meth lab renders a property defective and the defect is not reasonably discoverable, a seller and the seller’s real estate agent may have a duty to disclose that fact. The failure to disclose the prior existence of a meth

lab on the property may be constructive fraud. The real estate agent perpetrating the fraud may be disciplined.

It is my opinion that when a meth lab has been located on a property and the broker knows of this fact, this disclosure must be made so that purchasers can make the appropriate inquiry under N.D.C.C. § 23-20.3-11 to protect themselves from potential liability for cleanup of hazardous waste on the property. If the inquiry is made, and no hazardous waste is found, the purchaser will not be liable for cleanup of that waste if hazardous waste from the meth lab is later found on that property. In addition, such disclosure may be required by N.D.A.C. § 70-02-01-20 and the law applicable to fraud and the fiduciary responsibility of agents cited above. Violation of the above law or rules may subject a licensee to potential disciplinary action.

Sincerely,

Wayne Stenehjem
Attorney General

wgp/pg