

On Real Property

Fraudulent concealment: Scary thoughts for sellers?

A recent decision by the Court of Special Appeals conjures up distant memories of the 1982 Stephen Spielberg horror movie *Poltergeist*. *Rhee v. Highland Development Corp. et al.*, No. 1765, Sept. Term 2007 (Oct. 7, 2008). To its credit, the decision makes no reference to the movie, but the factual allegations in *Rhee*, if true, are nonetheless a chilling tale.

In allowing a subsequent purchaser to assert a fraudulent concealment claim

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against the original developers, with whom no privity exists, the *Rhee* court has extended the rationale of the decision last year by the Maryland Court of Appeals in *Diamond Point Plaza Ltd. Partnership v. Wells Fargo*

Bank, N.A., 400 Md. 718 (2007).

In *Diamond Point*, Maryland's highest court held that a defendant's duty to refrain from fraudulently misrepresenting a material fact extends to the people or "class of people" the defendant has "reason to expect" will rely on the misrepresentation. In *Rhee*, Maryland's intermediate appellate court ruled that a developer/seller's duty to refrain from fraudulently concealing a materially adverse condition of real property extends beyond the initial purchaser of the property to the people or "class of people" the developer/seller has "reason to expect" will rely on the concealment.

In both fraudulent misrepresentation and fraudulent concealment causes of action, Maryland's appellate courts have thus relaxed the strict privity rule and have allowed parties not party to the pertinent transaction to assert these species of fraud claims.

Desecration, concealment

The homeowners, James and Linda Rhee, sued the developers of a residential subdivision for fraud in the Circuit Court for Howard County. The Rhees bought the home that the developers had sold to the initial purchasers, thereby making the Rhees subsequent purchasers of the home.

The Rhees alleged that the developers discovered a small cemetery on the lot ("property") they ultimately purchased. The Rhees further alleged that the developers undertook several actions to conceal the visible presence of the cemetery on the property during the development process in the 1980s, including (a) removing more than 20 headstones, (b) moving the building restriction lot lines so that the desecrated cemetery was included in a no-build area on the property, and (c) deleting references to the cemetery in documents submitted to the county for subdivision approval.

The developers vigorously disputed these allegations.

The developers sold the property to the

initial purchasers, who never knew that a desecrated cemetery was located on the property. In 1991, the initial purchasers sold the property to the Rhees, who were likewise unaware of the desecrated cemetery.

In 2004 — 13 years after they bought the property — the Rhees learned from a third party there was a desecrated cemetery on the property.

In their suit for fraud, the Rhees alleged that the developers fraudulently concealed the desecrated cemetery on the property, thereby inducing them to buy the property. Based on this fraudulent concealment, the Rhees alleged that the value of the property is significantly less than it would be absent the presence of a desecrated cemetery thereon.

The trial court dismissed the Rhees' fraud complaint, ruling that the developers did not owe a duty to the Rhees as subsequent purchasers of the property. The Rhees filed a timely appeal to Maryland's intermediate appellate court.

The *Rhee* court reversed the decision of the trial court, holding that a real property developer/seller's duty to refrain from fraudulently concealing a materially adverse condition of real property extends beyond the initial purchaser of the property to the people or "class of people" the developer/seller has "reason to expect" will rely on the concealment.

Legal duty to whom?

In *Rhee*, the developers made no affirmative misrepresentation to the Rhees. Indeed, the Rhees and the developers had no communication at all, except for the alleged concealment of information about the property.

Thus, the core issue in *Rhee* is whether a developer/seller of real property's duty to refrain from actively, intentionally concealing a material defect in the property can extend beyond the immediate purchaser (with whom the developer/seller transacted the sale) to a subsequent purchaser.

Under Maryland law, the non-disclosure of a material fact ordinarily is not actionable in the sale of real property. By contrast, fraudulent concealment of a material fact is actionable, but an essential element of the cause of action is that the defendant owe a duty to the plaintiff to disclose a material fact — i.e., the seller actively and with the intent to deceive conceals a material fact about the property, the purchaser justifiably relies on the concealment in buying the property, and the purchaser suffers damages as a proximate result thereof.

Although *Diamond Point* involved an affirmative misrepresentation of material fact and not a concealment of a material fact, the *Rhee* court found persuasive the rationale of the *Diamond Point* court and its reliance on the Restatement (Second) Of Torts §§531 and 533.

Restatement §531 says, in pertinent part that one who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he

or she has reason to expect to act or to refrain from action in reliance on the misrepresentation.

Restatement §533, which deals with representations made to a third person, provides in pertinent part that the maker of a fraudulent misrepresentation is subject to liability if the maker intends or has reason to expect that its terms will be repeated or its substance communicated to the other and that it will influence the other's conduct in the transaction or type of transaction involved.

The *Rhee* court pointed to two reasons why the rationale of §§531 and 533 should be extended to fraudulent concealment cases. First, the common law causes of action for fraudulent misrepresentation and fraudulent concealment are substantively the same. For that reason, it would not make sense to apply §§531 and 533 to fraudulent misrepresentation cases but not to fraudulent concealment cases.

Second, parties to subsequent transactions involving the same property who rely on the same concealed facts will be misled. As a result, the tortfeasor concealing the facts has reason to expect that secondary misrepresentations will occur. A seller/developer who actively conceals the defect in the real property from the initial purchaser will logically assume that the concealment will be passed on to subsequent purchasers.

As the *Rhee* court observed:

The more ingenious the deception by concealment, the more likely it is that the defect will be passed unknowingly from one purchaser to the next. If the concealment keeps the seller/developer's immediate purchasers in the dark about the existence of the defect, that is due to his proficiency in perpetrating the fraud. He should not be protected from liability for fraud because the defect he has concealed does not become manifest until after the property has transferred hands.

The *Rhee* court was careful to point out that the class of people to whom the duty not to defraud is owed is not indeterminate. Instead, the tortfeasor had reason to expect that the class of people involved (i.e., future purchasers of the property) who would be defrauded by the concealment was a limited and defined class of people.

Sound policy rationale

The extension of the principles set forth in §§531 and 533 from fraudulent misrepresentation causes of action to fraudulent concealment causes of action is sensible. Developers/sellers should not be able to evade liability for defrauding buyers by a fortuitous intervening sale of the property. Subsequent purchasers, just

as much as initial purchasers, who have been defrauded by a developer/seller should have recourse against the tortfeasor who has actively concealed material facts about the property. In *Rhee*, the Rhees simply could not have readily discovered the concealed facts because of the alleged fraudulent acts of the developers.

The *Rhee* court noted in *dicta* that the Rhees could expose themselves to liability for constructive fraud, based on "passive concealment," if they prevail in the instant case and recover damages for fraudulent concealment, leave the desecrated cemetery concealed, and then resell the property without disclosing the

desecrated cemetery's existence or without lowering the sales price to account for its presence. The *Rhee* court cited no Maryland case in support of this analysis and, for that reason, it is not clear whether Maryland's highest court would

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recognize the passive concealment theory of fraud.

Although the *Rhee* court repeatedly casts the holding in terms of reliance on the "concealment," technically a buyer will not rely on the concealment; rather, the buyer is relying on a set of facts or circumstances that are untrue or misleading because of the seller's fraudulent conduct in concealing the true facts or circumstances.

Conclusion

The *Rhee* court's logical extension of the *Diamond Point* holding will prevent sellers/developers of real property from profiting from their fraud. *Rhee* represents yet another expansion of those to whom a seller/developer of real property owes a legal duty. Given the continued expansion of liability, sellers/developers need to ensure that they not engage in activity that could be viewed as actively concealing a material fact about the property with the intent to deceive.

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