Markets and Law Reform: The Tension Between Uniformity and Idealism

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I. INTRODUCTION

Property law is not a realm where uniform legislation has thrived. Only a handful of efforts have impressed enough state legislatures to have meaningful impact. Of the few successes, most are narrow in scope. For example, the Uniform Simultaneous Death Act¹ deals with the transfer of property rights in cases when the sequence of deaths among multiple or competing owners is difficult to prove, and the Uniform Vendor and Purchaser Risk Act ("UVPRA")² allocates losses from casualty and

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condemnation that occur while real property is subject to a contract of sale, prior to closing.

In property, success has befallen only two uniform acts that have breadth, in that they treat an entire topic or type of legal relationship. The Uniform Probate Code ("UPC")\(^3\) and the Uniform Residential Landlord and Tenant Act ("URLTA")\(^4\) stand alone in this regard. First, approximately half of the states have adopted all or a significant part of the UPC. Approved in 1969, and expanded and amended several times since, it provides comprehensive treatment for the transmission of property at an owner's death via probate and nonprobate transfers, guardianship, and related matters. Second, the URLTA, approved in 1972, has garnered adoption by fifteen states.\(^5\) It provides statutory rules governing all facets of the landlord-tenant relationship for residential tenancies.

The most ambitious effort at uniform property legislation ever launched was the Uniform Land Transactions Act ("ULTA")\(^6\) and its companion, the Uniform Simplification of Land Transfers Act ("USLTA").\(^7\) Both measures caught the eyes of property scholars,\(^8\) including law casebook authors,\(^9\) most of whom were generally approving. Both Acts, however, met with singular failure in the sense of uniform legislative shunning and have not substantially influenced judges in their lawmaking roles. In published

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5. During the 1970s, 13 states, beginning with Hawaii in 1972, enacted the URLTA. Its sails have lost the wind; since then there have been only two adoptions, Rhode Island and South Carolina, both in 1986. Id. at 60 (Supp. 1995).
9. See, e.g., JOHN CRIBBET & CORWIN JOHNSON, PROPERTY, at xviii (4th ed. 1978) (stating that adoption of the Acts by the Commissioners "points the way toward further reform in the law relating to the sale of land"); GRANT NELSON & DALE WHITMAN, REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT 2 (2d ed. 1981) (stating that the ULTA "represents an interesting and often useful alternative to existing legal rules," to which the authors refer throughout the book). Recent casebooks generally pay much less attention to the ULTA and the USLTA than those published in the 1970s and early 1980s.
opinions, very few courts have relied upon the ULTA or USLTA positions for analogous support.\(^\text{10}\)

Why did a single state legislature, somewhere in America, not pass at least one of the Acts? More than twenty years have elapsed since promulgation, so certainly they have had time. Causation, often a prime concern of lawyers, is tricky here. When a legislature enacts a statute, it is often hard to pick one's way through the process to determine precisely why the legislature acted and why it made particular drafting choices. Legislative history for state statutes, compared to federal acts, is often sketchy. On occasion, there is no extant written history. But at least the legislature has spoken through its vote and the words of the act.

Here, we are investigating the legislature's refusal to speak or its lack of interest. When the law, in its examination of human conduct, recognizes the distinction between an affirmative act and an omission, as it often does, the distinction typically is grounded on the difficulty of ascribing intent or motivation to an omission. This raises an important caveat for our purposes. We cannot tell for sure why the legislatures eschewed the USLTA and the ULTA. There may be no single reason. In some states, there may have been more pressing legislative business for a number of sessions; in other states, there may have been no energetic proponents or available sponsors; in others, a searching study may have disclosed that the Acts' principles were not compatible with the states' perceived needs.

My purpose is not to make a comprehensive study either of the causes for legislative rejection of the Acts or of the merits of the Acts' provisions. As indicated above, one cannot be certain that lack of adoption is due to a perception that the Acts' substantive principles are deficient in terms of policy. My suggestion, however, is that one plausible explanation for the failure to garner adoptions is that the core principles of the Acts were rejected on their merits. The rejection occurred not because the principles are intrinsically flawed (which may or may not be the case), but because they embody major reforms that do not respond to contemporary market needs. Instead, the proposed reforms ignore market changes, including

\(^{10}\) A Westlaw search conducted by the author on January 24, 1996, revealed 30 published opinions citing the ULTA (27 in state courts and 3 in federal courts) and 3 published opinions (all in state courts) citing the USLTA. A majority of those opinions rely on the Acts to some extent, typically by pointing out that the rule they announce is compatible with or resembles the Acts' rule. Given the two decades since adoption of the Acts and the volumes of real property cases decided since, this is a small number of citations, reflecting minimal impact on the judiciary.
developing market-based solutions to legal problems concerning real estate transactions.

II. Market Changes and Law Reform

The real estate markets of today, as well as those of the 1970s when the Acts were approved, are vastly different from those of the early part of this century. Earlier, both real estate sales and loans tended to be local in nature, with the parties often having continuing, and sometimes personal, relationships. Seller and buyer often lived in the same community and, if not well acquainted, they may have known of the other’s reputation. The borrower, whether commercial or residential, knew his local banker. Real estate transactions involving local parties, just as today, sometimes fell apart and generated disputes, but local legal rules and local norms generally proved adequate to resolve them. Whether an outsider from a community in another state would understand those rules and norms was not considered to be of much importance. If an outsider chose to enter the local market, it was at his peril to ascertain the local rules by, for example, hiring a local agent or attorney.

This century the markets for real estate sales and finance matured, becoming mammoth in size at the national level and much larger at the local level in many American communities. Like other aspects of the American economy, the parties to transactions increasingly were strangers. Growing numbers of transactions involved parties from different communities, and as cities expanded, fewer residents knew each other. More property transactions with interstate dimensions took place.

Law evolves to respond to economic and social changes. Radically different real estate markets raised new problems, which existing property law and existing institutions were ill-equipped to handle. Persons entering large, depersonalized real estate markets needed certain legal protections, which existing law failed to provide. Buyers of new housing, who paid a price based on the assumption that the unit was satisfactory in quality and free of significant defects, no longer dealt with a local merchant who had a known track record and felt a need to preserve local goodwill.

Law and markets interact in many different ways. A particular legal problem, if and when it is solved, may be solved in any number of ways: by judicial efforts to revamp the common law, by federal legislation or regulation, by uniform or nonuniform state legislation, by private ordering accomplished by market participants, or by structural changes in markets as institutions evolve and new institutions emerge. Such approaches are not, of course, mutually exclusive. Responses to a given problem may include a mix from the above list. For example, judicial decisions may spark and
inform the drafting of legislation. In property, this combination gave birth to the URLTA. It was a reaction to the tide of judicial decisions embracing the implied warranty of habitability in residential leases. Similarly, in residential finance, reform came from the interplay between the private mortgage markets and new federal laws. During the 1970s and 1980s, the thriving secondary mortgage market created strong pressure for national standards for residential mortgage products.\textsuperscript{11}

The drafters of the ULTA and the USLTA naturally believed that many problems in real estate transactions were amenable to solution by uniform state legislation. A person not so persuaded, of course, would not join the effort nor expend valuable time on the project. For a number of the problems addressed by the Acts, the drafters missed the mark at this initial level of decision. They too readily embraced the idea that a state code, compared to other approaches, was a useful response. In particular, they failed to recognize that other institutions were coping with the perceived problems and with increasing effectiveness.

\section*{III. TENSION BETWEEN GOALS OF UNIFORMITY AND IDEALISM}

The Acts proposed many changes to well-established property doctrines. The drafters were not timid. They strove to fashion an ideal set of reformed rules which would govern the entire system of real estate sales, titles, and finance. As a general proposition, the more major changes contained in a proposed new statute, the more difficult it is to get it enacted. Lawmakers, legislators as well as judges, are accustomed to making incremental, modest changes. When a proposal envisions an entirely new scheme, a legislature must be willing to swallow the entire thing. The broader the new scheme, the more likely it is that some part of the scheme will prove unpalatable, leading to rejection of the whole.

This general principle has special meaning when the proposed statute is a uniform act. Success is not achieved if one or a few states adopt it. The overriding hope, implicit in the title "uniform," is widespread adoption by many states. For this reason, the goal of uniformity, in the sense of widespread state adoptions, is generally incompatible with an "ideal" code that seeks a large number of major reforms. This is simply an application of commonplace notion that plans imbued with an excess of idealism are not likely to succeed. Idealism must be tempered with realism. Uniform or widespread acceptability and revolutionary legal change inherently conflict.

Thus, proponents of codes and uniform laws should limit the number of major changes they propose to a relative few, picking those changes that are clearly merited in terms of policy and meaningful in terms of real-world impact. It is an uphill battle unless, prior to the proposal, there already exists a broad consensus that substantial flaws exist in the present system that the bill targets for reform. In contrast, such a consensus attended the success of other uniform legislation. Notably, both the UPC and the URLTA responded to “headline causes,” as did the Uniform Commercial Code (“UCC”) years earlier.12

With respect to real estate transactions, there was no such consensus that the system had substantial legal defects in the 1970s, nor is there one now. The proponents of the Acts, therefore, had the burden of convincing the legal community that the major reforms contained therein were necessary and important. This burden they failed to carry because the Acts attempted to reform established principles that no longer needed reformation. There simply was not sufficient market pressure to revamp the whole system. To the contrary, market forces were aligned to resist such drastic revision.

The remainder of this article explains the market context surrounding four of the Acts’ reform proposals, identifying two reasons why there was (and is) relatively little need for adoption of the Acts’ reforms. First, in some subject matter areas, institutions other than courts and legislatures had developed, or were developing, alternative solutions to the problems at hand. Two examples, discussed below, are warranties of quality for new homes and formal requirements for deeds. Second, in other areas, alternative solutions were being achieved by private ordering by the parties engaging in the transactions. Two examples, discussed below, are risk of loss and specific performance. Both areas are alike in that the Acts’ proposals were behind the times. The major problems addressed by the Acts were serious problems earlier this century, but when the problems had reached a sufficient magnitude, the market responded by finding solutions that developed in small, incremental steps. Real estate markets and institutions had changed drastically by the 1970s, and the Acts failed to take full account of those changes. Perhaps the Acts, in the forms they were promulgated, would have succeeded in the 1940s or 1950s, but they were too late to succeed today.

12. For example, Article 9 directly responded to substantial market concerns in many states about the validity of a “floating lien” on a business’ personal property. See U.C.C. art. 9, 3 U.L.A. 1 (1992 & Supp. 1995).
IV. SOLUTIONS FROM NONLEGAL INSTITUTIONS

A. Protecting Buyers from Homebuilders

The consumer protection movement came of age in the 1970s. In property law, one of its prime manifestations was the implied warranty of quality, developed by courts to protect the expectations of buyers of new homes. The implied warranty replaced the doctrine of caveat emptor, which shielded real estate sellers from post-closing liability for housing defects, except to the extent the seller gave an express warranty that survived closing.13

Adoption of the implied warranty followed and lagged behind reforms in the sales of personal property. Courts analogized to the protections afforded buyers of goods under the law of sales, recently codified in the UCC, reasoning that buyers of new housing deserved equivalent protection.14 This legal development recognized the changes in housing markets and methods of construction that have taken place this century. Once when many homes were custom-built by local builders who used local craftsmen, the typical purchaser might personally select a builder, based upon reputation and other factors, and become actively involved in the process of designing the house and supervising its construction. Today most homes are sold just like other commercial products. They are mass produced on a speculative basis, built according to stock plans, with the typical purchaser relying not on the personal characteristics of the builder, but solely on advertising, the salespersons' presentations, and the product appearance.

Affected by the tide of consumerism sweeping the law in the 1970s, which included the judicial implied warranty as one facet, the ULTA set forth an implied warranty for the sale of new housing by a merchant

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13. For a comprehensive analysis of implied warranties, see Jeff Sovem, Toward a Theory of Warranties in Sales of New Homes: Housing the Implied Warranty Advocates, Law and Economics Mavens, and Consumer Psychologists under One Roof, 1993 Wis. L. Rev. 13 (advocating system of standardized warranties, with disclosure to buyers of warranty choices, including choice of disclaiming all warranties).

14. The nature and content of the implied warranty varied somewhat from state to state, partially because of differences in how closely they tailored the new warranty to the personal property analogue. Some states called the warranty an "implied warranty of habitability," protecting the buyer only from extreme defects such as structural flaws that threatened the buyer's safety or made the unit wholly unlivable. Other courts conferred broader protection, analogizing to the UCC warranties of merchantability for the sale of goods.
seller. This is not exceptional, although the scope of the warranty is substantially broader than that developed by prevailing caselaw. What is exceptional, however, was the ULTA's decision to make the implied warranty incapable of disclaimer, waiver, or modification by buyers who occupy or intend to occupy the property. The home buyer, given the ULTA moniker of "protected party," is shielded from vicissitudes of freedom of contract. The apparent rationale is that home buyers lack the ability, information, and bargaining power to negotiate for express warranties of quality, and that without a mandatory statutory warranty, home buyers would be routinely victimized by sellers who contractually disclaim all liability for housing defects. In making the warranty mandatory, the ULTA rejected the position taken by a majority of courts, which treat the judicial implied warranty as implied in fact and thus capable of disclaimer in accordance with general principles of contract law. Courts have tended to look at disclaimers and modifications on a case-by-case basis, showing a high degree of deference to parties' contracts when the disclaimer is clearly expressed and conspicuous. Instead of deferring to these evolving judicial standards, the ULTA took the blunderbuss approach of invalidating all waivers of implied warranties of quality by protected parties.


[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 [new] improvements . . . will be:

(1) free from defective materials; and
(2) constructed in accordance with applicable law, according to sound engineering and construction standards, and in a workmanlike manner.

Id.

16. Id. § 2-311(c). The Act has a minor exception for known defects that the parties bargain over. Id. (stating, "seller may disclaim liability for a specific defect . . . if the defect . . . entered into and became a part of the basis of the bargain"). It has no bearing on the major problem, which is the allocation of risk between seller and buyer with respect to defects that are become evident only after the time of contracting or closing.

17. Id. § 1-203 (defining “protected party” to include an individual who buys improved residential real estate and who occupies or intends to occupy all or part of the real estate as a residence).

18. The ULTA position treats the home buyers the same as residential tenants, which a majority of jurisdictions protect with a nonwaivable implied warranty of habitability.

More importantly, the ULTA warranty of quality ignores reforms emanating from the homebuilding industry. When the ULTA was adopted in 1975, the industry was in the nascent stage of addressing the problem of new housing defects by a system of standardized, express warranties. Many builders offer their own express warranties, but more significant are warranties given or guaranteed by third-parties. The most prominent of such warranties, known as the Home Owner’s Warranty (“HOW”) Program, was founded by the National Association of Home Builders in 1972. The program is voluntary, and builders who meet the program’s standards are eligible to enroll. A buyer who purchases from a participating builder receives a HOW policy, which insures against a range of defects for certain time periods, which vary according to the type of defect. The builder pays the HOW Corporation approximately one-third of one percent of the sales price of the house for the policy. Over the years, the HOW plan has covered more than two million homes, a total representing approximately half of the market for third-party warranties.

There are three other major private warranty programs operated by the Home Buyers Warranty Corporation, the Residential Warranty Corporation, the Professional Warranty Corporation. Since 1994, the HOW Corporation has struggled with solvency problems, and its competitors are assuming a greater share of the market. Today, the HOW program and other warranty programs are well known, not only among real estate professionals, but also among knowledgeable home buyers. Participation in a national warranty program is a marketing advantage, and builders often advertise this feature of their product. According to a recent estimate, in 1995 almost ninety percent of new home buyers obtained an express warranty, with one-third of them issued by warranty companies, and the rest issued by the builder.

20. The standards relate to construction expertise, financial stability, and customer relations.

21. All defects in materials and workmanship are insured for the first year. Building systems, such as plumbing, heating, and air conditioning, are insured for 3 years and major structural defects are insured for 10 years.


23. In October 1994, the HOW Corporation was placed in receivership by the State of Virginia. Apparently, the premiums it charged were too low to cover the risk of housing defects it insured. The receiver has satisfied claims brought by insured homeowners at 40%. See Pat Rosen, HOW Offering 40 Percent on Claims, HOUSTON POST, Feb. 12, 1995, at C1.

24. See Elizabeth Birge, A Warranty Is Only as Good as the Builder Behind It, CHICAGO TRIB., Nov. 11, 1995, at HG1 (citing estimate of William Young, Director of Consumer Affairs for the National Association of Home Builders).
Although the HOW program has received criticism on the basis that it over protects the builder, in a number of key respects, third-party warranties better protect buyers than would the ULTA proposal. First, like other express warranties for the sales of other products, if a defect appears within the policy time limits, it is covered. Unlike the implied warranty, the buyer does not have to prove that the defect existed at the time of closing or completion of construction. Depending on the character of the defect, proof that because something is wrong now a defect existed years ago can be a substantial evidentiary burden. Second, under the HOW plan, if there is a dispute concerning the warranty, the buyer has the right to submit the matter to an arbitrator, whose decision binds the builder, but not the buyer. Last but not least, the builder’s warranty obligations are insured by the third-party warranty company. The buyer does not bear the full risk that the builder may become insolvent during the policy period, and in the home-building industry, where many small businesses fail, especially during housing recessions, this risk is material.

The HOW program was in its infancy at the time of ULTA adoption. The weakness of the ULTA approach lies not in its authors’ lack of prescience; who could foresee in the 1970s that the standardized warranties would evolve to become the dominant form of quality protection for new home buyers? Rather, the problem with the ULTA approach is that it assumed that the private market could not solve the problem of new housing defects, and government-mandated warranties, forced upon market participants whether they wanted it or not, was the only viable alternative. The rigidity of the ULTA warranty rules, had they been legislatively enacted, would have effectively precluded development of national standardized warranties.

B. Eliminating the Formalities of Conveyancing

Formalism has long been a whipping boy in legal circles. A dominant theme of twentieth century private law is to eliminate formal rules, replacing them with flexible, case-sensitive rules that look to the substance of the


26. The buyer reduces, but does not eliminate, the risk of an insolvent warrantor, a point illustrated by the recent receivership of the HOW Corporation. Purchasers of HOW policies, nonetheless, are in a better position than they would be with no third-party warranty at all because they receive part payment of claims from the receiver and retain the right to proceed against the builder for the deficiency.
parties' understandings and interests. The UCC exemplifies this approach. Consider two prime examples from Article 2 and Article 9. With respect to contracts of sale, title to the goods no longer serves as a linchpin to define the parties' relative rights and obligations. With respect to secured transactions, the form of the parties' security agreement is irrelevant; regardless of form, if the substance of the parties' agreement is that personal property secures the performance of an obligation, a single set of Article 9 rules govern their relationship.

Yet all vestiges of formalism have not disappeared from our legal system, and modern scholars recognize that some formal rules may promote important policies. The law of modern real estate transfers has worked out an accommodation between the competing ideals of formalism and anti-formalism. The resulting dialectic recognizes a division between the validity of the deed as between the parties and its status within the recording system. In the former realm, the substance of the parties' deal governs regardless of formalities; in the latter realm, formal rules prevail.

The architects of the USLTA embraced the ideal of anti-formalism, applying it to conveyancing practices. The USLTA codifies the modern law of the validity of deeds between the parties since it comports with anti-formalism ideology. Thus, under the Act, the only formal requisite for a deed, other than an identification of the parties and the land, is a signature by the grantor or his representative.

When it came to recording, the USLTA also seeks to cleanse the system of formalities. The Act starkly provides: "No signature, acknowledgement, seal, or witness is required for a document to be eligible for recording." Dropping the last two requisites reflects present state law and is sound. Dropping the first two completely reverses modern real estate practice, which bars the recording of instruments that are not both signed and acknowledged. Instead, instruments that patently are unenforceable as between the parties are entitled to recordation.


28. U.S.L.T.A. § 2-201. This comports with the standard principle that, as between the parties, an acknowledgement is not necessary. The USLTA also makes it clear that neither a seal nor a witness is necessary. Id. § 2-201(c). Again, this is not a significant change, as modern law has eviscerated the historic importance of writings under seal and only several states require third-party witnesses for deeds.

29. Id. § 2-301(b).
Recorded instruments under the USLTA system, provided they are signed, carry strong presumptions of legitimacy. These presumptions do not depend on whether the instrument is notarized or otherwise acknowledged. Thus, the USLTA reform directly raises the policy question whether acknowledgement of deeds and other instruments that affect title to real estate serves a useful purpose. The drafters apparently believe acknowledgement to be worthless. A comment observes: “Whatever the office of notary public once was, other methods, in particular civil liability for slander of title and possible criminal sanctions now appear to provide more effective and less burdensome methods of discouraging fraudulent behavior.” No empirical evidence bearing on the cost of notarizing real estate documents is offered, nor is any foundation given for the sanguine conclusion that real estate fraud is largely a thing of the past because modern crooks are afraid of slander of title actions and criminal prosecutions.

There are two reasons why the requirement of acknowledgement for recorded instruments may be worth retaining. First, although it obviously cannot stop all fraud stemming from forgery, it makes the forger’s task at least a little harder. The forger must either dupe a notary public or obtain illegal access to the notary’s tools, including his seal. Granted, a determined forger may succeed in doing this, but it is more probable that at least some will be deterred, diverted to other affairs. The USLTA recording reforms, by ridding the system of formalities, ignore the real-world reliance placed on recorded instruments and stack the cards in favor of the forger or the forger’s transferee.

Second and more importantly, acknowledgement is the only reason whether a presumption of legitimacy makes sense. The USLTA, as noted above, retains the well-established concept that a recorded signed instrument is presumed to be signed by the person named as grantor and is presumed to be delivered. This presumption makes sense under present law because acknowledgement evidences that the instrument was apparently signed in the presence of a disinterested third-party who is acting in an official capacity—the notary. Without this safeguard, not only is a forged unacknowledged deed recordable, once it is recorded it is presumed valid under the USLTA. The true owner who is the victim of the forgery has the burden of proving, by a preponderance of the evidence, that he did not sign the deed.

30. Id. § 2-305.
31. Id. § 2-201 cmt. 3.
Typically, the two main problems raised when the law imposes formal requirements upon market transactions are costs of compliance and sanctions applied to noncompliers. Acknowledgement of deeds and other instruments is not costless, but the costs are not high. Most deeds are prepared by attorneys or other professionals who have ready, convenient access to employees who are licensed notary publics. The USLTA reform would benefit society by reducing notaries’ workloads (but will this raise unemployment?), thus marginally reducing transaction costs for sellers and buyers of land. It is questionable, however, whether this small cost savings overcomes the probable benefits of fraud prevention and protection of true owners referred to above.

With respect to noncompliance with the formality of acknowledgement, a very small percentage of recorded instruments either are unacknowledged or defectively acknowledged. Such defects raise legal problems because the instruments are ineligible for recording, but are recorded in fact. The USLTA seeks to resolve the dichotomy, eliminating the need for courts occasionally to struggle with this problem. Solving this problem by statute is not highly important for two reasons. First, the risk is minimal in a statistical sense for several reasons. The requirement of notarization or another form of acknowledgement is extremely familiar to real estate attorneys, brokers, and everyone else who regularly deals with real estate. In most states, the risk from defective acknowledgements is substantially reduced by title curative acts and state and local bar standards that govern real estate titles. And even when there is a defective acknowledgement that is not cured by a statute or another doctrine, such as adverse possession, it is rare that loss will result. There can be a loss to the record claimant whose chain of title includes the defect only if an innocent third-party has stumbled upon the scene.32

Second, the minor statistical risk that remains in modern real estate practice is handled satisfactorily by title insurance. Virtually all lenders and most informed buyers obtain title insurance policies, which afford economic

32. For example, assume A has conveyed to B and B has conveyed to C. The A-to-B deed is genuine (signed and delivered by A), but it is defectively acknowledged. C has no risk from A because the A-to-B deed binds C. C is subject to some third-party risk, but it is remote. Much must happen. C loses some or all of his property only if A makes an adverse conveyance by, for example, selling the land to X. In this event, X may gain paramount title versus C on the theory that the A-B deed, which should not have been recorded, does not impart constructive notice to X. But X will succeed in almost all states (which have notice or race-notice recording acts) only if: 1) C is not in possession of the land and 2) X does not order a title search of the records (if X searches the records, X will see the A-to-B deed and will be bound by actual notice).
protection against the risk that loss will result from a defect concerning acknowledgement of an instrument in their chain of title. The USLTA recording reform fails to recognize that the real-world problem of parties failing to observe recording formalities, such as acknowledgement, is substantially solved by the institution of title insurance. Whatever vices stem from formalism, in this arena they were already minimized by the impact of another institution.

V. SOLUTIONS FROM THE PRIVATE ORDERING OF PARTIES

A. Risk of Loss under Executory Contracts

Under an executory contract of sale, the traditional common-law rule is that the buyer bears the risk of loss from fire or other casualty from the time the contract is signed. This rule is often explained as a corollary of the doctrine of equitable conversion; the buyer has equitable title, which is the substance of ownership, and the seller has legal title only for the purpose of securing payment of the purchase price.

The ULTA reverses the traditional risk of loss rule, adopting the position of the UVPRA. The UVPRA/ULTA rule allocates the risk of loss to the party who is in possession prior to closing. In other words, the seller retains the risk of loss until closing, unless the buyer takes possession

33. The National Conference of Commissioners on Uniform State Laws adopted the UVPRA in 1935. There are some differences in language between the ULTA and the UVPRA. The UVPRA shifts the risk to the seller only if “all or a material part of the property is destroyed.” U.V.P.R.A. § 1(a). The ULTA, however, protects the buyer from all destruction or damage, giving him the right to cancel if the loss “results in a substantial failure of the real estate to conform to the contract.” U.L.T.A. § 2-406(b)(1). For lesser losses, the ULTA buyer has the right to pick either an abatement of the purchase price or the benefit of the seller’s insurance proceeds or condemnation proceeds. Compare U.V.P.R.A. § 1(a) (1935) with U.L.T.A. § 2-406(b). The UVPRA risk allocations are overridden if the loss is the fault of either party; the text of the ULTA is silent on the matter, but the Commissioner’s Comment states the loss should fall on a party who is at fault. Compare U.V.P.R.A. § 1(a), (b) with U.L.T.A. § 2-406 & cmt. 1. The ULTA covers escrow closings, providing that the risk of loss passes to the buyer when the escrow conditions are fulfilled if this happens before the buyer has taken possession. U.L.T.A. § 2-406(c)(2). The UVPRA is silent on this matter. The UVPRA authorizes the parties to alter the statutory risk allocations by express contract. U.V.P.R.A. § 1. The ULTA does not discuss this matter, either in text or in the comments, although it is highly unlikely the authors meant to preclude the parties from contracting out of the ULTA scheme.
prior to closing. For most sales, this means the seller retains the risk of loss until closing because most buyers do not take possession until closing.\textsuperscript{34}

Twelve states have adopted the UVPRA, beginning with South Dakota in 1937. Long ago, the adoption process ground to a halt, reflecting the lack of contemporary concern about risk of loss among real estate professionals.\textsuperscript{35} Why is there so little interest in the rule? The most important facet of both the traditional pro-seller equitable conversion doctrine and the UVPRA rule is that it is an implied rule, which the parties are free to alter.\textsuperscript{36} And parties to written contracts of sale virtually always exercise this freedom.

A state's baseline risk of loss rule, whatever it may be, is not very significant because the parties' contract almost always has an express provision that governs risk of loss. Solving the problem this way is not expensive. With only two parties involved, transaction costs are generally low. Whenever a buyer is represented by an attorney, the contract will expressly deal with risk of loss. In a state following the traditional rule, an attorney who fails to have the contract address the issue would be guilty of malpractice. Many buyers, especially home buyers, do not hire an attorney and, accordingly, they are more vulnerable to the traditional rule. However, such buyers typically use a standard-form contract, often approved by a bar association or a brokers' association. Virtually all standard contracts address risk of loss, providing the buyer with a substantial degree of protection. In the large majority of transactions, that provision allocates all or most of the risk of loss to the seller. The implied rule thus applies to an extremely small percentage of real estate purchase transactions. This is the primary reason why so few states have bothered to change the traditional risk of loss rule. Granted, it may occasionally disappoint an unsophisticated buyer who is not represented by an attorney and who does not use a standard-form contract, but this is rare.

In essence, private ordering by parties to real property sales adequately handles risk of loss issues, making statutory reform relatively unnecessary.

\textsuperscript{34} The buyer has the right to take possession prior to closing only if both parties agree. Conceptually, this rule (that the right to possession follows legal title) is inconsistent with the doctrine of equitable conversion. Saying that the buyer has equitable title (the most important thing) from the signing of the contract implies that the buyer should have possession or its fruits.

\textsuperscript{35} Since Oklahoma became the tenth state to adopt the UVPRA in 1965, only Nevada, in 1977, and Texas, in 1989, have passed the Act. See U.V.P.R.A., 14 U.L.A. 469 (1990).

\textsuperscript{36} U.V.P.R.A. § 1. Oddly, the ULTA is silent on the right of the parties to change the statutory rule.
There is little real-world need for any state to change its risk of loss rule. Modern critics of the traditional rule have cogently stated their case. They are right. The traditional rule is founded on ancient, outmoded assumptions and in principle should be discarded, even though it harms extraordinarily few purchasers. However, what rule should replace the traditional rule is far from clear. While the UVPRA/ULTA rule is better in principle as reflecting the parties' probable expectations, for a state to switch to this rule is not costless, and for this reason it is debatable whether the costs exceed the benefits.

Two major costs of switching rules are apparent. First, the UVPRA and ULTA fail to set forth bright-line rules; their indeterminacy invites litigation much more than the relatively crisp traditional rule. Consider two examples of indeterminacy. Under the UVPRA/ULTA, the buyer can terminate due to casualty loss only if it results in a substantial failure of the real estate to conform to the contract. The term "substantial" is not defined, and in all but the easiest cases, buyer and seller will urge different interpretations. For losses that are less than substantial, the buyer cannot


38. One substantial flaw of the UVPRA/ULTA rule is that it applies only if neither party is at fault in causing the casualty loss. This is not an innovation, but a continuation of a tort-based fault principle customarily followed under the traditional equitable conversion regime. This is another example of the drafters of UVPRA/ULTA ignoring institutional and market changes. In medieval England, the crucible that gave birth to the fault-modified equitable conversion doctrine, a farmer whose barn burned did not call the "good hands people" at Allstate. Prudent property management by a landowner did not include obtaining fire and extended casualty insurance.

A modern risk of loss rule should take account of the fact that today casualty insurance is widespread and its purpose is to protect the owner from all covered losses, regardless of whether they stem from the owner's negligence or the negligence of others. Most fires are caused by someone's carelessness. Negligence of either party should be immaterial insofar as insurable risks are concerned.

In any executory contract of sale where the property contains a valuable building or other improvement that may suffer casualty loss, the property should be insured and, if it is not, the allocation of the risk of loss should turn on which party should have obtained insurance, not which party might be found negligent. In the absence of the parties' expressly contracting on responsibility for obtaining insurance, the preferable rule is to put the insurance burden on the seller. In most cases the seller will have insurance at the time the contract is signed. Indeed, if the seller's property is mortgaged, as most real estate is, the sellers' mortgagee almost always requires casualty insurance in order to protect its collateral. For a seller to cancel his insurance policy after signing a contract of sale but before closing would constitute a breach under his mortgage.
terminate, but is entitled to a price abatement equal to the reduction in fair market value caused by the loss. Again, the parties seldom will agree on the number, and buyer and seller will each find real estate appraisers to support their views. 39

A second major switching cost is educational. Attorneys who are intimately familiar with the traditional risk of loss rule and how to protect their buyer-clients from its bite will have to learn the new rule. They, of course, will also have to learn to protect their seller-clients from aspects of the new rule that, in the context of a particular transaction, may seem undesirable. This perhaps is not much of a problem. Many states have mandatory continuing legal education for lawyers, and speakers at these affairs always need topics to address.

The need to learn the new rule is a more important concern for nonlawyers, in particular those buyers and sellers who transact without hiring a lawyer. Most of these parties use standard-form contracts, and in many states the process of revising standard realty contracts is haphazard. While, as stated above, standard-form contracts virtually always have an express provision addressing risk of loss, it is not always the case that those provisions replace the entirety of the traditional rule. Sometimes there is an interplay between the express provision and the traditional rule. This interplay, where it exists, means that the standard contract should be revised as soon as the state legislature changes the base line rule. 40 In many states,

39. Indeterminacy is also added by the ULTA's decision to retain the fault principle to override the basic rule allocating risk to the possessor. This raises another litigable issue in many cases. Usually the possessor is the party most likely to be charged with negligence, but there are potential claims against the nonpossessor. For example, buyer takes possession in January two weeks before closing and the pipes freeze and break. Is buyer at fault for not taking precautions, such as letting the faucets drip? Is seller at fault for not warning buyer to take this step when the temperatures fall to the teens?

40. For example, Georgia follows the traditional rule that places the risk of loss on the buyer. See, e.g., Bleckley v. Langston, 143 S.E.2d 671 (Ga. Ct. App. 1965) (holding that buyer of pecan grove bears damages to trees from ice storm). A recent standard-form contract provides:

Should the Property be destroyed or substantially damaged before time of closing, Seller is to notify immediately the Buyer or Broker, after which the Buyer may declare this Agreement void and receive a refund of the earnest money deposited. In the event Buyer elects not to void this Agreement at this time, then within five (5) calendar days after Seller receives notification of the amount of the insurance proceeds, if any, Seller shall notify Buyer of the amount of insurance proceeds and the Seller's intent to repair or not to repair said damage. Within five (5) calendar days of Seller's notification, Buyer may (A) declare this Agreement void and receive a refund of the earnest money deposited,
standard contracts in wide use are examined and revised by legal experts only sporadically. Consequently, after a change in the law, many parties for a considerable period of time will use unrevised standard contracts that are inadequate and partially obsolete.

B. Specific Performance of Executory Contracts

The well-accepted baseline rule, learned religiously in first-year property, is that either party to a real estate contract of sale is ordinarily entitled to specific performance if the other party defaults.41 The ULTA retains the traditional rule for buyers, but overturns it for sellers. With respect to the buyer's remedy, a ULTA comment states that the Act

or (B) consummate this agreement and receive such insurance as is paid on claim of loss if Seller has elected not to repair said damage. Purchase and Sale Agreement ¶ 9 (Ga. Ass'n of Realtors, Inc. 1995). With this clause under present Georgia law, who is in possession does not matter, and Buyer retains the risk of loss for damage that is less than "substantial" and for takings by eminent domain. The effect of the clause on the parties' rights is reasonably clear, given the backdrop of existing law.

Were Georgia to adopt the ULTA or UVPRA risk provision, this paragraph should be redrafted because it would create grave ambiguities in three instances. First, if the buyer took possession prior to closing and substantial damage occurred, the buyer would argue the clause applies. The seller, however, would argue the statute applies because the clause assumes the seller is in possession and does not expressly provide a risk of loss rule for the buyer pre-closing possession. See U.L.T.A. § 2-406(c)(1). Second, if the damage was less than "substantial," the seller would argue the clause applies to place the risk on the buyer, but the buyer would argue the statute gives the buyer the right to an abatement of the purchase price. See id. § 2-406(b)(2). Third, if the government condemned all or part of the property, the buyer would argue that the statute applies, but the seller would argue the clause completely displaces the statute and permits the buyer to terminate only for physical destruction or damage.

41. See, e.g., JOHN E. CRIBBET & CORWIN W. JOHNSON, PRINCIPLES OF THE LAW OF PROPERTY 180 (3d ed. 1989); ROGER A. CUNNINGHAM ET AL., THE LAW OF PROPERTY 682-83 (2d ed. 1993). A traditional principle of equity limits specific performance to situations in which damages are inadequate. As to the buyer, the justification for making specific performance freely available is that each parcel of land is unique. Typically, courts presume uniqueness, with no requirement that the buyer prove his needs cannot be met by the purchase of a substitute tract. As to the seller, the uniqueness rationale is not available because he has bargained for money, the most fungible type of property in existence. As noted below, there are not that many reported cases that address specific performance for sellers. Nonetheless, the available cases generally award specific performance to sellers, without a discrete showing of the inadequacy of damages, often based on the idea that the parties' remedies should be mutual. A few modern courts have rejected the concept of mutuality of remedy. E.g., Centex Homes Corp. v. Boag, 320 A.2d 194 (N.J. Super. Ct. Ch. Div. 1974).
"continues the existing law under which a buyer of real estate is entitled to specific performance."  

For the seller, a comment asserts that under existing law "a seller of a freehold interest is automatically entitled to specific performance," an exaggeration given the equitable limits traditionally imposed on the remedy. Departing from present law, the Act restricts the seller's right to bring what is described as an "action for the price" to the situation where "the seller is unable after a reasonable effort to resell it at a reasonable price or the circumstances reasonably indicate the effort will be unavailing." Instead of specific performance, the seller may recover expectancy damages, based on the difference between the contract price and the fair market value of the property, or the seller may resell the property and recover the difference between the contract price and the resale price.

The seller's right to obtain specific performance if the buyer defaults is not very important. In modern real estate practice, it is a very rare case where it makes sense for the seller to litigate a specific performance claim to its conclusion. The prime remedy for real estate sellers is to terminate the contract, retain the earnest money already paid by the buyer, and seek another buyer. There is far more litigation in the courts over whether the seller may or may not retain the buyer's earnest money than over the question whether the seller may obtain specific performance. The ULTA

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42. U.L.T.A. § 2-511 cmt. The language of the Act itself is less clear, providing only "specific performance may be decreed against a seller," with no hint as to whether this should happen often or rarely. Id. § 2-511(a).

43. Id. § 2-506 cmt. 1.

44. Most courts, true to the historic tenets of equity jurisprudence, retain discretion to deny specific performance when the facts and circumstances show that specific performance would be unfair, harsh, or inequitable. See, e.g., Baker v. Jellibeans, Inc., 314 S.E.2d 874 (Ga. 1984) (holding that a purchaser must prove value of property so court can determine if price is "fair, just and not against good conscience").


46. Id. § 2-505(a).

47. Id. § 2-504.

48. Even though the seller's right to specific performance is seldom judicially exercised, it may serve another role. When a buyer refuses to go forward and the seller claims the buyer has breached, negotiation often ensues. The seller's arguable right to specifically enforce the contract may serve as leverage for negotiation. This thought perhaps underlies the traditional notion of mutuality of remedies; because the buyer has the right to specific performance, on the theory that land is unique, the seller should also have that right. Mutual rights to specific performance serves to equalize the parties' bargaining positions.
has an important provision authorizing liquidated damages.\(^{49}\) This provision codifies present law, which allows the seller to retain the buyer's deposit as liquidated damages if it is reasonable in amount, considering facts such as the probable harm stemming from default and the difficulty of proving actual harm.\(^{50}\)

The ULTA revision may be right, as a matter of principle, in adopting a bright-line rule that generally disqualifies sellers of real property from obtaining specific performance. As a strategy for drafting a uniform statute that is likely to be enacted, this reform is not advisable. The existing rule does not have a major impact on many real-world transactions. Private ordering by buyers and sellers, reflected in the bargains they reach and document in written contracts, demonstrate that earnest money payment and retention is a key contract provision and that the seller's right to specific performance is not.

VI. CONCLUSION

The drafters of the ULTA and the USLTA were ambitious, seeking to overhaul a good many long-embedded property law doctrines. They sought to purge the law of ancient rules perceived no longer to serve the needs of modern markets. In so doing, they went too far. Instead of focusing on a small number of revisions to rules that were both obsolete and harmful, they painted with a broad brush, fashioning a code decreeing sweeping changes to the property laws of any state that chose enactment. Uniform acts succeed only if they respond to significant needs felt by market participants. For the ULTA and the USLTA, this impetus was lacking. By trying to sell a major reform package, they made nationwide adoption improbable. In so doing, the goal of uniformity was sacrificed to the goal of legal perfection.

\(^{49}\) U.L.T.A. § 2-516(a) states:

> Damages for breach by either party may be liquidated in the agreement, but only in an amount that is not unreasonable in the light of the anticipated or actual harm caused by the breach, the time the real estate is withheld from the market, the difficulties of proof of loss, and the inconvenience or nonfeasibility of otherwise obtaining an adequate remedy. A provision for unreasonably large liquidated damages is void.

\(^{50}\) Id.

It may have been more useful if the Act contained guidelines bearing on amounts that the seller may retain. Given the tremendous variety in types of contracts, including their duration, hard-and-fast rules probably would be unwise. Some courts, however, presume that the seller generally may retain a deposit of up to 10% of the purchase price. A statutory presumption along these lines would be worthwhile guidance for parties and for the courts.
In essence, the reformers aimed at too many targets. In two categories, ammunition was sent toward the wrong marks. First, they assumed that direct legislative action to solve a problem is preferable to market-based solutions, without making a careful examination as to the necessity for and costs of market intervention. The potential for solutions by other market institutions was overlooked. With respect to implied warranties of quality for the sale of new homes, the Acts mandated the use of a single standard, depriving the parties of the freedom of choosing to make their own bargain. This choice neglected the emerging response of the home-building industry in creating a system of private warranties, spearheaded by the HOW program. Similarly, the Acts’ call for the elimination of formalities for recorded deeds and other recorded instruments ignored the fact that very few private parties misunderstand the formalities and that, when they do, the system of title insurance provides affordable protection from the risk at low cost to the parties.

Second, in identifying problem areas, the Acts’ architects disregarded the extent to which private ordering by parties, in written real property agreements, replace implied legal rules, greatly diminishing the importance of the implied rules. With respect to risk of loss, buyers almost always contract for some modification to the doctrine of equitable conversion, which generally allocates the entire risk to the buyer. With respect to specific performance, this remedy is generally not attractive for sellers, who in case of buyer default, strongly prefer to retain the buyer’s earnest money as liquidated damages.