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POTENTIAL LENDER LIABILITY IN FINANCING HOUSING DEVELOPMENTS

I. INTRODUCTION

In *Connor v. Great Western Savings and Loan Ass'n*¹ Goldberg,² an inexperienced and undercapitalized developer, sought to develop a community which would have eventually reached two thousand homes. In January 1959, Goldberg agreed to buy one hundred acres from McRea immediately, with the right to buy a remaining four hundred and forty-seven acres over a ten year period. Not having the resources to undertake a development of this magnitude, Goldberg approached Great Western Savings and Loan Association for the necessary funds to purchase the first one hundred acres. Great Western consented to undertake the financing of this land, but demanded in return that it should receive: (1) the right to finance the construction of homes to be developed on the tract; (2) the right of first refusal on the making of mortgage loans to the buyers; and (3) a "gentleman's agreement" that it would have the right to first refusal on construction loans if the remaining four hundred forty-seven acres were developed.

The interim financing of the construction project was undertaken by a land warehousing agreement.³ The operation was to work in the following fashion: Prospective buyers were to reserve lots after considering the three model homes which were constructed on the otherwise barren tract. At this point, Goldberg's sales agents informed the buyers that Great Western was willing to make the long-term mortgage loans on the premises. The sales agents then were to take credit information for transmission to Great Western. A procedure of this sort was necessitated by the granting of the

¹ 69 Cal. 2d 850, 447 P.2d 609, 73 Cal. Rptr. 369 (1968). Additional law review references to this case may be found in Comment, *The Undetermined Scope of a Lender's Liability for the Negligence of His Debtor*, 26 WASH. & LEE L. REV. 392 (1969); Note, *The Expanding Scope of Enterprise Liability*, 69 COLUM. L. REV. 1084 (1969); 6 SAN DIEGO L. REV. 320 (1969); 4 U. SAN FRANCISCO L. REV. 188 (1969); 73 DICK. L. REV. 730 (1969); 21 S.C.L. REV. 484 (1969).

² This article will refer to Goldberg only. In reality, he worked through various sham corporations organized for the purpose of developing different housing tracts.

³ Under a land warehousing arrangement, the financing party holds the land for the developer, until he is ready to use it. The title to the land is in the financier, and it is "sold" by the financial institution to the developer as needed.

right of first refusal for the construction loans. If an approved buyer wished to obtain a long-term loan elsewhere, Great Western had ten days to meet the terms of the proposed financing; if it met the terms and the loan was not placed with Great Western, Goldberg was required to pay Great Western the fees and interest obtained by the other lender in connection with the loan. Furthermore, Great Western demanded from Goldberg a one and one-half percent fee for loans made to buyers who, in the opinion of the savings and loans' were poor risks.

Goldberg was to make his profit on the transaction by taking second mortgages on the balance of the sale price that was not financed by Great Western. He had planned to discount the notes at fifty percent of their face value and use the proceeds to pay the interest and fees to Great Western and to provide a profit for himself. The evidence indicated, however, that Goldberg pared estimated profits to the dangerously thin margin of five hundred dollars per house, and that he exceeded his expertise, which resulted in a deterioration in his financial position as construction progressed.

There was evidence presented at the trial that adobe soil was common in the area, and "some evidence that, in the exercise of due care, Great Western was, or should have been, on notice that this condition prevailed."⁴ This type of soil is known to be "expansive," that is, it will absorb water and will expand. "Presumably anyone knowledgeable as to soil conditions in southern California, would, upon inspection or inquiry in the area, be placed on notice at least that the soil in the tract deserved careful investigation."⁵ An engineering firm, employed by Goldberg submitted several letters which established that the soil in the area was not suitable for normal foundation. These recommendations were not followed; however, there was no evidence that they were transmitted to Great Western.

Plaintiff homeowners brought this action after their homes suffered serious damage from cracking in the foundations which were not able to withstand the expansion and contraction of the adobe soil. Plaintiffs sought rescission or damages, alternatively, from the various parties involved in the tract development. Great Western was made a defendant for the obvious reason that Goldberg had no money to indemnify them for their losses. The appeal was from a nonsuit entered in favor of Great Western.

⁴ *Connor v. Conejo Valley Development Co.*, Cal. Rptr. 333, 339 (1967). Noted at 56 GEO. L.J. 788 (1968) and 37 U. CIN. L. REV. 219 (1968). It should also be noted that in some cases, such as this one, where the California Supreme Court takes the case, the District Court of Appeals' judgment has no force or effect. See CAL. CONST., art. 6 § 12 (1966) and CAL. SUP. CT. R. 24.

⁵ 61 Cal. Rptr. at 340.

Plaintiffs sought to hold Great Western liable on either of two theories: (1) that a joint venture existed between Goldberg and Great Western; or (2) that the defendant Great Western breached an independent duty of care to the plaintiffs. Both the lower appellate court⁶ and the California Supreme Court⁷ found that there was no joint venture. However, the California Supreme Court, in holding that Great Western could be liable for its negligent acts said:

[The financial institution] became much more than a lender content to lend money at interest on the security of real property. It became an active participant in a home construction enterprise. . . . It received not only interest on its construction loans, but also substantial fees for making them, a 20 percent capital gain for "warehousing" the land, and protection from loss of profits in the event individual home buyers sought permanent financing elsewhere.⁸

The central question in the case was whether the savings and loan association owed a duty of care to the homebuyers in this tract. As a defense, Great Western raised the lack of privity of contract with the homebuyer-plaintiffs. In order to understand the reason for positing this defense, it is helpful to examine the legal authority in the area today.

II. PRIVITY

The distinction has been made in the area of products liability between cases involving economic loss or physical damage⁹ to the product itself and cases involving damage to the person or the owner of the product or to third parties. The effect of privity varies between the two lines of cases, with the requirements for the product-damage, economic loss cases being somewhat more stringent.¹⁰ The distinction between the two lines of cases has broken down to a great extent for the reason that the imposition of liability in the personal harm cases which come first shows the development of the common law.¹¹

⁶ 61 Cal. Rptr. at 342.

⁷ 69 Cal. 2d at 863, 447 P.2d at 615, 73 Cal. Rptr. at 375.

⁸ 69 Cal. 2d at 864, 447 P.2d at 616, 73 Cal. Rptr. at 376.

⁹ The leading case today involving privity and allowing recovery against a remote party is *Santor v. A. & M. Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305 (1965).

¹⁰ W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* §§ 97-99 at 672-96 (3d ed. 1964).

¹¹ For an interesting articulation of the development of the law in this area, see Prosser, *The Assault Upon the Citadel*, 69 YALE L.J. 1099 (1960) and Prosser, *The Fall of the Citadel (Strict Liability to the Consumer)*, 50 MINN. L. REV. 791 (1966).

Privity traditionally has been raised as a defense by the manufacturer of an article which is purchased from a dealer, who is in privity of contract with the buyer. The manufacturer in claiming the lack of privity of contract seeks to avoid any liability on the transaction. The flaw in this line of reasoning is apparent, as the manufacturer is often the one responsible for the defect in the first place.

The "wholesaler" cases, though much fewer in number, present conceptually greater difficulties. Here, the manufacturer sells the product to the wholesaler who in turn sells it to the retailer who is in privity of contract with the purchaser. Where the wholesaler effects no change in the item, but merely inventories it and sells it to the retailer, the question is whether liability should attach to the wholesaler simply by virtue of the fact that he is in the chain of distribution.¹² The courts are split on this issue.¹³

By a strict parity of reasoning, Great Western is not a wholesaler. However, like the wholesaler, Great Western is involved in the distribution of the product and, like the average wholesaler, it had no direct control over the manufacturer. Furthermore, in many product distribution chains, the manufacturer is only manufacturing goods to the wholesaler's specification, which goods will be labeled with the wholesaler's name. Like the wholesaler, Great Western could vary its degree of control and participation in a given project depending upon the role it chose to play, or thought it had to play, to protect its investment.

Assuming, *arguendo*, that Great Western holds the position of a wholesaler in this particular chain of distribution, and applying the "wholesaler" reasoning, should it be liable on either theory? The record indicates that to a considerable extent Great Western was as interested in the profitability of this project as was Goldberg. Its desire to place long term mortgages is what involved it in the interim financing of Goldberg's development. Moreover, Great Western had ample opportunity to inspect the construction of the houses, and in fact it had an independent duty to its share-

¹² *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962), argues that the reason for strict liability is to insure that the costs of injury are borne by the parties putting the products on the market rather than the defenseless consumer. *Id.* at 61, 377 P.2d at 901, 27 Cal. Rptr. at 701.

¹³ Compare *Graham v. Bottenfield's, Inc.*, 176 Kan. 68, 269 P.2d 413 (1954) with *Blitzstein v. Ford Motor Co.*, 288 F.2d 738 (5th Cir. 1961), and *Peaslee-Gaulbert Co. v. McMath's Adm.*, 148 Ky. 265, 146 S.W. 770 (1912) and *Willey v. Fyrogas Co.*, 363 Mo. 406, 251 S.W.2d 635 (1952).

holders to inspect the construction.¹⁴ As long as it was chargeable with inspection for one purpose, there¹⁵ is no reason why the duty to inspect should not carry over.¹⁶

The decision in this case should have come as no surprise to Great Western for in 1962, in *Merrill v. Buck*,¹⁷ this same court held a realtor who was not in privity of contract with either the lessor or the lessee liable for damages that the lessee suffered after falling down concealed stairs on the premises. The court said:

In showing this home to plaintiff these defendants [the real estate agent and her employer] were not motivated by altruism but by the hope of business profit. The rental of real property was a part of their regular business. In the pursuit of that business they were led to undertake the showing of the property to plaintiff by the hope of earning a commission from the property owners if they could be persuaded to rent it. . . . Privity of contract is not necessary to establish the existence of a duty to exercise ordinary care not to injure another, but such duty may arise out of a voluntarily assumed relationship if public policy dictates the existence of such a duty.¹⁸

The case presented to the court was not dissimilar from *Merrill v. Buck*. In both cases, though in the absence of privity of contract, a party that would profit from the transaction was held liable. The same set of economic relationships that are apparent in *Merrill v. Buck* are present in the "wholesaler" cases and are present here. In all three cases the "wholesaler" is in a position of control, though in some cases that control is limited. In each case the "wholesaler" is an integral part of the chain of distribution. And in each case the "wholesaler" profits from the transaction.

In this case, as in most others concerning the distributive chain, if the economic entity refuses or abrogates its responsibilities for control or lessens its quality standard, which is one means of increasing profitability, it should be held liable for the harm caused.¹⁹ As control can only be exerted in or on the chain of distribution, public policy dictates that the lender in a situation such as this one make its presence felt. If the control is not felt, the concomitant is the factual result in the case under consideration.

¹⁴ CAL. CORP. CODE § 820 (West 1954), states, in part: "Directors and officers shall exercise their powers . . . with a view to the interests of the corporation." 1 G. HORNSTEIN, CORPORATION LAW AND PRACTICE § 446 (1959). Cf. CAL. FIN. CODE § 5606 (West 1968). But see 6 SAN DIEGO L. REV. 320, 322 (1969); 26 WASH. & LEE L. REV. 392, 394 (1969).

¹⁵ 69 Cal. 2d at 866-67, 447 P.2d at 619, 73 Cal. Rptr. at 379.

¹⁶ See *Rowland v. Christian*, 69 Cal. 2d 108, 443 P.2d 561, 70 Cal. Rptr. 97 (1968).

¹⁷ 58 Cal. 2d 552, 375 P.2d 304, 25 Cal. Rptr. 456 (1962).

¹⁸ *Id.* at 561, 375 P.2d at 310, 25 Cal. Rptr. at 462.

¹⁹ *Price v. Gatlin*, 241 Ore. 315, 319, 405 P.2d 502, 505 (1965) (dissenting opinion).

III. DUTY

The principal defense raised by Great Western was that there was no duty owing to the homeowners, its mortgagors. For the purpose of establishing the existence of a duty the court relied upon past decisions, which articulated a six-pronged test in deciding this issue. The factors balanced by the court to determine the duty owing were: (1) the extent to which the transactions were intended to affect the plaintiff; (2) the foreseeability of harm to him; (3) the degree of certainty that the plaintiff suffered injury; (4) the closeness of the connection between the defendant's conduct and the injury suffered; (5) the moral blame attached to the defendant's conduct; and (6) the policy of preventing future harm.²⁰ At this point, it might be well to consider the majority opinion in relation to the dissenting opinion of Justice Mosk, concerning especially the latter's comments as to these six criteria.

A. THE EXTENT TO WHICH THE TRANSACTIONS WERE INTENDED TO AFFECT THE PLAINTIFF

The essence of the majority position with respect to this factor is that "[t]he success of Great Western's transactions with [Goldberg] depended entirely upon the ability of the parties to induce plaintiffs to buy homes in the . . . tract and to finance the purchases with funds supplied by Great Western."²¹ The dissent answers this proposition by saying that any undertaking that Great Western might have accomplished was for "its own purposes exclusively," and that "there can be no question that the transaction was intended to affect the lender and the borrower, and was not for the benefit direct or indirect of the plaintiff."²² As the tests used in this case are from *Biakanja v. Irving*,²³ a prior decision of this court, analysis of that decision may prove helpful.

In *Biakanja*, the defendant-notary public had negligently drawn a will. He was held liable for damages to the plaintiff who was the sole beneficiary under the will when the will failed to qualify for probate. The court said in that case "[t]he 'end and aim' of the transaction was to provide for the passing of [the] estate to plaintiff."²⁴ Similarly, as the lower appellate court found, from the standpoint of Great Western the end and aim of its transactions with

²⁰ 69 Cal. 2d at 865, 447 P.2d at 617, 73 Cal. Rptr. at 377.

²¹ *Id.*

²² *Id.* at 877-78, 447 P.2d at 624-25, 73 Cal. Rptr. at 384-85.

²³ 49 Cal. 2d 647, 320 P.2d 16 (1958).

²⁴ *Id.* at 650, 320 P.2d at 19.

Goldberg was to commit long term mortgage loans on these homes,²⁵ that is, the entire set of transactions of Great Western was to tie down the long term mortgages on these homes.²⁶

B. FORESEEABILITY OF HARM

The question to be decided in this regard is whether Great Western would have reasonably foreseen the harm that came to the plaintiff-homeowners, as a result of its negligence in inspection. The dissent contends that there was no foreseeability of harm to the homeowners as by simply providing funds it did not put itself in a position to foresee any harm. This argument misses the point entirely. Great Western had a duty to its stockholders to inspect the construction to protect the security of their loans. Great Western also had the duty to inquire as to Goldberg, for it "knew or should have known that . . . Goldberg [had never] developed a tract of similar magnitude."²⁷ They knew or should have known that Goldberg was highly undercapitalized, and that a condition of this sort frequently results in shoddy construction and "corner-cutting."²⁸ It is only reasonable to assume that before Great Western would lend the amounts of money needed for a project of this nature that they would investigate the builder.

Obviously Great Western was in a position to know the possible harm that might have come to the plaintiffs. Furthermore, the law in California is that no distinction will be made between the various classes to whom a duty might be owed.²⁹ Logically then, there was foreseeability of harm.

C. CERTAINTY OF INJURY

This point was not in issue as the counsel stipulated that injury was present, and further stipulated that only specified damages would have to be shown.

D. CLOSENESS OF CONNECTION BETWEEN INJURY SUFFERED AND DEFENDANT'S CONDUCT

The majority argues that had Great Western exercised reasonable care in its control over the defendant-builder, Goldberg, the injury would not have happened. The dissent pointed out that there

²⁵ 61 Cal. Rptr. at 337.

²⁶ Note, *Liability of the Institutional Lender for Structural Defects in New Housing*, 35 U. CHI. L. REV. 739, 744 (1968).

²⁷ 61 Cal. Rptr. at 337.

²⁸ *Id.*

²⁹ *Rowland v. Christian*, 69 Cal. 2d 108, 443 P.2d 561, 70 Cal. Rptr. 97 (1968).

was no ability to control present here. The dissent's position is probably true on a day-to-day basis in that Great Western could hardly be expected to have an inspector present on the construction site during the entirety of the tract's erection. The dissent is incorrect, however, in its view that Great Western could not have exercised some control over Goldberg. Simply by virtue of its considerable economic power over Goldberg, and the fact that it was in a position to disapprove of the plans for the houses would have been enough to give Great Western considerable suasion over Goldberg's activities.³⁰ Furthermore, even if Great Western was not malfeasant in its control, there is still the question of its duty to inspect the construction project. Obviously, Great Western did not undertake an adequate inspection.

E. MORAL BLAME

The dissent argues here that "[b]lameworthiness implies responsibility"³¹ and that the only duty owed was to the shareholders. From the standpoint of social policy, this view is erroneous. As the majority points out, the savings and loan association is in a better position to assess the construction plans and progress, and they are more experienced in this area. The homebuyer, on the other hand, is not experienced in the least. Furthermore, the buying of a home is a substantial investment for the average individual,³² quite likely the largest purchase he will make in his lifetime. The probability is quite real that when the homebuyer's equity interest in his home is seriously impaired, a substantial portion of his assets are gone. It cannot be seriously questioned that there is an important social policy in the law of promoting and maintaining home ownership.³³ If this general proposition is true, then it is incumbent upon any court to recognize and promote this aim. An ostrich-like attitude of limiting one's view of social responsibility to the most immediate facts of a given case is totally unwarranted.

F. THE POLICY OF PREVENTING FUTURE HARM

Justice Mosk, dissenting, said: "Rules of law or conduct intended to determine or minimize the risk of future harm are imposed only

³⁰ Lefcoe & Dobson, *Savings Associations As Land Developers*, 75 YALE L.J. 1271 (1966) [hereinafter cited as Lefcoe & Dobson].

³¹ 69 Cal. 2d at 878, 447 P.2d at 625, 73 Cal. Rptr. at 385.

³² U.S. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES 323 (89th ed. 1968).

³³ See 26 C.F.R. § 1.163-1(b) (1968).

upon those creating and controlling the risk of harm."³⁴ This language could reasonably be construed as favoring the majority view.³⁵ The savings and loan association, especially when dealing with an inexperienced builder, is creating, or at the least fostering, the potentiality for the creation of harm.³⁶ Policy considerations, considering the incremental effort which would be incumbent upon a savings and loan association in inspecting a construction project, surely dictate that the savings and loan remain on the watch for structural defects (especially major structural defects, as here) about which they could or should have known.³⁷

The conclusion derived from examining the facts in light of the foregoing test is that the court was correct in holding Great Western liable.

IV. ECONOMIC IMPLICATIONS

The defense evidently argued that the increased housing costs implicit in requiring supervision are not justified, for marginal builders will be driven out of business and the total supply of housing will be decreased in a period when housing demand is high. Two arguments tend to refute this view: (1) if the small undercapitalized builder is driven out of business, then the homebuyer could be more confident that adequate construction will be the norm, *ceteris paribus*;³⁸ and (2) the increment in construction costs to cover inspection expenses is not sufficiently great as to decrease the availability of housing.

Even if more careful housing inspection were to cost five hundred dollars per unit, on houses selling at around sixteen thousand dollars as these houses did, the increased cost would amount only to about three percent. Amortized out over the period of the loan, even with interest charges added at today's rates, the result would not be an exorbitant burden to place upon the homebuyer. Furthermore, since the lender or homebuyer, in lieu of passing on all inspection costs to the homebuyer, could require the contractor to be bonded as to the quality of his product, the only increment in

³⁴ 69 Cal. 2d at 878, 447 P.2d at 625, 73 Cal. Rptr. at 385.

³⁵ See *id.* at 867, 447 P.2d at 618, 73 Cal. Rptr. at 378.

³⁶ Note, *Liability of the Institutional Lender for Structural Defects in New Housing*, 35 U. CHI. L. REV. 739, 742-43 (1968).

³⁷ *Id.* at 748.

³⁸ "A surety company extends bonding credit on the basis of capacity, character, and capital. Our underwriting requires prudent, conservative, experienced and well equipped operators." Universal Surety Co., Lincoln, Neb., *Rate Manual, Contract Bonds* at C-1.

cost would be that of the service charge on the bond. As the norm is well constructed houses, the premium would probably be quite small in relation to the costs of the houses.³⁹

V. WHY THIS DECISION?

This question might well be answered in one of two ways: economically or legally. As to the second, this decision is not unexpected. The previous California decisions concerning housing defects and privity requirements have not been overly conservative.⁴⁰ If anything, they have sought to put the liability where fault lies. As a result, in each area taken by itself, liability could be established. This decision is merely a meshing of the two lines of cases.

Perhaps the more important explanation is that of the savings and loan association as an economic entity. This opinion may well be meant as a warning to the savings and loan industry (or to any other financial institution) that in the interest of increasing their market position they must place some constraints on their behavior.⁴¹ In California, savings and loan associations are allowed to invest in land subdivisions to five percent of their assets,⁴² and arrangements of the type that they had with Goldberg are feeble excuses for accomplishing what the governing statute will not allow them to do.

³⁹ The rate applicable to "residences" is \$7.50 per \$1000 of contract price. Universal Surety Co., Lincoln, Neb., *Rate Manual, Contract Bonds* at C-9. Therefore, on a \$16,000 house, the price of those involved in the suit in this case, the service charge would have been \$120 or about .75% of the contract price of the house.

⁴⁰ As to privity requirements see 1 R. HURSH, *AMERICAN LAW OF PRODUCTS LIABILITY* §§ 5A:1 to 5A:3 (Supp. 1969), and the concurring opinion of Justice Traynor in *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 150 P.2d 436 (1944). It is submitted that the reasoning of Justice Traynor is now applicable to the case under discussion. See discussion accompanying note 9 *supra*. The leading law review article arguing for products liability to apply to realty is Bearman, *Caveat Emptor in Sales of Realty—Recent Assaults upon the Rule*, 14 VAND. L. REV. 541 (1961); it was followed by Roberts, *The Case of the Unwary Home Buyer: The Housing Merchant Did It*, 52 CORNELL L.Q. 835 (1967). See *Glisan v. Smolenske*, 153 Colo. 274, 387 P.2d 260 (1963); *Bethlahmy v. Bechtel*, 91 Idaho 55, 415 P.2d 698 (1966); *Schipper v. Levitt & Sons, Inc.*, 44 N.J. 70, 207 A.2d 314 (1965); *Hoye v. Century Builders*, 52 Wash. 2d 830, 329 P.2d 474 (1958). See also *Greenman v. Yuba Power Products, Inc.*, 59 Cal. 2d 57, 377 P.2d 897, 27 Cal. Rptr. 697 (1962) and *Merrill v. Buck*, 58 Cal. 2d 552, 375 P.2d 304, 25 Cal. Rptr. 456 (1962). But see *Seely v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965).

⁴¹ See generally, Lefcoe & Dobson, note 30 *supra*.

⁴² CAL. FIN. CODE § 6705 (West 1968).

Perhaps the answer lies in liberalizing the statutes governing their legal investments, and in allowing the savings and loan associations to become developers of real estate in their own right.⁴³ This course of conduct will not likely be available in the near future. The traditional notion is that savings and loan associations are lending institutions, and that they would be outside of their bailiwick if allowed to participate too actively in the development business.⁴⁴

VI. WHERE DO WE GO FROM HERE?

The foregoing analysis of the California Supreme Court propounds the rule that in a state where privity is no longer a necessity for the finding of liability, the test from *Biakanja v. Irving* will be applied to determine whether liability should attach in the absence of privity. The essence of this test, as applied to financial institutions, is that for the plaintiff to establish the liability of the lender, he must show the court that the lender has deviated from its characteristic role as a supplier of capital only. A true joint venture situation would not have to be shown. All that would be necessary is a showing that the lender shares a community of economic interest with the entrepreneur. In other words, where the lender's potential risk of profit on a given transaction is measured on the positive (profit) side by a return of more than interest income, but amounts to an effective participation in the enterprise, and on the negative side by simply losing its investment, public policy dictates that the lender not be insulated from liability. It is submitted that the foregoing test, put in the lender-borrower relationship, is the essence of the test propounded in *Biakanja*.

In operation this test looks to the facts of a given set of transactions to ascertain the status of the lender in this particular type of transaction. A lender who only participated in a given transaction as an actual lender of debt capital would not, under a test of this sort, be liable to third parties for the entrepreneur's faults. However, where, in an economic sense, the lender was not beneficially interested in the transactions of the borrower, then liability would not attach.

VII. CONNOR RECONSIDERED

The result in *Connor* is correct. The savings and loan associations, in their desire to augment their incomes, must remember that the legislatures of the several states have decreed their legal

⁴³ Lefcoe & Dobson, note 30 *supra*, at 1293-99.

⁴⁴ See restrictions of CAL. FIN. CODE § 6705 (West 1968).

areas of investment.⁴⁵ If they deviate from the legislative standard in hopes of a greater profit, they must accede to the responsibility which a developer of real estate has to the community. The result of the decision is not unfair from the foregoing standpoint; furthermore, it may well shift the responsibility of protecting community interest to someone who is in a position of economic control.⁴⁶ The increment in costs to the homebuyer would be negligible as it is possible to bond the contractor and pass this cost on to the homebuyer.⁴⁷ This would protect the security interest of the lender and the equity interest of the homebuyer in the event that the contractor failed to perform adequately.⁴⁸ As the rule of *caveat emptor* applies in many jurisdictions, the preceding would be a feasible arrangement for protecting the homebuyer.

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⁴⁵ *Id.*

⁴⁶ "If the conduct of the actor has brought him into a human relationship with another, of such character that sound social policy requires either some affirmative action or some precaution on his part to avoid harm, the duty to act or take precaution is imposed by law.' It has been suggested that the imposition of such a duty in a particular case depends upon the *closeness of the relationship* between the parties and the existence of a *reasonable opportunity to control* the harmful conduct." 35 U. CHI. L. REV. 739, 757, quoting, Harper & Kime, *The Duty to Control the Conduct of Another*, 43 YALE L.J. 886 (1934).

⁴⁷ See note 38 *supra*. See also 10 J. APPLEMAN, INSURANCE LAW AND PRACTICE 58 (1943).

⁴⁸ Compare 1st Nat'l. St. Bank, N.J. v. Carlyle House, Inc., 102 N.J. Super. 300, 315-16, 246 A.2d 22, 30-31 (1968) with Humber v. Morton, 426 S.W.2d 554, 561 (Tex. Civ. App. 1968).