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Real Estate Alert

from the Real Estate Law Group of Poyner Spruill LLP

Location, Location, Location? Try Disclose, Disclose, Disclose

by Josh Durham

Two cases against real estate agents recently caught my attention. The cases, discussed below, stress the importance of disclosing material facts, and agents hoping to avoid litigation here should take a few moments to see what happened to their colleagues in California and Washington. Here's what happened.

Case 1 – The House that Couldn't Close

Agent Sieglinde Summer listed a home for sale in Huntington Beach, California. The asking price ranged from $749,000 to $799,000, and Summer advertised that the seller was very motivated. Phil and Jeanille Holmes saw the listing and became interested. After Summer showed them the house, the Holmeses offered to purchase it for $700,000, free and clear of all monetary liens and encumbrances, other than the loan they intended to obtain. The seller, through Summer, countered at $749,000, which the Holmeses accepted. They then sold their existing home in order to complete the purchase on the seller's house.

Unfortunately, they learned too late that the seller's home was encumbered by $1,141,000 in loans. The Holmeses claimed these loans made it impossible for the property to close at the agreed upon price, since the lenders would be highly unlikely to accept such a reduced payoff. The Holmeses filed suit against Summer and his firm, claiming that Summer, as listing agent, owed them a duty of disclosure about the existing loans. The trial court disagreed and dismissed the case prior to trial.

Recently, the California Court of Appeals reversed that decision. The court said that the law is well established that when agents know of facts that affect the value or desirability of property, and knows that such facts are not known or reasonably discoverable by the buyer, the facts must be disclosed. Summer contended that matters pertaining to financing were separate from matters affecting the value or desirability of the home, but the court rejected this argument. The purpose of the rule, after all, is to permit buyers to make informed decisions about whether to purchase homes. Requiring listing agents to disclose that a sale is at a high risk of failure furthers this purpose. Therefore, Summer and his firm could be liable, and the case will proceed to trial.

Case 2 – The Bad Recommendation

Mark and Carol DeCoursey wanted to move to Washington state, and with the help of agent Paul Stickney, they bought a home there. They also wanted to make renovations to the home, so they turned to their agent for recommendations. Stickney recommended Home Improvement Help, Inc. (HIH). On such recommendation, the DeCourseys hired HIH to do the work. Unfortunately, HIH's finished product had a number of structural and other safety issues, which the DeCourseys anticipated would cost $525,289.78 to repair.

Unbeknownst to the DeCourseys, Stickney and HIH's owner formed a real estate joint venture eight years earlier and incurred approximately $400,000 in debt together. According to HIH's corporate documents, Stickney was a twenty-percent shareholder in the company. The evidence at trial showed that Stickney gave a cell phone to HIH's owner and allowed HIH to store documents on his computer. In addition to his recommendation to the DeCourseys, Stickney had recommended HIH to at least thirty of his other clients in the preceding five years. Stickney, of course, disclosed none of this.

In an effort to recover the costs of repairing the home, the DeCourseys filed suit against Stickney and the firm at which he worked. The jury found that Stickney had a conflict of interest that he did not disclose to the DeCourseys and awarded them $522,200 in damages. The trial judge also awarded the DeCourseys $508,427 in legal fees and court costs. The brokerage was liable for these amounts, too.

Lessons Learned

Both results should not be surprising. When an agent knows that a third party, such as a lender, governmental authority, or board of directors, must approve the terms of a deal before it can close, that must be disclosed to the buyer. As the court correctly pointed out, such a duty arises because of an agent's obligation to disclose material facts and to treat all parties to the transaction fairly. As for making recommendations, agents are wise to disclose all past and present dealings, personal or professional, that the agent has with the person or company being recommended. Even if the agent is simply passing along a list of potential contractors or inspectors, such connections should be disclosed.

What is troubling, however, is that Stickney claimed he did not believe he had a conflict of interest. This suggests he considered the issue at some point and ultimately concluded no conflict existed. In doing so, he violated a significant rule of real estate brokerage: when in doubt, disclose. In other words, if one has to consider whether to disclose a connection with a contractor or a potential obstacle to closing, the answer is clear: yes.

Doing otherwise might just cost you a million dollars.

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