Real Estate Inspections and Misrepresentations: Must the Real Estate Agent Beware?

Introduction

One factor fairly unique to the housing bubble, which by many economists' estimates existed between 2004 and 2006, was the pace at which residential properties were being sold. It was not unusual, for example, for a buyer to receive offers before formally listing a property. Listed properties were often the subject of multiple offers, with each prospective purchaser vying to make the most attractive offer in order to lock in a sale. During this time, many buyers' offers did not include inspection contingencies, the rationale being that a seller would more likely accept a non-contingent offer than a contingent one.

With the collapse of the real estate market several years ago, the number of fraud and misrepresentation claims filed by buyers against real estate agents and brokers, as well as sellers, has been rising. This trend will likely continue as more homeowners face foreclosure. Buyers desperate to hold on to their homes will look to any possible source of recovery, including selling agents and brokers. [1] One way to do this is to argue that the agent committed fraud or otherwise misrepresented the nature of the subject property.

The Elements of Fraud

In order to prove such a claim, a buyer must ordinarily prove certain elements: that the agent made a false or misleading statement, or concealed information which should have been disclosed; that the misrepresentation dealt with fact, and was not "puffery"; that the misrepresentation was material to the transaction; that the misrepresentation was made intentionally, recklessly, or negligently; and, that the buyer was harmed as a result of the misrepresentation. Note that these are general rules, and that different states impose varying requirements.

In all cases, however, the purchaser must prove that he justifiably relied upon the agent's statement or failure to disclose. In other words, the real estate buyer must have behaved differently because of the misrepresentation – by entering into a contract to buy, usually – and it must have been reasonable for the buyer to behave as he or she did. See, e.g., *Barnes v. Lopez*, 544 P.2d 694 (1976) (holding that it was reasonable for buyer to rely on representations concerning zoning); *Dugan v. Jones*, 615 P.2d 1211 (Utah 1980) (holding that a buyer could reasonably rely on statements concerning acreage); *Horner v. Ahern*, 153 S.E.2d 216 (Va. 1967) (holding that purchasers could rely on representations concerning latent defects in the property). The standard of reliance may be an objective one, meaning that the plaintiff must prove that a "reasonable person" would have relied on the representation, or a subjective one, meaning that the plaintiff need prove only that it was reasonable for him to rely on the representation under all the circumstances, including the plaintiff's own level of education, intelligence, and so forth. Additionally, in many states a listing agent must disclose the existence of latent defects in a property, which are generally defined as defects which would not be found on a non-intrusive inspection. (Some states, such as Maryland, further limit latent defects to those defects which would endanger the health or safety of someone in the house. See Md. Code Ann., Real Prop. § 10-702).

Reliance and the Availability of a Home Inspection

In cases not involving latent defects, courts have generally considered the availability and, where applicable, the results of an independent home inspection in deciding whether a purchaser could have justifiably relied upon statements made by a real estate professional during the time leading up to a sale. In other words, where a buyer in an arms length transaction could have discovered a defect by inspecting the property, the buyer should not be permitted later to sue the listing agent for failing to disclose the existence of the defect. In some states, this is true even if the agent makes an affirmative misrepresentation. See *Copeland v. Home Sav. Of America*, 433 S.E.2d 327

(Ga. App. 1993) (holding that a purchaser could not have reasonably relied on agent's statement that house was not in a flood zone because the danger of flood was apparent and the fact that the home was in a flood zone could have been determined by checking county records or speaking with the purchaser's insurance agent); *Jackowski v. Borchelt*, 209 P.3d 514 (Wash. Ct. App. Div. 2 2009) (holding that buyers did not justifiably rely upon seller's disclaimer of sliding of the property or other material defects where a reasonable inspection would have disclosed the risk of landslide and buyer failed to inspect despite opportunity to do so). For many agents, offering a right to inspect has been the "gold standard" for risk management concerning property disclosures. If a buyer waives inspection, the thinking goes, even better.

But not all courts are willing to hold the opportunity for inspection against real estate purchasers. In a recent case decided by the Supreme Court of Oklahoma, the court held that even when a buyer is offered the opportunity to inspect a property and fails to do so, the buyer may legitimately rely on statements made by the real estate agent concerning the condition of the property. *Bowman v. Presley*, 212 P.3d 1210, 1221-22 (Okla. 2009).

In *Bowman*, the purchasers were looking for a home that was larger than their then current residence. The defendants, the seller and the listing agent (who was also the seller's mother), represented to the purchasers that the subject property was 2,890 square feet in size. Based on this representation, the plaintiffs both determined the sales price of the property and decided to enter into a contract to purchase the property. After the sale had been consummated, they were dismayed to receive an appraisal from their mortgage lender advising that the property was in fact only 2,187 square feet. The plaintiffs eventually learned that the same appraisal company had provided a report to the sellers with the lower figure well before the property had been listed.

In their defense, the agent and the sellers argued that the MLS description for the property stated that the representations made therein were "deemed reliable, but not guaranteed." More

importantly, they argued that the purchasers had signed a sales contract which stated that they had either inspected the property on their own or were waiving their right to an inspection. But the court was not persuaded. It held:

> The common law doctrine of caveat emptor does not reach situations where a purchaser of real property has relied upon a positive representation of material fact. A representation of size, such as a firm figure of square footage, constitutes a statement of material fact the ascertainment of which serves as a positive assurance upon which a purchaser may rely without being compelled independently to determine the truth or falsity of the fact presented. The very fact of the material representation is itself enough to justify a buyer's reasonable reliance upon its accuracy.

Id.

Accordingly, under *Bowman* if a statement is specific enough, a buyer is relieved of the duty to inspect concerning that condition. Determining the specificity of a statement is easy in a square footage case (and surely the court was influenced in reaching its decision by the audaciousness of the misrepresentation itself, based on the previous appraisal). But what if the statement had been that the property was "in excellent condition" or that the property was "free of leaks" (when in fact the property had had a significant leak, say, ten years ago)?

Other courts have not stretched the concept of reliance so far. The court in *Taylor v. Pannico*, 2009 WL 1011150 (D. Colo. April 15, 2009), was asked to determine whether purchasers who had been given the opportunity to conduct a mold inspection of a house but did not obtain the inspection could subsequently sue a transactional broker when it turned out that there was in fact mold in the house. The buyers, Mr. and Mrs. Taylor, had been in a hurry to enter into a contract because they had previously sold their home and wanted to obtain favorable tax treatment for the proceeds of the sale. They entered into an agreement to purchase the subject property, even though they had never seen the house itself, on the day of the tax deadline.

Mrs. Taylor suffered from a health problem and advised the broker that any house purchased would have to be free of mold. However, the Taylors contracted with a home inspector to perform only a basic home inspection, and did not request air sampling or other tests specific for mold. When Mrs. Taylor eventually personally toured the home she had an immediate allergic reaction. Nevertheless, she and her husband elected to proceed with the sale. According to the Taylors, the broker made misrepresentations of fact when she told them that the home had been thoroughly inspected and that the results of the inspection were acceptable.

The court determined that the Taylors could not have justifiably relied upon the broker's statements, for several reasons. First, the Taylors themselves read the inspection report and accordingly knew that no mold testing had been done. Mrs. Taylor admitted that she formed her own opinions about the adequacy of the report and even confronted the broker about the fact that a mold inspection had not been performed. Coupled with the fact that the Taylors proceeded to sale despite Mrs. Taylor's physical reaction to the house, the court refused to hold the broker liable to the Taylors for misrepresentation.

Likewise, in *Jackowski v. Borchelt*, 209 P.3d 514 (Wash. Ct. App. Div. 2 2009), the buyers of a house situated on a slope sued their own agent, the sellers, and the selling agent when the house was damaged in a landslide. Despite knowledge that an expert had previously inspected the site and concluded that an area of the property that was unstable, the sellers told the buyers, with the listing agent's approval, that the property had not previously been subject to slippage, sliding or settling. The unstable area was not near the house when the expert conducted his testing, but the sellers later built an addition which rested on the unstable area. The sellers did, however, provide a copy of the expert's report to the buyers. Additionally, the buyers failed to utilize an inspection contingency before ratifying the sale. The court concluded that the buyers' reliance on the form disclosure could

not have been reasonable because an inspection would have determined that the addition was in an unstable area.

Practice Pointers

Counsel advising real estate professionals should educate their clients about the importance of independent home inspections and especially about the adequacy of inspection waivers. When a prospective purchaser waives a home inspection, the contract of sale should reflect a knowing and voluntary waiver made without reliance upon advice of the listing professional. Counsel must also make sure that their clients understand the laws of their particular jurisdiction, particularly with respect to material misrepresentations. Obviously no professional should ever lie, but in states applying a *Bowman*-type analysis, it may be preferable to make no definitive statement at all about matters, like square footage, that can be independently determined by a prospective purchaser.

Counsel defending agents and brokers should carefully investigate the circumstances leading up to a disputed transaction. When a home inspection has been waived, counsel should determine whether a carefully performed inspection would have revealed the defects at issue in litigation. Even where a home inspection has been performed, counsel should determine whether the buyers had reason to obtain further or more complete inspections that would have revealed problems. Where a properly performed inspection would have uncovered the deficiencies which form the basis for a claim, it should be argued that purchasers who did not obtain such an inspection could not have justifiably relied on statements made by the selling professional.

Author's Biography

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Endnotes

[1] There is, of course, a difference between brokers and agents. Because these kinds of cases almost always involve an agent, the term "agent" will be used throughout the remainder of this article.