



## REAL ESTATE LITIGATION UPDATE

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### **REAL ESTATE BROKER LIABILITY: MINIMIZING CLAIMS THROUGH DISCLOSURE**

**By: Marc C. Singer, Esq.**

In an uncertain real estate market, where prices decline and expectations based upon prior market conditions become unrealistic, real estate professionals become targets for malpractice claims. Such claims are sometimes fueled more by frustration with the marketplace than the conduct of the real estate professional.

There is no way to anticipate all of the circumstances which may give rise to a malpractice claim. However, by understanding the various duties owed by real estate professionals to buyers and sellers, strategies can be implemented to minimize exposure. This update is not intended to be an exhaustive explanation of all potential claims real estate professionals can face. Rather, it provides a framework of legal issues and relationships to be familiar with, identifies common concerns faced by the brokerage industry and proposes some practical strategies to follow to reduce claims.

#### **DISCLOSING KNOWN DEFECTS**

A real estate professional must disclose to a prospective buyer known material defects or conditions affecting the value of the property. Over the years, the courts and legislature have expanded the affirmative duties imposed upon real estate professionals to disclose conditions that could adversely affect the value of a property or impact a reasonable buyer's decision to purchase a property. It has long been the rule that any known material defects in a property must be disclosed by the broker to prospective purchasers. So, for example, if the broker is aware that a property has a water problem or is infested with termites, such information must be disclosed. See *Weintraub v. Krobatsch*, 64 N.J. 445 (1974). Real estate professionals will be subject to liability if they fail to disclose a known material defect to a buyer if the condition is not readily observable to the buyer. See *Mango*, 370 N.J. Super. at 254. Similarly, the real estate agent must disclose to the seller material information concerning the buyer which

relates to the transaction. Take, for example, a buyer who the agent knows lacks sufficient funds to perform. Such information should be disclosed. See *Restatement (Second) of Torts* §551 (1977 & Supp. 1997).

While the law is clearer concerning the duty to disclose material issues affecting the property or transaction, less clear is how far this duty to disclose extends to off-site conditions. Recent case law and legislation in New Jersey has imposed upon real estate brokers and agents the duty to disclose material off-site conditions not evident to the buyer that could impact the value of a property. For example, knowledge of the existence of a superfund site within close proximity to a property is something that should be disclosed. See *Strawn v. Canuso*, 140 N.J. 43 (1995). The New Residential Real Estate Off-Site Conditions Disclosure Act, N.J.S.A. 46:3C-1 to 12 (the "Disclosure Act"), passed shortly after the decision in *Strawn*, imposes a statutory duty that real estate agents involved in the business of selling newly constructed residential real estate advise prospective purchasers of the availability of information and lists concerning the existence of off-site conditions that are harmful or could materially impact the value of the property. Municipalities and other government agencies are required to maintain and make publically available lists of material off-site conditions. The existence of these lists must be disclosed to prospective buyers. These lists include, among others, environmental sites on the National Priorities List or involving hazardous discharge, landfills, high voltage electrical utility lines and transformers, wastewater treatment plants and airport safety zones. Similarly, New Jersey's Megan's Law requires brokers to provide buyers with municipal contact information to ascertain the existence of registered sex offenders in the area.

Compliance with the Disclosure Act extinguishes common law claims and bars claims for damages under the Consumer Fraud Act (see below). *Nobrega v. Edison Glen Associates*, 167 N.J. 520, 534 (2001). However, the courts have strictly construed the statute finding any deviation from the statutory language, even if factually accurate, could dilute the legislative intent and thus, could preclude the use of the Disclosure Act as a defense to common law and other statutory claims. See *Cohen v. W. B. Associates, Inc.*, 380 N.J. Super. 436, 441-42 (Law Div. 2005).

#### **BEWARE OF THE CONSUMER FRAUD ACT**

Understanding and following these disclosure rules is critical. Real estate brokers and agents are not only subject to general common law claims such as fraud and negligence, but also are subject to liability under the

New Jersey Consumer Fraud Act, N.J.S.A., 56:8-2, et seq. (the “CFA”). The CFA protects buyers and sellers against affirmative acts involving deception, fraud or misrepresentation, as well as acts of omission where material facts are concealed or omitted. Any misrepresentation, whether by commission or omission, that is “material to the transaction” may be actionable under the CFA. See *Vagias v. Woodmont Properties, LLC*, 284 N.J. Super. 129, 134-135 (App. Div. 2006). Where the misrepresentation is by omission or concealment, fraudulent intent must be established by clear and convincing evidence. See *Cox v. Sears Roebuck & Co.*, 138 N.J. 2, 18 (1994); *Weil v. Express Container Corp.*, 360 N.J. Super. 599, 613 (App. Div. 2003). Affirmative misrepresentations must be false, material and relied upon by the buyers. See *Kern v. Huettl*, 2009 WL 2461074 \*5 (N.J. App. Div. August 13, 2009) (citing *Gennari v. Weichert Realtors*, 288 N.J. Super. 504, 535 (App. Div. 1996), *aff’d as modified*, 148 N.J. 582, 607 (1997)).

The *Vagias* case illustrates the importance of verifying critical information. There, the real estate agent sold a property to the buyers knowing they wanted to purchase a property located in a particular section of town because the schools were better and the area was more prestigious. The agent mistakenly (but unintentionally) represented that the property was located in that section without verifying that fact. Because the buyers’ decision to purchase was based primarily on this misrepresentation, the agent was held liable under the CFA. Simply put, when a real estate professional is confronted with facts critical to a transaction, he or she must verify that information or, if unverifiable, make it clear that the information is unreliable and should be further investigated.

#### **WHAT IS MATERIAL?**

Whether a fact is “material” depends upon the circumstances. The courts generally look to whether the defect, condition or representation is critical to the value of the property or the decision to enter into the transaction. For example, representing that a property is zoned for multifamily use when it is zoned only for single family use is material when the buyer is purchasing based upon this representation. See *Ji v. Palmer*, 333 N.J. Super 451 (App. Div. 2000). Conversely, a broker does not have a duty to investigate and disclose offensive or abusive neighbors where that is not a condition of the sale. See *Levine v. The Kramer Group*, 354 N.J. Super. 397, 405 (App. Div. 2002).

#### **SHIFTING THE BURDEN**

Real estate professionals often do not live in the properties they sell and therefore, they are less likely to know about material defects with the property. To deal with this, New Jersey has adopted a Seller’s Disclosure requirement which a seller fills out identifying any known defects concerning the property. A real estate agent should not fill this form out for the seller. It should be completed based solely upon the seller’s personal knowledge. This reduces the exposure to potential negligence and fraud claims by placing the primary burden of disclosure on the seller. If the real estate professional complies with this regulation and properly obtains and provides a Seller’s Disclosure, the broker and agent will be exempt from certain provisions of the CFA, thereby precluding an award of attorneys’ fees or punitive damages. N.J.A.C. 13:45A-29.1

The agent must, however, affirmatively make reasonable efforts to ascertain that the information in the disclosures is not false and disclose any information it discovers concerning a material defect in the property that is otherwise not disclosed; especially if that information contradicts a statement in the Seller’s Disclosure. *Id.*

#### **STRATEGIES TO MINIMIZE EXPOSURE**

To minimize exposure to potential litigation, it is prudent for the brokerage company and its brokers and agents to implement the following types of practices and policies in their business activities:

- 1. Do not give legal advice** – a buyer or seller may look to a real estate agent for legal advice believing that he or she may understand the legal issues. Real estate professionals should avoid giving legal advice and recommend the party seek advice from qualified counsel.
- 2. Put it in writing** – avoid the “he said, she said” or “had I only known” scenarios by recommending that agents confirm their conversations contemporaneously through a letter or e-mail. Also, keeping copious notes of those conversations helps avoid questions as to what was said at the time.
- 3. Do not speculate** – while it is important to disclose material conditions, the real estate professional should not speculate when or how a particular condition arose. The downside of being wrong is greater than not knowing.
- 4. Never discourage further investigation** – real estate professionals are often concerned that insignificant items may be blown out of proportion if

investigation is suggested. A truly insignificant item will likely have little impact on the transaction. If the issue is significant, however, the real estate professional may have avoided liability for negligence or worse, fraud.

**5. Be Careful Making Referrals** – buyers and sellers often ask for referrals of home inspectors, attorneys and the like. To avoid conflict issues that may arise from a bad referral, clients should be reminded they are free to choose whomever they wish and recommend they interview several professionals before choosing.

**6. Provide Sources of Information** – too many agents make representations that are not based on personal knowledge or a competent source. If the source of the information is other than personal knowledge; say so. That will build trust and avoid accusations of misrepresentation.

**7. Verify Material Facts** – because the CFA can impose liability for unintentional misrepresentations, checking the accuracy of the information or, at a minimum, qualifying that the information is questionable and should not be relied upon is a best practice.

**8. Avoid Modifying or Opinion Words** – words have varying connotations and their context may mislead a party into believing an issue is more or less important than it really is. Avoid words such as “normal,” “minor,” “cosmetic,” “noticeable,” “simple,” “large” or “small.”

**9. Be Honest** – while perhaps the easiest practice to follow; simply being upfront and honest will go a long way in building relationships which can not only prevent litigation, but may actually facilitate more business.

## CONCLUSION

There is no way to prevent all malpractice claims. However, proper training of real estate professionals in understanding their duties and the various affirmative disclosures they must make, coupled with the implementation of clear policies and procedures to follow, can help reduce their exposure to liability in this economic climate.

*Marc C. Singer is a member of Saiber LLC. He handles various litigation issues affecting the real estate industry and regularly represents real estate brokers and agents against malpractice and related claims. Mr. Singer has lectured on broker liability issues and best practices in the brokerage industry. He also has held a New Jersey real estate broker's license since 1988.*

**Marc C. Singer, Esq.**  
**Saiber LLC**  
**18 Columbia Tpk., Suite 200**  
**Florham Park, NJ 07102**  
**Direct: 973.622.8413**  
[msinger@saiber.com](mailto:msinger@saiber.com)  
[www.saiber.com](http://www.saiber.com)