

## **Ten Most Frequently Made Claims Against Real Estate Licensees**

by Lana Schroeder, Esq., Claims Specialist for Rice Insurance Services Company, LLC

It is no secret we live in a litigious society made worse by a difficult market economy. Lawsuits are filed every day in every part of the country. There are no guarantees that you will never receive a demand letter or be named in a lawsuit concerning your professional services as a real estate agent. However, by educating and familiarizing yourself with the most common types of claims made against our insureds, you may be able to recognize and hopefully avoid similar situations.

The ten most common claims made during the period 1/1/2001 through 7/31/2010 against our insureds include:

1. Fraud;
2. Breach of Duty;
3. Breach of Contract;
4. Negligence;
5. Bodily Injury / Property Damage;
6. Misrepresentation regarding the Condition of the Property;
7. Consumer Protection Act;
8. Earnest / Escrow Money Dispute;
9. Misrepresentation regarding Flooding or Leaks; and
10. Misrepresentation regarding the Value of the Property.

### ***Fraud***

Fraud claims are the most common cause of action we see from claimants and plaintiffs. Generally speaking, fraud contains an element of intent. In other words, for a plaintiff to succeed on a fraud claim, the plaintiff must convince the judge or jury that there was an intentional act of the defendant that was designed to cause harm to the plaintiff. The “intentional act” complained of may be an affirmative statement by the real estate agent, or it could be the purposeful withholding of a material fact about which the real estate agent has knowledge. Claimed injuries are specific to each and every situation and therefore vary from lawsuit to lawsuit, but can include diminution of value of the subject property, cost to repair the defect, replace costs, lost profits, closing costs, physical and emotional distress, loss of consortium, and the plaintiffs’ attorney’s fees associated with the litigation.

Some frequent examples of fraud claims include:

- My real estate agent knew there was a discrepancy regarding the square footage of the home, and he purposefully did not disclose the discrepancy to us, the buyers.
- The listing agent had actual knowledge the well on the property did not produce the amount of water that she represented on the MLS.
- Even though the real estate agent knew there were problems jeopardizing the future of the development that we, the buyers, invested in, he purposefully withheld that information from us.

Damages may include not only the plaintiff's actual damages, but also punitive damages, which are meant to be a punishment to the defendant or an example to the public to deter others from acting in such a way in the future. As a matter of public policy, damages awarded for acts of fraud are not insurable. Therefore, insurance carriers will not pay a judgment based on fraud. Because the defendant will be personally responsible for those amounts, fraud claims can be very dangerous. (<http://dictionary.law.com/Default.aspx?selected=785>).

### ***Breach of Duty***

As you know, real estate agents have a duty to act in the best interests of his/her clients. Failure to do so may result in a claim alleging breach of fiduciary duty. A fiduciary obligation is one that involves a special trust, confidence, and reliance on the fiduciary to exercise his discretion or expertise in acting for the client. When a fiduciary relationship exists, the law forbids the fiduciary from acting in any manner adverse or contrary to the interests of the client, or from acting for his/her own benefit in relation to the subject matter. The client is entitled to the best efforts of the fiduciary, who must exercise all of the skill, care and diligence at his/her disposal when acting on behalf of the client. A person acting in a fiduciary capacity is held to a high standard of honesty and full disclosure in regard to the client and must not obtain a personal benefit at the expense of the client. (<http://definitions.uslegal.com/b/breach-of-fiduciary-duty/>). The basis for a breach of duty claim may derive from a negligent or intentional act.

Some examples of breach of duty claims include:

- My real estate agent breached her duty by failing to verify the lot I contracted to purchase was the same lot she showed me.
- The listing agent failed to disclose the propensity of the road in front of the subject property to flood and therefore breached his duty to me, the buyer.
- My real estate agent breached her duty by purposefully not disclosing the seller's dispute with the neighboring property owner over the water rights.

### ***Breach of Contract***

We regularly encounter lawsuits wherein one party, usually the plaintiff, asserts a breach of contract claim against the insured real estate agent. Breach of contract is a cause of action based upon an allegation that one or more parties failed to perform under the terms of a contract. (<http://dictionary.law.com/Default.aspx?selected=93>). If a Court finds a breach occurred, it will award damages in such an event. Note that plaintiffs will sometimes claim breach of the real estate contract; however, a breach of contract claim should not exist against the real estate agent in this circumstance, unless the agent was party to the real estate contract itself. This is distinguishable from allegations that the real estate agent breached his/her legal duties which arose out of the buying or listing agreement. It is for this reason that we typically see breach of contract claims in conjunction with other causes of action, such as breach of duty, negligence, fraud, etc.

### ***Negligence***

Generally speaking, negligence is a cause of action alleging the failure to exercise due care toward others which a reasonable or prudent person would do in the circumstances (<http://dictionary.law.com/Default.aspx?selected=1314>). The plaintiff must show the defendant had a duty to the plaintiff; the defendant's act or inaction breached that duty; the defendant's act

or inaction was the cause of the plaintiff's harm; and the plaintiff must have suffered a discernable injury. Acts of negligence are set apart from intentional torts such as fraud, since negligence claims lack an element of intent. For example, a plaintiff does not have to prove the defendant purposefully concealed a property defect, but rather that the defendant knew or should have known about the complained of defect and failed to disclose it. Typically most plaintiffs will plead fraud and negligence in the alternative, which means that in the event the plaintiffs fail to prove fraud, the defendant can still be found to have acted negligently.

Some examples of negligence claims include:

- Our agent failed to transmit written notice to the listing agent before the deadline that we were opting out of the purchase and sale agreement per the inspection contingency in the contract.
- Our real estate agent should have known that even though the property was advertised as a 4-bedroom house, the septic system was only approved for a 2-bedroom house.
- The real estate agent should have known there was termite damage to the house and disclosed it to us, the buyers.

Normally, plaintiffs are not entitled to punitive damages in a negligence claim, but rather are limited to the actual damages suffered, which may or may not include the costs of the litigation.

### ***Bodily Injury / Property Damage***

Most often the types of claims we see in this area concern undisclosed latent defects, such as water intrusion in the basement, a leaking roof, termite damage, etc. Typically, claimed damages will include damage to or destruction of personal property and diminution of value of the subject property. We also receive claims concerning the bodily injury of the claimant or plaintiff. Examples may include physical injury occurring on the property while it is being shown or managed by the insured, sickness or disease resulting from an undisclosed mold problem, mental anguish, pain or suffering, or emotional distress.

### ***Misrepresentation Regarding the Condition of the Property***

When plaintiffs allege the misrepresentation of numerous issues concerning the subject property, which happens frequently, we classify the claim under this general heading. Oftentimes a claim or lawsuit based primarily on the misrepresentation or nondisclosure of one issue will also contain several incidental allegations. On the other hand, some lawsuits or claims may simply contain a laundry list of unrelated problems the plaintiff claims were misrepresented or undisclosed. Examples may include misrepresentation concerning water intrusion, foundation defects, age of the home, type of flooring, condition of the roof, nature of the drywall, synthetic stucco, presence of mold, etc.

### ***Consumer Protection Act***

Most jurisdictions have enacted consumer protection laws that challenge any "unfair methods of competition..., and unfair or deceptive acts or practices in or affecting commerce," (<http://definitions.uslegal.com/f/federal-trade-commission/>). Some courts have held consumer protection laws applicable to real estate transactions. Therefore, it is feasible for a plaintiff to invoke his/her jurisdiction's applicable consumer protection laws in regard to a lawsuit concerning a real estate transaction. Multiple damages, e.g. treble damages, may also be

awarded if the plaintiff can successfully prove the defendant violated the consumer protection law. An award of treble damages is a tripling of the plaintiff's actual damages. Treble damages are allowed by certain statutes, which vary jurisdiction to jurisdiction (<http://definitions.uslegal.com/t/treble-damages/>). Like punitive damages, insurance carriers do not typically consider treble damages a covered damage. Therefore, it is possible the defendant would be personally responsible for an award of treble damages.

### ***Earnest / Escrow Money Dispute***

Another commonly made claim stems from the alleged failure of the real estate agent to pay, collect or return insurance premiums, escrow monies, earnest money deposits, security deposits, tax money or commissions. For example, a seller may allege the real estate agent failed to collect the earnest money deposit from the purported buyer. In the alternative, a buyer may allege the real estate agent erroneously disbursed the earnest money deposit to the seller. Earnest money disputes may not be covered by your E & O policy. However, some insurers do allow the licensee to supplement his/her basic coverage to include an optional endorsement, sometimes referred to as a rider, which provides additional coverage in this area.

### ***Misrepresentation Regarding Flooding or Leaks***

We see many claims regarding the failure to disclose or the misrepresentation of flooding or leaks in a subject property. These claims will likely include incidental allegations and/or claimed damages, such as damage to personal property, structural defects, difference in value of the subject property, and repair costs.

Some examples of claims in this area include:

- The seller told the real estate that the basement floods, but the real estate agent told the sellers not to disclose it. (In this situation, we would typically see a complaint filed by the buyers based in negligence, fraud, and the applicable consumer protection statute, followed by a cross-claim from the sellers.)
- The real estate agent should have known of the house's propensity to flood because of the water stains on the basement walls.
- The real estate agent told us the water was wind driven and came in through the roof during a hurricane, when in actuality the house has a propensity to flood during lesser storms.

### ***Misrepresentation Regarding the Value of the Property***

Claims alleging the misrepresentation of the value of the property may occur in a number of scenarios. For example, the buyer of a home or the mortgage lender may allege the appraisal overvalued the subject property. In addition to appraisals, plaintiffs may allege misrepresentation concerning broker price opinions (BPOs), which provide a fair market value estimate of the subject property. (Note that some jurisdictions place limits on BPOs done by licensed real agents.) In contrast, a seller may allege his or her real estate agent undervalued the subject property and listed it for too little.

### ***How can I avoid a claim?***

Unfortunately, there is no unassailable plan of action that will insulate you completely from a claim. Even the most meticulous and conscientious real estate agent may find him- or herself

involved in a dispute or lawsuit. However, you may reduce your risk of liability or exposure if you follow these general principles outlined below.

- Know your jurisdiction's laws concerning your obligations and duties as a real estate professional. Be comfortable with policies, practices, standards of care, etc. If you have questions or concerns, express them to your qualifying broker or contact your jurisdiction's real estate commission.
- Perform only those activities that are within the scope of a real estate agent. It may seem that going above and beyond in order to satisfy a client will set you apart from the rest. However, by taking on more responsibility than is normally required of a real estate agent, you may have just increased your risk of liability and exposure should a claim arise. Furthermore, your real estate E & O coverage may not apply to activities that do not require a real estate license.
- Stay current with any changes in real estate by taking advantage of continuing education opportunities.
- Be active in national and local professional organizations.
- Memorialize conversations in writing. Two people may remember one conversation completely differently. Who will the jury believe? The answer could surprise you. A credibility contest is an unpredictable scenario in which to find yourself.
- Have clients initialize changes to documents. A contract alteration without written authorization is unlikely to stand up in court. Additionally, you may want to consider having clients initial other transaction documents, e.g., property disclosure forms, home inspection reports, septic inspection reports, estimates for repairs, to indicate the documents have been delivered to the client.
- Don't admit liability. Even though you may feel remorse at your client's unhappiness, it does not necessarily mean you are legally responsible for his or her claimed damages. What you may think of as good P.R. could backfire on you. By making such an admission in an effort to assuage your client's feelings, you may taint your defense position and jeopardize insurance coverage.

### ***I've just received a claim – what do I do now?***

At some point in your professional career, an unhappy client may attempt to state a claim against you, whether that claim is in the form of a verbal statement, an email, a letter, or a lawsuit. If you receive any of the aforementioned items, notify your E & O carrier *immediately*, taking care to comply with the reporting provisions of your policy. It is the insured's responsibility to report the claim to the carrier timely and in accordance with the policy.

Many E & O policies are "Claims Made and Reported" policies. A "Claims Made and Reported" policy has two requirements: (1) the claim must be made during the applicable policy period, and (2) the claim must also be reported during this same policy period. For example, let's assume your E & O policy runs from January 1, 2010 to January 1, 2011. If you receive a claim on December 15, 2010, but do not report the claim to your E & O carrier until April 1, 2011, you may have jeopardized coverage of an otherwise covered claim. In order to avoid notice issues such as this, report the claim to your E & O carrier without delay.

Cooperate with your E & O carrier – they are there to help you. You will likely be required to provide file materials and other documentation specific to your claim. Please do so promptly and

efficiently. Communicate with your E & O carrier in a forthcoming and candid manner. If you have questions about your claim, ask them. Your claims representative will be happy to address any concerns you may have.

If your claim is not covered or you do not carry E & O insurance, you may choose to seek the assistance of an attorney. If you are named in a lawsuit and you have no insurance coverage, we strongly suggest you retain legal representation in order to protect your interests.

Even if your E & O carrier provides coverage for your claim, you may choose to retain a personal attorney. Be aware that the defense attorney retained by the E & O carrier cannot respond to any issues regarding coverage, as that would present a conflict of interest.

Lastly, do not speak about your claim to other people, as you may inadvertently jeopardize your defense position and/or coverage.

A note about the author - Lana Schroeder, Esq. is a Claims Specialist with Rice Insurance Services Company, LLC (RISC). RISC is an agency that exclusively administers real estate errors and omission insurance programs in states that have mandatory insurance programs for real estate licensees. RISC is the group provider in eleven of the thirteen states with current mandatory programs for real estate licensees.