

The Pitfalls of Failing to Disclose in Real Estate: a CRES Risk Management Video Webinar

Laura Prouse ([00:00](#)):

...For joining us today for the Pitfalls of Failing to Disclose. I'm Laura Prouse with CRES Insurance Services. Today, we welcome attorney Mark Carlson from the Carlson Law Group. Mark has been defending real estate professionals since 1993 and has worked with CRES for over 20 years as a founding member of our legal panel. Along with Mark, we have Dave Miller, regional vice president with Fidelity National Home Warranty. Dave manages the CRES Advantage Home Warranty Plan, which ties in with CRES's E&O insurance. We have a lot to cover, so let's get started, and Dave, I'll hand it over to you.

Dave Miller ([00:31](#)):

Thanks, Laura. I just want to first off say thank you to everybody for watching. This is the third webinar that we've done, the first one on COVID forms and how to use those in a transaction in a COVID world. And then also we did a second webinar on the CRES website page here. The second one was on property management, which continues to be a hot topic. This one is on the pitfalls of failure to disclose, which we could probably go on for a couple of hours, but we're going to try to keep it short for everybody. So let's start with, Mark, my first question is, I was talking about Laura yesterday, she said it's estimated about 70% of the E&O lawsuits out there are a result of a party failing to disclose. So what's the most common disclosure lawsuit against real estate professionals for failing to disclose?

Mark Carlson ([01:25](#)):

Well, I don't know that there's any one particular topic, like permit issues or leaky roofs or neighbor problems. I mean, those are kind of varied, but I would say that the 70% estimate on lawsuits arising out of sales transactions, setting property management aside, that 70% is probably low. I've been doing this for longer than I care to admit, and the majority of our cases have always been just forgetting to disclose something or concealing something that is pertinent about the property. We've seen asbestos come and go. We've seen reg Z lawsuits come and go, mold come and go. But disclosure issues are always present and are always the large majority of the lawsuits we see.

Dave Miller ([02:14](#)):

Of course, you talked about water intrusion there a second ago. Regarding water intrusion, and we see a lot of this with mold, too, what are the responsibilities of the sellers to disclose these, and what types of nondisclosure issue is most likely to result in a lawsuit?

Mark Carlson ([02:32](#)):

Yeah, there's nothing like water intrusion to guarantee a lawsuit. People will put up with a lot of different things, but when there's water coming into the house, that's when people are almost guaranteed to file a lawsuit, and it's difficult for agents because a lot of times, especially in Southern California, there isn't a whole lot of evidence of water intrusion. It only happens when it rains. Unless

you happen to be there when there's rainfall, it's hard for an agent to know. But being careful about asking things like have you repainted recently and looking for signs of stains and pointing them out, rather than just glossing over them, all that is really important. You've got to be extra diligent, looking at windowsills and things of that nature. Just if it looks wrong, you should probably ask about it so that the transaction doesn't close with with an undisclosed water intrusion problem somewhere.

Dave Miller ([03:34](#)):

Got it. How about wood destroying pests and rodents? What should agents do to handle those properly?

Mark Carlson ([03:39](#)):

Well, the biggest issue right now is, you know, on termite issues, it's been since 2002 that the California or the [inaudible 00:03:51] has made reference to section one, section two items, but we still see people holding on to that concept and forcing the seller to pay for section one items. And it's been almost three years now that the WPA, the Wood Destroying Pest Addendum, has been removed from the list of forms, but people are still putting it in the terms, additional terms, seller to pay for section one items. And it's so dangerous, because you don't know what is going to be discovered once you ultimately do the inspection. Even if you say, "Hey, I'm a smart agent, I'm going to do the inspection before I list the property," well, you know, the purchase agreement says that the buyer has the right to do their own termite inspection. So even if you get your own, if the seller gets their own, then if the buyer comes in and gets another one, and the recommended repairs are different, there's going to be a dispute.

And so another thing, too, is at least with the WPA, and agents I think don't consider this enough typically, there's regulations that pest control operators have to follow. And one of those regulations is if I see, as a pest control operator, evidence of active infestation that goes into an inaccessible area, I'm obligated to stop and say, "Hey, you need to open this area up." And then I'm obligated to come back out and do a re-inspection. Well, at least the WPA had terms that provided for who pays for all that, and who pays to put the property back together. And when you just write in, on the other term, seller did pay section one items, you are exposing the parties to uncertainty as to cost for something that you know that the home inspector, or the, I'm sorry, the pest control operator is going to have to do.

So CAR has been trying for an awful long time to get brokers and agents to handle pest issues like any other request for repair. And it really is the better way to do it. It lets the market dictate who's obligated to incur those expenses. In a hot market, the seller's probably going to say, "I'm not doing anything." In a soft market, the buyers are going to say, "If it's not perfect, I'm not buying." And that really is the way that it should go, not just a relic of a habit that agents and brokers have created for themselves.

And then with respect [crosstalk 00:06:11], with respect to rodents, that's another thing, too, that a lot of people, you know, that's a separate license for pest control operators. And so when there's evidence of rodent infestation, I've seen this an awful lot, where people just sort of ignore it. And then it becomes, if a house in the attic or crawlspace are infested by rodents, it is so difficult to get that remedied. So that's something to really pay attention to, if somebody calls out that there might be a rodent problem.

Dave Miller ([06:42](#)):

You mentioned a couple of minutes ago about a hot market. Of course, everybody in California knows this, actually across the country. We are an extremely competitive, hot real estate market, multiple offers, over asking. Talk about a little bit about buyer's agents recommending to their buyers

non-contingent offers, and that's risky. So what's your advice, and how do buyers and buyer's agents navigate through that?

Mark Carlson ([07:08](#)):

Yeah. So that's another problem that the industry has created for themselves. Agents have this idea that having a non-contingent quick close is most desirable to all sellers. And in reality, the sellers mostly just want a high purchase price, and especially in a hot market, which is what it makes it difficult logically to justify it. In a hot market, when you have multiple offers, if somebody goes through inspections and then cancels, well, you've got multiple other buyers waiting in the lanes. So just get somebody else in there.

So rarely I think is a circumstance where a seller really needs to close quickly and making a non-contingent offer is the best solution for the seller. But we can all pretend that isn't happening in the marketplace, where it is. So then you've got to figure out, well, how do I deal with this, what's happening all around me? There's a couple of things that I like to recommend. Firstly, to get a list or get some inspections done prior to listing, and then deliver the home inspection report and other reports, other inspection reports, before any of the offers come in.

Another strategy that I've heard that I really like is when you have multiple offers, you say to all the potential buyers, "We are going to make a decision five days from now." And within those five days, you all can agree to hire your own home inspector and come in and inspect, or you can all get your own home inspectors. But within that five day, if you want to do your inspection, you can do the inspection and then decide whether you want to make the offer five days from now. So at least the buyers or the seller have the protection of the buyer getting an inspection period, so to speak.

And you know, it isn't all gravy, a non-contingent offer isn't all gravy for a seller, either, because I know what's going to happen is agents are going to say, or buyers, I'm sorry, are going to say, "Yeah, I got into this house and there's a whole bunch of problems. And my agent told me, or the listing agent told me or told my agent, if you want to be considered, you've got to be non-contingent. So I was forced to, even though I didn't want to." So it creates additional risk to the seller. And if you, as a seller, say, "Okay, I'm accepting you, buyer number whatever, four, but in my counter to you, I'm going to give you an inspection period of whatever number of days," and I think that would be the best way to deal with it as a seller, to force the buyer to get an inspection.

Dave Miller ([09:40](#)):

[inaudible 00:09:40] sounds so risky there.

Mark Carlson ([09:44](#)):

We've had things like you put an offer in non-contingent, all of a sudden the HOA says, "Hey, you know what? The seller is two years in the rear on dues," and there's not enough money in the deal to pay the dues. So now the buyer's left with either having to pay the dues or canceling, because it wasn't anything that they could have ever figured out prior to accepting or making a non-contingent offer.

Dave Miller ([10:05](#)):

Right. Gosh, let's open up a whole can of worms here and talk about flip properties. Of course, that market is still out there, although it's not as significant as it was even five years ago or even one year ago. Even the distressed properties out there are overpriced and hard to get. But talk about flip properties real quick. And agents, let's go to both sides of this. We'll start with agents representing sellers on the transaction that maybe never even lived there. They just went in, and it's an investment

property and they flipped it. Or maybe they did some renovations themselves. What should they be looking for when they represent sellers on a flipped, obviously a flipped property?

Mark Carlson ([10:44](#)):

Yeah. So the risks are different if you're selling or listing with respect to flip properties. What I've seen often on the listing side is that an agent will be asked to come in and evaluate a property prior to the flip. So maybe the agent represented the buyer when they acquired, or the flipper, when the flipper acquired the property. And then the argument is, well, you saw how bad everything was and so you should have disclosed that there was this problem or that problem, which of course the agent really isn't paying that much attention to, thinking that all those issues are going to be remedied in the course of the flip.

And it's just sort of the reality that people that are buying properties to flip and resell are not using fixtures and finishes and doing things as though they were living in the property. They're trying to keep costs to a minimum. And not necessarily to say that it's done with mal-intent, but, you know, it's just, "Hey, we could make this thing right for a little bit more money." And the flipper's mentality usually is, well, it's working, so I'm not going to do something I don't have to do. Whereas if you were living there, you might pay the extra money to correct a small issue.

So for a listing agent, be careful about how much time is spent. Well, I had one case where it was like an eight month remodel, and the listing agent was on the property numerous times during the course of the sale. And so the, or I'm sorry, in the course of the construction. And that was a real difficult one, because there was a lot of innuendo that the listing agent should have known that the repairs weren't being done properly.

If you are on the selling side, it's the reverse. So now you've got a buyer who's expecting a brand new flipped, perfect home, or I'm sorry, remodeled perfect home, and then solely discovers that there were corners cut here and there. So I think from a buyer's agent's perspective, you still want to be diligent about inspections, maybe even more so, to make sure that the work that was done was done properly. A lot of times work is done without permits, and so I see that, that buyers don't go and pull permits, even though they know it's a flip. And so that's a big problem after the deal, then the buyers say, "Well, why didn't you ever tell me to go pull permits?" Or maybe there is an oral recommendation, but not a written recommendation to the buyer. You know, "Listen, this is a flip. Work was done. You're going to be a fool if you don't go pull permits prior to close." You need to be that direct about it.

Dave Miller ([13:22](#)):

Right. I'll tell you, I've talked to so many agents over the years, and it's kind of funny, but they'll be running around from listing appointment to listing appointment, and they're just like, "Dave, I'm so busy. I'm doing this, I'm doing that." And I'm going, they consider those interviews, you know, they're interviewing for the listing. And I always tell them, I always put my risk management hat on and say, "Boy, if you're not the one interviewing them, you could really potentially get yourself in trouble, and those sellers could take down your career." So when you go on all those listing appointments, it's great. You're going to tell them how great you are and display your services to them. But you should ultimately be the one interviewing them.

So why is it so important for sellers and agents to kind of team up, and what can the agents do to verify that what the seller is saying about the property is true? I mean, I didn't live there, but if I'm listing your house, Mark, I have to just kind of go with what you said with the conditions of the home.

Mark Carlson ([14:19](#)):

Right. So the concept of interviewing the seller is really important, as experienced agents will all get a sixth sense about their clients. And I can't tell you how many lawsuits that I've had where the agents will say, "Geez, I knew they were a problem right from the beginning." And sometimes it's about the listings you don't take versus trying to take every single listing.

So a couple of things you can do to sort of vet the seller more carefully, number one, sit down and go over the disclosures with them as they're filling them out. Don't write the answers yourself, because then it looks like you're the one that provided the information, but go over the seller property questionnaire with the seller as they're filling it out, and then tell them, "Okay, well, here's what this means. Have you had any of those problems?" And then listen to the response, and if they waffle or, "Oh, yeah, maybe, but it was no big deal," then you're able to ask more questions and follow up. And then if you think that there's an issue that they're trying to hide, hopefully in that process, that'll become more apparent. So that's certainly one thing that you can do.

And with the transfer disclosure, same way, and really is better practice for agents on both sides, buyers and sellers, to go over the documents paragraph by paragraph. You don't have to read it to them, but at least say, "Okay, here's what this is talking about. You have an inspection period. Here's what it means," and so that way the clients get professional service and the agents have the opportunity to try to get a feel for whether there's something that isn't being disclosed properly.

Dave Miller ([16:06](#)):

Right. Are some of the failures to disclose about the, we talked about permits a little bit, too, about the condition of the home? Are most of the failures to disclose about those, as well, the actual structure itself, or is it more of the things that we just talked about?

Mark Carlson ([16:22](#)):

Yeah, I would say that the majority of the nondisclosure cases are that there's some physical defect in the house. And then I would say within that, there's, oh, maybe a little bit more than half are sellers that say, "I never had that problem when I was here." Or, "You know what, I just forgot about that. We did that repair 20 years ago, and I just forgot." And then for whatever reason, it resurfaces after close of escrow. And then the small portion of it, or a small portion of the cases, are where the sellers knew they had a problem and they were just trying to brush it under the rug so that they could get rid of the problem and pass it on to somebody else.

Dave Miller ([17:11](#)):

Right. So real basic question. I know a lot of agents ask me this all the time. What is the difference between just simply failing to disclose, whoops, I just missed that, or I intentionally failed to disclose that? And we all know that Laura tells us that fraud is not covered under an E&O policy. Do you have to at least open the claim on that to determine if it was fraudulent, or was it just a whoops, I forgot? What's the difference between those two?

Mark Carlson ([17:40](#)):

Well, the element is intent. And so to go through briefly, a negligent nondisclosure is that you make a representation of fact that's false, and you had no reasonable basis for believing it to be true. And then the fact caused, or the issue caused damage to the buyer or to the plaintiff. On an intentional misrepresentation, you make an assertion of fact, knowing it to be false. So that's the difference. And then the rest of the elements are the same, that the other side relied on that to their detriment and

caused them damage. So it really is just a matter of proving that the person making the representation knew it was false and intended to cause the other side to rely on the misrepresentation.

And concealment is the same way. I knew something. I had a duty to disclose it, and I intentionally failed to disclose, so as to get the other party to act in a particular way. Concealment is a little bit more difficult, because first, I think we can all say that there's a duty, but when you're trying to prove a negative, you knew it and didn't tell me, because you wanted me to rely, that's where it factually gets to be difficult.

Dave Miller ([19:03](#)):

Right. And I swear, this is the last question, but what if I'm listing your property, and I know as the listing agent that something you're saying is not truthful? How far do I get into that? Do I walk away from the listing, knowing that you're failing to disclose something that even I know about, maybe because you told me, and you put on the form that it was something different?

Mark Carlson ([19:23](#)):

Yeah. So the seller's obligation to disclose arises out of the contract. There's contractual obligations to make disclosure, but then civil code section 1102, which is where the TDS comes from, that's what imposes duties upon the seller to make disclosures. An agent's obligation to make disclosures arises out of civil code section 2079. So there's a separate, distinct statutory obligation to make disclosure that the agents have, apart from the seller. So if you know something as an agent and the seller doesn't disclose it, you still have to disclose it. And if the seller says, "Well, don't disclose it," then you really have to either say, "Well, I can't do that," and then convince the seller that they're not acting properly, or just give up the listing and say, "I can't complete a transaction, if you are going to tell me not to disclose something that I'm statutorily obligated to disclose."

Dave Miller ([20:21](#)):

Right. I'll tell you, just great information today. I think I've been most excited about this one, because it's the most common, not only in E&O, but in real estate professionals' daily, day-to-day operations, is the fear of failure to disclose. So I hope this information was valuable to everybody. Mark, thanks so much for your intel, as always. And we look forward to the next webinar on risk management.

Mark Carlson ([20:45](#)):

All right, well it's my pleasure.

Dave Miller ([20:47](#)):

Laura, back to you.

Laura Prouse ([20:49](#)):

Thank you, Mark. Thank you Dave. As always, very, very informative. Looking forward to our next webinar. And just for our audience, thank you for watching. And also, just so you know, a copy of this webinar is available on the CRES insurance homepage, if you look under the ClaimPrevent blog. Again, thank you both, and we'll look forward to seeing you again soon. Take care.

Dave Miller ([21:06](#)):

Thank you, guys.

Laura Prouse ([21:07](#)):

Bye-bye.