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DISCLOSURE: Courts Define Broker's Duty

By Judon Fambrough

Failure to disclose certain information during real estate transactions can be an offense both under the Texas Deceptive Trade Practices Act (DTPA) and the rules and regulations of the Texas Real Estate Commission. The homebuyer is protected as a consumer by the DTPA. The law holds that knowingly withholding relevant facts to induce a consumer into a transaction is a deceptive trade practice. Seven recent appellate cases expound the owner's and broker's duty to disclose facts that should have been known. Brokers are liable for relaying inaccurate information and must disclose all information that might affect the buyer's decision.

Silence may not be golden, especially in real estate transactions. Words not spoken are potentially damaging under the Texas Deceptive Trade Practices Act (DTPA).

The Texas DTPA, amended in 1979, includes a twenty-third item to the so-called laundry list of false, misleading or deceptive business practices. The new item establishes that silence can be construed as an offense under the DTPA. It is a deceptive business practice to knowingly withhold relevant facts to induce a consumer into a transaction.

In 1980 and 1981, the Texas Supreme Court examined the new amendment as it applied to real estate brokers. However, many questions were left unanswered. Five additional cases, one involving the Texas Supreme Court, expanded upon the agent's disclosure duty.

The Texas Supreme Court was asked in 1980 to decide two issues involving a real estate broker's services. First, did the purchaser of a home have "consumer" status under the DTPA as to the services rendered by a broker? Second, did the real estate broker have a duty to disclose facts that the broker **should have known** about the property? *Delaney Realty, Inc., v. Ozuna,* 593 S.W. 2d 796 (Tex. 1980).

The broker-defendant in this case sold a house that was prone to flooding. At trial, the only evidence presented was that **the broker should have known** about the flooding. There was no evidence that the broker knew of the flooding.

The El Paso Court of Appeals in 1979 held that the purchaser was not a consumer of the real estate broker's services under the DTPA. When appealed to the Texas Supreme Court, the court refused to hear the case but reserved the issue for a later date.

A year later, the Texas Supreme Court heard *Cameron v. Terrell and Garrett, Inc.,* 618 S.W. 2d 535 (Tex. 1981). A real estate broker represented to the purchaser that a house contained 2,400 square feet as shown in the Multiple Listing Service guide. The broker had no actual knowledge about the accuracy of the information. In fact, the house contained only 2,245 square feet. The court of civil appeals held the broker was not liable under the DTPA for two reasons. First, the broker had no actual knowledge of the misrepresentation. Second, the buyer was not a consumer of the broker's services under the DTPA.

The Texas Supreme Court reversed the court of civil appeals. It held the buyer was a consumer of the broker's services under the DTPA. The court found that there was sufficient evidence, when viewed in the most favorable light, to support the finding that Terrell and Garrett misrepresented the square footage. However, the court did not discuss the evidence presented in the case.

What particular information must be disclosed remains unclear. Obviously, the broker must disclose all relevant information of which he or she is aware. What is unclear is whether the broker must disclose relevant facts **that the broker should have known.** Six recent cases have clarified this and other agency disclosure issues.

The first is the Texas Supreme Court case of *Ojeda de Toca v. Wise and Wise Developments, Inc.,* 748 S.W.2d 449 (Tex. 1988). The plaintiff, who was from Mexico, purchased a Houston home to use while her mother received medical treatment. She purchased the house from Wise Development, Inc., and immediately went back to Mexico. When she returned, the house had been demolished.

The plaintiff sued both the title insurance company and seller (Wise) for failing to tell her that the property had been posted for demolition at the time of the sale. The title company settled with the

plaintiff out of court. The case against the seller was appealed to the Texas Supreme Court.

At trial, the evidence showed that Wise knew the property was subject to the demolition order at the time of sale and failed to disclose it to induce the plaintiff into the purchase. The plaintiff would not have purchased the property had she known.

Wise contended that one need not disclose facts contained in public deed records. The recording statutes give constructive notice of the facts to all persons as a matter of law.

The Texas Supreme Court ruled in favor of the plaintiff. The purchaser's failure to search the deed records does not bar a consumer's action for DTPA damages. Imputed notice under the real property recording statutes is not a defense to the DTPA.

A 1988 appellate case also involved instruments recorded in deed records. However, the controversy was between the broker and owner. *Kinnard v. Homann,* 750 S.W. 2d 30 (Tex. App. 1988). Kinnard, the owner-plaintiff, lived in Odessa but owned a home in Luling. Kinnard listed the Luling property with Homann, a real estate broker. After the listing, Homann became aware that Kinnard was delinquent in her mortgage payments. The lienholder accelerated the note, posted the property and eventually sold it at a foreclosure sale. Homann did not inform Kinnard of any of these facts.

Kinnard sued Homann for damages, claiming among other things, that Homann breached his fiduciary duty by failing to reveal the impending foreclosure to her. Homann contended the parties' relationship was limited to showing the property and finding a purchaser. It was outside the scope of their relationship to disclose the impending foreclosure.

The trial court agreed with the broker and ruled in Homann's favor by way of a summary judgment. (A summary judgment is granted when the judge feels that there is no genuine issue of material fact and, assuming all the facts were true, a plaintiff would not be entitled to a judgment.)

The appellate court disagreed and remanded the case for trial. The unique feature of the case was that the owner did not sue the broker under the DTPA but on the rules and regulations promulgated by the Texas Real Estate Commission. One or more of the regulations impose a fiduciary obligation on the broker. The fiduciary duty becomes part of the contract. Valid agency rules have the force and effect of law.

Although the case now will be decided by trial, it raises some disturbing issues. Why should a broker have to tell listed homeowners they are in default on their payments? What other items could fall within the fiduciary disclosure list? Does the broker need to tell the seller that the roof requires new shingles, the air conditioner is broken, the lawn needs mowing and so forth?

The third case is a DTPA lawsuit similar to the *Ozuna* and *Cameron* cases. If it goes to the Texas Supreme Court, it may decide whether a broker is obligated to disclose facts about which he or she should have known. *Pfeiffer v. Ebby Halliday Real Estate,* 747 S.W. 2d 887 (Tex. App. 1988).

The plaintiff (Pfeiffer) purchased a home brokered by Ebby Halliday Real Estate (Halliday). The issue was whether Halliday violated the DTPA by failing to disclose information to the plaintiffs about possible foundation problems.

At trial, the facts showed that there was visual evidence of previous foundation repairs, evidence of previous repairs and problems inside the house, evidence of common knowledge among real estate dealers in the area that the house had a history of foundation problems and that other real estate agents would not list the property. However, there also was evidence that an inspection report, prepared for the Pfeiffers by a company recommended by Halliday, indicated "some foundation settling" that would cause someone to look more closely at the structure.

The jury found Halliday liable under the DTPA. The trial judge overturned the jury's decision by entering a judgment notwithstanding the verdict. (A judgment notwithstanding the verdict is granted when the judge feels that the jury could not have reached the verdict based on the evidence.) Pfeiffer appealed.

The appellate court sustained the judgment in Halliday's favor. In doing so, the court stated, "There is a distinction between misrepresentations and a failure to disclose information. One cannot be held liable under the act for failure to disclose facts about which he does not know."

The court went on to hold:

- A repaired foundation does not establish Halliday knew of a defective condition in the foundation.
- Halliday cannot be charged with "common knowledge" because of a reluctance to list by other agents.
- Through an expert recommended by Halliday, the Pfeiffers learned of the foundation problems before the purchase.
- Halliday had no more obligation to proceed to "actual knowledge" of the foundation's defect than did the Pfeiffers once the report indicated "some foundation settling."

The appellate court held that Halliday had the duty to disclose only information Halliday knew. The court did not impose a duty on Halliday to disclose information that Halliday should have known.

Similar to the *Pfeiffer* case, the fourth 1988 case involves a third-party inspection of property, *Dubow v. Dragon,* 746 S.W. 2d 857 (Tex. App. 1988). The plaintiffs (Dubows) purchased a home from the defendant-sellers (Dragons). The asking price was $495,000. The interior appeared shabby, but the Dubows liked the lot. The Dubows were given the right to inspect the house. During inspection, they identified several existing and potential problems stemming from movement in the concrete slab. The Dubows then hired a foundation specialist who found additional problems attributable to differential foundation movement. The Dubows also had an architect and contractor look at the house prior to closing.

The price was reduced to $445,000 during the inspections. After all inspections were completed, the contract price was reduced $17,500 more, even

though the estimated cost of the foundation repairs was only $4,000. In addition, the contract was modified as follows:

"After careful inspection of the house, and with professional opinions, [w]e feel that the house will need extensive on-going maintenance because of the site positioning, foundation and draining. See attached inspection report. We will take the home as is, WITH ALL CONTINGENCIES REMOVED [emphasis original]."

After closing and taking possession, the Dubows encountered foundation problems as feared and brought suit against the Dragons under the DTPA for failing to disclose the defects. The issue was whether the Dubows had relied on the Dragons' statements and failure to disclose or on their own inspections. The trial judge ruled the Dubows had relied on their own inspections and rendered a summary judgment for the Dragons. The Dubows appealed.

The court of civil appeals affirmed the trial court's summary judgment. The court held "that, as a matter of law, the Dubows' 'careful' inspection of the house's condition constituted a new and independent basis for the purchase which intervened and superseded the Dragons' alleged wrongful act. . . . Any alleged statements or failures to disclose on the part of the Dragons were not a producing cause of any damage to the Dubows."

The fifth case, *Kubinsky v. Van Zandt Realtors,* 811 S.W. 2d 77, also involved the DTPA. In 1987, the sellers retained a real estate company to list their home. In August, the house was sold to the Kubinskys.

Prior to the sale, the buyers enlisted their own real estate agent to assist them in the purchase. The buyers also hired the Meruss Inspection Company to inspect the house prior to closing. The inspection revealed minor foundation movement. Both the buyers and the buyers' agent were present during the inspection. The buyers went outside to see what the inspector had found. No one questioned the sellers about the foundation movement nor asked if any repairs had been performed.

Within two to three weeks after closing, the buyers noticed cracks around the doors and windows and in the slab. Upon further inquiry, the buyers discovered that the foundation had been repaired approximately three months before the sale.

The buyers filed suit against the sellers, the listing broker and the inspector. The listing broker asked for and received a summary judgment dismissing the company from the litigation. The buyers appealed the summary judgment.

The appellate court held that a listing broker has no legal duty to inspect listed property for defects other than asking the vendors if a defect exists. (There is a duty to inspect in California.) The Texas Real Estate License Act (TRELA) does not list the inspection of real estate as a duty of a licensed real estate agent. In fact, Section 18C of the TRELA specifically prohibits blending the functions of broker or salesperson and inspector.

Furthermore, licensed brokers give no implied warranty that their services will be performed in a good and workmanlike manner. In *Melody Home Mfg. Co. v. Barnes,* 741 S.W. 2d 349, the Texas Supreme Court held that such an implied duty does exist for repairs to tangible goods. However, the court refused to decide if the same standard applied to services. Two subsequent Texas appellate cases, *Forestpark Enterprises v. Culpepper,* 754 S.W. 2d 775, and *Dennis v. Allison,* 698 S.W. 2d 95, have refused to apply the implied warranty to services.

The decision noted that the buyers had engaged the services of their own licensed brokers and an inspector to protect them. The buyers' reliance on these professions removed or lessened any reliance on the listing broker

The sixth case, *Hagans v. Woodruff,* (A14-91-000925-CV), 4/30/92, involved, among other things, allegations of a breach of the DTPA being levied against a Realtor for failing to disclose information concerning a fault lying beneath a subdivision.

The plaintiffs contacted the defendant, a real estate broker, to show them a house in the Windgate subdivision. Also, the defendant had served as the property manager of the home for several months and had overseen all the repairs during that time. The plaintiffs purchased the home.

After the plaintiffs moved in, they learned there was a fault in the ground running beneath the subdivision and their home. Later, they noticed separations in the structure and sued the defendant for violation of the DTPA. The court ruled that there were no damages for breach of the DTPA.

On appeal, the judgment was affirmed. Although the plaintiffs alleged that the defendant **should have been aware of the fault line** running through the subdivision, there was never any evidence the defendant knew of the fault nor provided false information about it.

The defendant told the plaintiffs the house was on a sound foundation. At the time, nothing indicated there was damage to the foundation. Also, the defendant said the house was in a good neighborhood. However, "being in a good neighborhood" could hardly be perceived as an all-encompassing representation that no faults lay beneath the neighborhood.

What do these cases mean to the real estate broker? First, **the broker must disclose to the purchaser all known facts about the property that will influence the purchaser's decision to buy.** The known facts must be disclosed even though they are recorded in the deed records. However, the broker is not obligated to search the deed records on the purchaser's behalf. So far, the broker does not have a duty to disclose facts that he or she should have known.

Second, the broker is liable for relaying false or inaccurate information about the property, even if the information was provided by the seller.

Third, the fiduciary obligation imposed by the Texas Real Estate Commission's rules and regulations **requires the broker to disclose to the principal all information that might affect the principal's decision about the listed property.** This may include telling the principal he or she is delinquent on the house payments **if known to the broker.**

Fourth, the broker should **urge the purchaser to obtain an independent inspection** of the property. Two cases ruled that an independent inspection report became the motivating force of purchasers' decisions and not statements or nondisclosures made by the seller or broker.

Finally, according to the Kubinsky case, the listing broker may have a duty to ask the vendor if defects exist in the property. This inquiry may be nullified by property disclosure statements required effective January 1, 1994, or a third-party inspection.

But what about the disclosure of prior occupants having AIDS or previous murders or suicides being committed on the premises?

Again, the 73rd Texas Legislature came to the rescue of brokers. Effective September 1, 1993, HB 991 amended the Texas Real Estate License Act to provide that a broker has *no* duty to inquire about, make a disclosure related to or release information concerning a previous or current occupant having AIDS, HIV-related illness or an HIV infection.

The same applies to a death occurring on the property by natural causes, suicide or an accident unrelated to the condition of the property.

In the seventh case, decided on July 14, 1994, a new disclosure requirement, previously skirted by the new statutes, was announced by a Texas appellate court. Between the time of closing and the move-in date, the plaintiff-buyers discovered the prior owner had been charged but acquitted of molesting several children in the home.

The facts were known to the broker, who did not disclose them when asked prior to closing. The plaintiffs did not move into the house and made no mortgage payments. They unsuccessfully tried to cancel the sale. Eventually the Veteran's Administration foreclosed.

The plaintiffs sued the broker under the DTPA for closing costs and mental anguish. The plaintiffs' award for $117,800 was upheld on appeal.

This is the first appellate case in Texas requiring disclosure of nonphysical characteristics of property under the DTPA.

Sanchez v. Guerrero, 885 S.W. 2d 487 (Tex. App. 1994).

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