

# 2018-2019 General Update Course

## Section Two Disclosure of Material Facts



1. Sara, a broker, lists a property for sale on behalf of an owner. Sara lives in the same neighborhood as her listed property. Around the time that she lists the home, a road expansion project is announced that will begin in a few months and is estimated to cause various traffic delays and detours around the neighborhood. The project receives significant news coverage, and several community meetings are held because so many community members are not in favor of the project. Sara does not mention the project to any prospective buyers. The home sells quickly. Later, when the new owners learn of the project and complain that she did not properly disclose it to them, she states that the project was so widely covered, it didn't seem necessary to mention it.

Should Sara have disclosed this information to the buyers? \_\_\_\_\_

If so, would this be considered a misrepresentation or omission of a material fact?

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2. Barry, a broker, lists a property for sale on behalf of an owner. Barry markets the residential property as being 2,600 square feet, noting, "Square footage per tax records." The property is sold, and the buyers are represented by a cooperating firm. Several years later, the buyer-owners decide to sell and discover that the home is only 1,800 square feet of heated living space.

May Barry be held responsible for the misrepresentation? \_\_\_\_\_

Does the original Buyer's Agent share any responsibility? \_\_\_\_\_

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### LEARNING OBJECTIVES

After completing this Section you should be able to:

- determine what is (and what is not) a material fact;
- summarize and explain the duties of a Listing Agent;
- determine whether a BIC's supervision of a PB is sufficient;
- differentiate between negligent and willful misrepresentation and omission; and
- explain all requirements for maintaining active licensure.

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## OVERVIEW

**This Section will review the facts of several disciplinary cases related to material fact disclosure.**

Licenses are required by statute to discover and disclose material facts, and may be subject to disciplinary action for either willfully or negligently misrepresenting facts or omitting/failing to disclose a material fact. [G.S. 93A-6(a)(1).]

A “material fact” is any fact that is important or relevant to the issue at hand.

**The Commission considers “material facts” to include at least the following categories, regardless of whom an agent represents in the transaction.**

- 1. Facts about the property itself.** This category includes but is not limited to any significant property defects or abnormalities, such as a structural defect, a malfunctioning system, a leaking roof, or drainage or flooding problem.
- 2. Facts that relate directly to the property.** These are typically external factors that affect the use, desirability, or value of a property, such as a pending zoning change, the existence of restrictive covenants, plans to widen an adjacent street, or plans to build a shopping center on an adjacent property.
- 3. Facts directly affecting the principal’s ability to complete the transaction.** This category includes any fact that might adversely affect the ability of a principal (seller or buyer) to consummate the transaction. Examples include a buyer’s inability to qualify for a loan; a buyer’s inability to close on a home purchase without first selling a currently owned home; or a seller’s inability to convey clear title due to the commencement of a foreclosure proceeding (posting of a notice of sale) against the seller.
- 4. Facts that are known to be of special importance to a party.** There are many facts relating in some way to a property that normally would not be considered “material,” but because a broker knows they are of special interest or importance to a party, they become material facts that the broker must discover and disclose. Examples include a buyer who asks the broker about specific zoning restrictions in a residential property because the buyer wants run a small, home-based business, a buyer that informs his/her broker that they will not purchase a home in a neighborhood with an HOA, or that a buyer will only purchase a property in a neighborhood with a pool and clubhouse.

## Additional Facts That Must Be Disclosed to an Agent's PRINCIPAL

Under agency law, an agent must disclose to the principal any information that may affect the principal's rights and interests or influence the principal's decision in the transaction. Examples of relevant information a broker-agent must share only with his/her principal include:

- the other party's willingness to agree to a price or terms different from those previously stated;
- the other party's motivation for engaging in the transaction; or
- any other information that might affect the principal's rights and interests or influence the principal's decision in a transaction.

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## CASE #D16-0450: LOT #584



Read the following case summary.

Determine what, if any, errors were made by the broker(s) and which License Laws or Commission Rules were violated.

*NOTE: A sewer grinder pump grinds up wastewater produced in a home and pumps it into the public sewer system. A grinder pump is placed in a tank (or well) that is buried in an outdoor location on a homeowner's property or installed indoors. When water is used in the house, wastewater flows into the tank. When the wastewater in the tank reaches a pre-set level, the grinder pump automatically turns on, grinds the waste, and pumps it out of the tank via the homeowner's on-site sewer service line and into the public sewer system. Read more at <https://www.wsscwater.com/customer-service/frequently-asked-questions/grinder-pump-faqs.html>.*

### **PARTIES:**

The Complainant was the Buyer of a residential building lot. Respondents were the Buyer's Agent and his Firm.

### **COMPLAINT:**

In August 2015, the Buyer closed on the purchase of lot #584 in a planned development. Sometime after closing, the Buyer learned from the private water company (that provided water and sewer service to the development) that lot #584 would require a sewer grinder pump at a cost of approximately \$7500. The Buyer filed a complaint against her Buyer's Agent and Firm alleging that the Buyer's Agent represented that no grinder pump was required for the subject lot.

**FACTS:**

The Buyer and Buyer's Agent began working together in early 2015. The Buyer was located out of state and wanted to purchase a lot in NC on which to build a home. The subject lot was located in a community where the Buyer's Agent had identified other lots but had not found anything acceptable to the Buyer. The Buyer's Agent was aware that lot #584 had been purchased by a client of a broker who previously worked in the Buyer's Agent's firm, so he spoke with that broker about the possibility of his client selling the lot. It turned out that the owner was interested in selling the lot.

In a March 2015 email from the Buyer's Agent to the Buyer, the Buyer's Agent stated that lot #584 was the "least expensive lot alternative at around \$60K, and it already includes \$15k of tap fees." In June 2015, the Buyer's Agent relayed to the Buyer that he had learned that the owner of lot #584 was "willing to sell it at \$68K." The Buyer's Agent went on to assert the value of the lot, stating "with the tap fees already paid and no need for the \$10K grinder pump, it offers a really great scenario to start your new home."

In her complaint, the Buyer included an October 2015 email from the private water & sewer company which stated that lot #584 required the installation of a grinder pump and that the company had not been pre-paid for this cost.

In the Buyer's Agent's response to the Commission's inquiry, he stated that in researching the lots in the subject community, he learned that the water and sewer tap fees had been pre-paid for many of the lots. The Buyer's Agent alleged that he contacted the HOA management company about various lots in the development and received information regarding whether water & sewer tap fees were pre-paid for a particular lot and whether the lot required a grinder pump. The Buyer's Agent further alleged that the HOA representatives told him regarding lot #584 that "all water and sewer related fees had been paid."

When asked where he had gotten the numbers for his March 15 email stating that lot #584 included "\$15k of tap fees", he responded that tap fees were typically \$5k and a grinder pump ran \$5k-\$10k, so the \$15k was the amount including a grinder pump. When asked if he was saying that he was told that the grinder pump was pre-paid for this lot, he responded that he believed that all costs associated with water/sewer were pre-paid. When asked why he stated in a June 15 email that "there was no need for the \$10k grinder pump," he replied that he was told by the HOA representatives that the subject lot did not need a grinder pump.

The Buyer's Agent stated that he learned from the Buyer after closing that the lot would require the installation of a grinder pump at the owner's expense; however, he did not address the emails he sent to the Buyer that alternately claimed that the lot purchase included \$15K of pre-paid tap fees and that there was no need for a grinder pump.

The Buyer's Agent provided a copy of his transaction file with a *Working with Real Estate Agents* (WWREA) disclosure, Buyer's Agency Agreement and Offer to Purchase and Contract which all appeared to have been signed by the Buyer simultaneously on or about August 7, 2015. The file also included an NCAR form 770 "Confirmation of Compensation", the purpose of which is to disclose to a broker's client (usually the buyer) the compensation the broker expects to receive from another party, typically the Seller. However, the Buyer's Agent used this form as a commission agreement with the Seller, who signed the form agreeing to pay an 8% commission to be split 6% to the Buyer's Agent and 2% to the referral Broker.

The Buyer's Agent had no written disclosure to the Buyer of his expected compensation other than the HUD-1.

The Buyer's Agent provided the names of the HOA representatives and alleged that he spoke to one of them regarding the subject lot in the spring of 2015 and the other in August 2015 just prior to submitting the Buyer's offer. He alleged that both HOA representatives told him that the water/sewer tap fees were pre-paid and that the subject lot did not require a grinder pump. The VP and Area Manager of the HOA stated that the HOA had 2 spreadsheets, one which designated if the tap fees had been pre-paid for each lot and another designating whether each lot was gravity fed or required a grinder pump. The tap fees spreadsheet indicated that tap fees had been pre-paid for lot #584. The other spreadsheet also had 2 columns with the lot number and either the letter "A", "B" or "C" for the grinder pump size required for each lot or the designation that the lot would be gravity fed. This spreadsheet indicated that lot #584 required a grinder pump size "A."

The VP verified that the representatives identified by the Buyer's Agent were those whom he would have spoken to if and when he inquired; he provided emails from each one regarding the matter. Both representatives stated that while they did not recall the specific inquiry for lot #584, they recalled the Buyer's Agent requesting this information for several lots. Both attested that they were certain that they would have provided accurate information to the Buyer's Agent and that there is no way that they could have misread the spreadsheet. The HOA VP further opined that it would have been impossible to misread the spreadsheet as no lots above lot #373 were designated as gravity fed and that the possibility that two different people made the same unlikely mistake was implausible.

## Main Points - Lot # 584

Early 2015: Buyer and Buyer's agent began working together. Buyer was out-of-state; wanted to purchase a building lot.

March 2015: Buyer's Agent presented lot #584 to Buyer and stated that tap fees were paid and grinder pump was not needed.

Closing occurred in August 2015.

Buyer received a notice in October 2015 that a \$7500 grinder pump was needed.

Buyer's Agent stated:

- he had learned that the water and sewer tap fees had been pre-paid for many of the lots;
- the HOA representatives told him regarding lot #584 that all water and sewer related fees had been paid; and
- he learned from the Buyer after closing that the grinder fee was not paid.

Buyer's Agent's transaction file included:

- WWREA brochure, agency agreement, and sales contract, which were signed at the same time;
- NCAR Form 770, used as a compensation agreement with Seller; and
- no written disclosure of compensation to Buyer.

HOA representatives:

- provided spreadsheets used to track taps fees for lots; and
- asserted they did not give inaccurate information.

## Evaluation and Discussion - Lot # 584

Errors made by Buyer's Agent: \_\_\_\_\_  
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\_\_\_\_\_  
\_\_\_\_\_

## Related Law and Rule Considerations - Lot # 584

### Misrepresentation

**Misrepresentation:** an assertion of alleged fact which ultimately is false.

- **Negligent or unintentional misrepresentation:** an assertion without actual knowledge of its falsity.
- **Willful or intentional misrepresentation:** an individual either has actual knowledge of the falsity or acts without regard to the truth or accuracy of the matter being stated.

## Agency Disclosure

Commission Rule 58A .0104 dictates that the *Working with Real Estate Agents (WWREA)* brochure must be provided and reviewed in ALL SALES transactions (commercial and residential) with all sellers and all buyers at (no later than) first substantial contact.

### ***What is first substantial contact?***

First substantial contact (FSC) occurs when either the broker or the consumer begins to act as if an agency relationship exists or the consumer begins to share confidential or personal information that could be used against them in negotiations.

The WWREA brochure must be provided and reviewed before confidential information is disclosed. First substantial contact may occur in person, by telephone, by electronic communications, or through an agent's website.

View agency disclosure (the WWREA brochure) as a type of real estate Miranda warning. The intent is not only to inform consumers of their choices, but also to alert them that "anything you say may be used against you later" until such time as the consumer decides whether and how to work with a broker.

## Disclosure of Compensation

Commission 58A .0109 requires:

1. A broker in a sales transaction cannot be compensated by his client unless that compensation is provided for in a written agency contract meeting the requirements of Commission rule 58A .0104. Buyer agents and listing agents need written agency agreements in every transaction that provide for compensation.
2. A broker in a sales transaction cannot receive any compensation, incentive, or bonus of more than nominal value from any other party unless the broker provides full and timely disclosure of the payment or incentive, or the promise or expectation of such payment or incentive, to the broker's principal. This disclosure can be oral, but must be confirmed in writing before an offer is made or accepted by the principal.
3. Full disclosure requires a description of the compensation, incentive, or bonus, including its value and the identity of the party by whom it will or may be paid. The value can be expressed using a specific dollar figure, percentage or other mathematical formula. It is not sufficient to describe compensation as being any amount "up to" a certain amount, or "between" two figures. Disclosure is timely if it is made in sufficient time to aid a reasonable person's decision-making.

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## CASE #D18-0378: THE LANDFILL NEXT DOOR



Read the following case summary.

Determine what, if any, errors were made by the broker(s) and which License Laws or Commission Rules were violated.

### **PARTIES:**

The Complainant was the Buyer of a residential property. Respondents were the Listing Agent who was the QB and BIC of his firm and the Buyer's Agent.

### **COMPLAINT:**

Buyer was under contract to purchase a residential home. During the due diligence period (DDP), the Buyer noticed an odor outside of the property and discovered that it was due to a landfill located less than 2000 feet from the house. The buyer filed a complaint against the Listing Agent.

### **FACTS:**

On question #26 of the *Residential Property and Owners Association Disclosure Statement* ("Is there any noise, odor, smoke, etc. from commercial, industrial or military sources which affects the property?"), the Seller had answered no.

In the complaint the Buyer provided a link to a news article that focused on how [badly] the areas surrounding the landfill were affected. The article was written on June 29, 2017. The Seller signed the property disclosure on June 28, 2017, and the property was listed on July 6, 2017. The Buyer also included information about various other articles related to the landfill and its negative affect on nearby property owners.

The Buyer sent an email to the Listing Agent on July 30, 2017, asking if the Listing Agent was aware of this issue. The Listing Agent responded the following day. He stated that he, too, lived in the neighborhood and was aware of the odor, but that the odor varied by location, affecting some houses and not others. He did not think the odor affected the subject property given its location in the neighborhood.

The Buyer terminated the contract on August 4, 2017. The Seller returned the \$2000 earnest money deposit (EMD) but refused to return the \$1000 due diligence fee (DDF) or to compensate the Buyer for any inspection fees.

During the Commission's investigation, the Listing Agent contended that he represented the property based on his own personal experiences at the property and the information of the Seller. He claimed that due to its size and visibility, the landfill is not something he could attempt to misrepresent or hide. He stated that he was aware that areas near the landfill could at times be impacted by bad odors but that not everyone had the same experiences. He had not experienced any odors on his visits and took the Seller's word for it on the property disclosure that she had never had any issues with landfill odors at her house. He included pictures from the entrance of the neighborhood which clearly show the landfill. He also included photos of maps and aerials that show the landfill in a simple search of the subject property's address.

The Buyer's Agent said that she was not aware of the location of the property in relation to the landfill. She stated in a letter to the Listing Firm, "The odor caused by the landfill is a material fact and while not disclosed by the Seller of the property on Woodlark, should have been disclosed by the Listing Agent, especially since he resides in the community." In an email dated Aug 4, 2017, the Buyer's Agent again stated to the Listing Agent that this was a material fact and should have been disclosed.

## **Main Points - The Landfill Next Door**

During the DDP, Buyer noticed an odor and discovered it was due to a landfill located less than 2000 feet from the subject property.

Buyer found news articles about the odor problem that were written prior to the listing.

When asked about the odor, the Listing Agent said he was aware of the odor but did not think it affected the subject property.

Buyer terminated contract; Seller refunded EMD but refused to refund the DDF or any inspection fees.

### **Listing Agent:**

- said that the landfill is not something that could be hidden;
- claimed he represented the information based on his own experience and the word of the Seller; and
- provided pictures and maps which clearly showed the landfill

### **Buyer's Agent:**

- said she was not aware of the landfill's location; and
- agreed the landfill was a material fact that should have been disclosed.

## Evaluation & Discussion - The Landfill Next Door

Errors made by Listing Agent: \_\_\_\_\_

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Errors made by Buyer's Agent: \_\_\_\_\_

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## Related Law and Rule Considerations - The Landfill Next Door

### Omission

**Omission of material fact:** failure to disclose when there is a duty to disclose.

- **Negligent or unintentional omission:** a lack of disclosure when a broker “reasonably should have known” of a material fact
- **Willful or intentional omission:** an intentional failure to disclose when a broker has “actual knowledge” of material facts.



*In The Landfill Next Door case, why is this considered to be negligent rather than willful omission?*

Answer:

The definition of willful omission is an intentional failure to disclose when a broker has *actual knowledge* of material facts. In this case, the investigation did not reveal proof that the listing and buyer's agents had actual knowledge of the odor. The Listing Agent stated that odor was not an issue at every property in the neighborhood, and he relied on the seller's assertion that odor was not an issue at the subject property. The buyer's agent was not aware of the landfill. Consequently, they both should have alerted the buyer to the presence of the landfill and possibility of an odor, but they were not deemed to have had actual knowledge of the odor issue, so they were guilty of negligent (rather than willful) omission.

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## ANSWERS TO DISCUSSION QUESTIONS

### For Discussion on page 25

1. Sara, a broker, lists a property for sale on behalf of an owner. Sara lives in the same neighborhood as her listed property. Around the time that she lists the home, a road expansion project is announced that will begin in a few months and is estimated to cause various traffic delays and detours around the neighborhood. The project receives significant news coverage, and several community meetings are held, because so many community members are not in favor of the project. Sara does not mention the project to any prospective buyers. The home sells quickly. Later, when the new owners learn of the project and complain that she did not properly disclose it to them, she states that the project was so widely covered, it didn't seem necessary to mention it.

Should Sara have disclosed this information to the buyers?

*Answer: Yes.*

If so, would this be considered a misrepresentation or omission of a material fact?

*Answer: Willful omission.*

2. Barry, a broker, lists a property for sale on behalf of an owner. Barry markets the residential property as being 2600 square feet, noting, "Square footage per tax records." The property is sold, and the buyers are represented by a cooperating firm. Several years later, the buyer-owners decide to sell and discover that the home is only 1800 square feet of heated living space.

May Barry be held responsible for the misrepresentation?

Does the original Buyer's Agent share any responsibility?

*Answer: Yes, Barry and the Buyer's Agent may be held responsible for the misrepresentation.*

### Case Outcome - Lot # 584

Errors identified during the Commission's Investigation

- **Willful Misrepresentation:** The Buyer's Agent told the Buyer that the lot was gravity fed and did not require a grinder pump, though the Buyer's Agent knew the opposite was true. Because the Broker gave (represented) information he knew to be false, this is considered willful misrepresentation.
- Buyer's Agent failed to provide timely agency disclosure.
- Buyer's Agent failed to disclose his expected compensation to his client.

## Law & Rule Violations identified during the Commission's Investigation

- N.C.G.S. § 93A-6(a)(1) - Making any willful or negligent misrepresentation or any willful or negligent omission of material fact.
- N.C.G.S. § 93A-6(a)(8) - Being unworthy or incompetent to act as a real estate broker in a manner as to endanger the interest of the public.
- N.C.G.S. § 93A-6(a)(15)- Violating any rule adopted by the Commission.
- Commission Rule 21 NCAC 58A .0104(c) - Agency Agreement and Disclosure
- Commission Rule 21 NCAC 58A .0109(c)(2) & (d) - Brokerage Fees and Compensation

## Sanctions Imposed by Commission

- Buyer's Agent: Reprimand - reduced to Dismissal because he timely completed a course in agency law. (He had a choice of taking a course on either agency or material facts.)

## Case Outcome - The Landfill Next Door

### Errors identified during the Commission's Investigation

- Negligent Omission: The Listing Agent did not disclose the landfill odor.

### Possible Law & Rule Violations

- N.C.G.S. § 93A-6(a)(1) - Making any willful or negligent misrepresentation or any willful or negligent omission of material fact.

### Sanctions Imposed by Commission: Close and Warn as to Listing and Buyer's Agents

NCREC Comments: It is reasonable that any buyers should be made aware of the landfill. The odor issue isn't continuous, and a buyer may miss it visiting the area, even multiple times. The odor itself is dependent upon many variables according to the landfill's director. From discussion with an experienced Holly Springs broker and the landfill's director, Commission Staff gleaned that a broker practicing in this town should be aware of this issue at this time. Even without knowledge of the issue, with little effort by the broker, he or she could quickly research the area and subject property's proximity to the landfill, if not see it from the neighborhood. Odor affects everyone differently, so it may not be of concern to everyone, but the best practice is disclosure by both brokers on either side of the transaction in this case.

The property disclosure issues with the Seller checking "No" as to item 26 is a civil matter. The listing agent cannot make a seller answer one way or the other.