Real Estate Broker Liability Limitation

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Chapter 1: Introduction

In a landmark study Zumpano and Johnson (2003) declared:

> "… In an increasingly litigious society, the threat of a legal action against real estate professionals is very real. The possibility of a lawsuit is not only an increasing source of anxiety, but as some industry people claim, it has also raised the cost of doing business and, in some cases, altered the way this business is conducted. There is a growing perception within the industry and among regulators that the number of lawsuits filed against real estate brokers has been increasing, even if most of the evidence appears to be anecdotal…"[1]

The present study was undertaken for the Ohio Real Estate Commission with two goals in mind. The first goal was to determine the extent to which real estate professionals in Ohio are exposed to legal liability in the practice of their profession and identify some of the reasons for the problem. The second goal was to attempt to identify strategies, regulations, and brokerage practices that could reduce the occurrence of lawsuits against real estate professionals.

As a first step on the analysis, Ohio case law was analyzed. In general, Ohio law has one of the most favorable legal environments for real estate licensees and sellers. Ohio courts early adopted and continue to enforce the doctrine of caveat emptor which is a defense to suits by buyers of real estate. As set out in *Layman v. Binns*, "the doctrine of caveat emptor precludes recovery in an action by the purchaser for a structural defect in real estate where (1) the condition complained of is open to observation or discoverable upon reasonable inspection, (2) the purchaser had the full and unimpeded opportunity to examine the premises, and (3) there is no evidence of fraud on the part of the vendor."[2] To date, Ohio courts have resisted expanding seller and licensee liability as has been done in some other states. In addition, significant seller

[1] Leonard V. Zumpano & Ken H. Johnson, *Real Estate Broker Liability and Property Condition Disclosure*, 31 Real Estate L.J. 285 (2003). The paper was based on L.V. Zumpano and K.H. Johnson, Real Estate Broker Liability: An Interstate Comparison, (1999), Alabama Real Estate Research and Education Center, Culverhouse College of Commerce and Business Administration, page 1, and consequently, looks at real estate liability as of the late 1990s.
[2] Layman v. Binns, 519 N.E.2d 642 (Ohio 1988).

disclosure legislation and agency legislation seems to have had a significant impact on the decline in the incidence of suits against Ohio's real estate licensees.

In Ohio, even though a successful plaintiff must prove specific allegations based under the *Layman* test, many disappointed real estate buyers continue to sue sellers and brokers, hoping to be able to present enough evidence to recover. Sometimes a disappointed real estate seller will sue a broker when the transaction does not progress as the seller hoped. Some of these law suits are unwarranted. All of these suits by real estate sellers and buyers against brokers are expensive. The expense of defending against such lawsuits may increase the cost of insurance for brokers. Also, defending a lawsuit increases the broker's costs of doing business. Ultimately, these expenses are passed on to the real estate customer. Ohio real estate brokers are looking for protection from these suits. The goal of this paper is to examine the current policies to determine if improvement can be made.

The paper explores the frequency and severity of suits against Ohio's licensees by examining data from three sources: Ohio appellate cases regarding brokers and brokerages, E&O claims data, and complaints filed against Ohio brokers and brokerages from 2002 to 2007 in Cuyahoga, Franklin, and Lucas counties. The analysis reveals that litigation against real estate licensees has not increased, perhaps because of the success of many of the steps taken to reduce licensee liability such as seller disclosure laws, increased educational requirements, and improved agency disclosure legislation.

The paper also explores various avenues to curtail licensee liability. It examines the standard Error and Omissions [hereinafter E&O] policy, finding that some significant problems arise because some of the major classes of litigation claims, such as fraud, are excluded from

coverage. I conclude that because of these problems insurance coverage is not the sole answer to real estate agents' liability concerns.

One avenue that has received insufficient attention is limiting liability by contractual provisions. The study of Ohio law and the law of other states indicates that Ohio has a very favorable environment in which to draft liability limitation clauses in real estate contracts. Subject to some limitations, Ohio courts have in general supported reasonable restrictions on liability. In particular, restrictions can be negotiated on clauses limiting the amount of liability, clauses that limit the time in which a suit can be brought, clauses limiting the forum for bringing an action, "as is" clauses and non-reliance clauses.

The most promising arena for relief may be changes to the institutional environment in which real estate firms operate. These include: improving the Seller Property Disclosure Forms, examining the possibility of a seller Disclosure Opt-Out provision, requiring mandatory notices of the need for home inspections, encouraging the growth of the home warranties business, passing a two-year statute of limitations with regard to real estate transactions, expanding explanations in brokerage agency disclosures to include the legal expectations of the role of buyers and sellers in a residential real estate transaction[3], reviewing the status and legality of dual agency[4], standardizing E&O contracts, and continuing to improve the educational requirements and training of Ohio real estate licensees.

Some liability management can be done by the real estate agents themselves. The National Association of Realtors (NAR) has outlined in Real Estate Brokerage Essentials many of the procedures that brokers can undertake to reduce their legal liability and manage their risk.

[3] The Ohio courts have increasingly expected buyers when given the opportunity to rigorously investigate the defects in the property, or face the consequences of their inaction. Buyers need to know that if they fail exercise their right to investigate, the outcome in any future litigation will not be favorable.

[4] Academics have long decried the dual agency status. There are practical reasons for maintaining dual agency, but it is clear that some of the more difficult ethical conflicts arise in the context of dual agency.

Among the salient issues identified in this area are: implementation of risk management procedures such as having in place an in-house policy/procedures manual that includes proper agency and seller disclosure procedures; having procedures to document that relevant disclosures have been made; making sure to properly use home inspectors and structural engineers; avoiding conflicts of interest; having a system for conflict resolution; using a standard contract; and encouraging the use of a home warranty or home protection plan. Sage real estate brokers will follow the lead of their state and national associations and aggressively seek to reduce their liability at the firm level.

Chapter 2: Review of Broker Liability Laws

The liability of a broker in a real estate transaction in Ohio revolves around the nature of the relationship between the complainant and the broker. For example, the duty a broker owes to the broker's client is governed in large part by statutory law, whereas the duty a broker owes to the other party in the transaction is governed mainly under common law.[1] This chapter will first examine Ohio law regarding the liability of brokers to their client. Next, it will look at the liability of brokers in relation to the other party in a transaction.

A. Broker's Liability to Client in Ohio

An Ohio broker has a fiduciary duty to the broker's client. As set out in Ohio Revised Code § 4735.62, a broker is a "fiduciary of the client and shall use best efforts to further the interest of the client..."[2] The statute provides a non-exhaustive list of duties a broker must follow. These duties include:

> (A) Exercising reasonable skill and care in representing the client and carrying out the responsibilities of the agency relationship;
>
> (B) Performing the terms of any written agency agreement;
>
> (C) Following any lawful instructions of the client;
>
> (D) Performing all duties specified in this chapter in a manner that is loyal to the interest of the client;
>
> (E) Complying with all requirements of this chapter and other applicable statutes, rules, and regulations, including the Ohio fair housing law, division (H) of section 4112.02 of the Revised Code, and the federal fair housing law, 42 U.S.C.A. 3601;

[1] *See* OHIO REV. CODE ANN. § 4735.52 (2000) (except to the extent the duties of a real estate agent are specifically set forth in this chapter, or otherwise modified by agreement, the duties of a real estate agent are determined by the common law.).
[2] OHIO REV. CODE ANN. § 4735.62 (2000).

(F) Disclosing to the client any material facts of the transaction of which the licensee is aware or should be aware in the exercise of reasonable skill and care and that are not confidential information pursuant to a current or prior agency or dual agency relationship;

(G) Advising the client to obtain expert advice related to material matters when necessary or appropriate;[3]

(H) Accounting in a timely manner for all moneys and property received in which the client has or may have an interest;

(I) Keeping confidential all confidential information, unless the licensee is permitted to disclose the information pursuant to division (B) of section 4735.74 of the Revised Code. This requirement includes not disclosing confidential information to any licensee who is not an agent of the client.[4]

A client cannot waive any of these duties through contractual agreement.[5] Further, the defense of caveat emptor and the inclusion of an "as is" clause will not preclude a broker from liability when the broker fails to disclose known material facts regarding the transaction to the broker's client.[6]

Other duties apply to a broker depending on the nature of relationship of the broker. There are four types of broker relationships: (1) a broker representing a seller, (2) a broker representing a buyer, (3) a dual agency relationship with the broker representing both the buyer and the seller, and (4) a sub-agency between a broker and the client of another broker.[7] The duties required for the specific relationships may be waived by the client if the client agrees to waive the duties and signs a waiver of duties statement.[8]

A broker representing the seller in a transaction must:

[3] The broker is not required to name an expert but rather tell the client that it would be in his best interest to seek expert advice. Hannah v. Cibcy Cline Realtors, 769 N.E.2d 876, 887 (1st App. Dist. Ohio 2001).
[4] *Id.*
[5] *Id.* at § 4735.621(A).
[6] Nunez v. J.L. Sims Co., 2003 Ohio 3386 (1st Dist. 2003).
[7] OHIO REV. CODE ANN. § 4735.53 (2000).
[8] *Id.* at § 4735.621(B).

(1) Seek a purchase offer at a price and with terms acceptable to the seller. Unless the seller so directs, the licensee is not obligated to seek additional offers if the property is subject to a contract of sale, lease, or letter of intent to lease;

(2) Accept delivery of and present any purchase offer to the seller in a timely manner, even if the property is subject to a contract of sale, lease, or letter of intent to lease;

(3) Within the scope of knowledge required for licensure, answer the seller's questions and provide information to the seller regarding any offers or counteroffers;

(4) Assist the seller in developing, communicating, and presenting offers or counteroffers;

(5) Within the scope of knowledge required for licensure, answer the seller's questions regarding the steps the seller must take to fulfill the terms of any contract.[9]

A broker does not violate any of these interests by showing other properties to prospective buyers.[10] However, a broker representing the seller cannot extend an offer of sub-agency to another broker or offer compensation to a buyer's broker without permission of the seller.[11]

In representing a buyer, a licensee must:

(1) Seek a property at a price and with purchase or lease terms acceptable to the purchaser. Unless the client so directs, the licensee is not obligated to seek additional purchase or lease possibilities if the purchaser is a party to a contract to purchase property, or has entered into a lease or has extended a letter of intent to lease.

(2) Within the scope of knowledge required for licensure, answer the purchaser's questions and provide information to the purchaser regarding any offers or counteroffers;

(3) Assist the purchaser in developing, communicating, and presenting offers or counteroffers;

[9] *Id.* at § 4735.63(A).
[10] *Id.* at § 4735.63(B).
[11] *Id.* at § 4735.64.

(4) Present any offer to purchase or lease to the seller or the seller's agent in a timely manner, even if the property is subject to a contract of sale, lease, or letter of intent to lease, and accept delivery of and present any counteroffers to the purchaser in a timely manner;

(5) Within the scope of knowledge required for licensure, answer the purchaser's questions regarding the steps the purchaser must take to fulfill the terms of any contract.[12]

A broker is allowed to show a property to other prospective buyers without breaching the broker's duties to the broker's clients.[13] However, a broker cannot purchase or make an offer on a property on behalf of himself if the broker is representing a buyer in a transaction relating to that property.[14] In such a case, the broker will be legally responsible for any lost profits accrued by the broker's client.[15]

In a dual agency, where a broker or brokerage represents both the buyer and the seller, the broker is required to obtain written consent from both parties.[16] Prior to this, the broker or brokerage must fully inform both parties of all relevant facts necessary for the parties to make an informed decision.[17] Additionally, if two brokers from the same brokerage represent opposite clients in a transaction, the brokerage must ensure that neither brokers have access to confidential information of the other broker's client. Further, the brokerage must see that each broker fulfills the broker's duties exclusively to the broker's client.[18]

Additional duties also apply to a brokerage involved in a dual agency relationship. The brokerage must supervise the actions of the brokers; however, it must remain neutral in the

[12] *Id.* at §4735.65.
[13] *Id.*
[14] *Weidle v. Leist*, 2004 Ohio 4693 (2d Dist. 2004).
[15] *Id.*
[16] OHIO REV. CODE ANN. § 4735.71 (2000).
[17] *Id.*
[18] *Id.*

transaction and refrain from negotiating or advocating on behalf of one of the parties.[19] Also, the brokerage is required to maintain the confidentiality of the information of the parties. If confidential information becomes known, the brokerage must notify both clients immediately and offer its resignation from the transaction.[20] Any factual non-confidential information regarding the parties, however, may be disclosed to the parties in an unbiased manner.[21] Beyond these additional duties, a broker or brokerage must adhere to the fiduciary duties set out in Ohio Revised Code § 4735.62.

Ohio courts have split on whether a violation of the statutory duties of a broker is compensable through civil damages. One court held that, unless specifically provided for, violations of statutory duties under § 4735 by brokers are not compensable.[22] On the other hand, another court stated that there is no reason not to create a civil remedy under § 4375.[23] Because this issue has not been resolved by the Ohio Supreme Court, brokers should be aware that if a statutory violation occurs, courts may be willing to enforce both statutory and civil remedies.

B. Broker's Liability to the Other Party in Ohio

Even with the enactment of legislation that requires a mandatory seller's disclosure form,[24] Ohio still observes the doctrine of caveat emptor. The Supreme Court of Ohio reaffirmed the status of the doctrine in *Layman v. Binns*.[25] The doctrine of caveat emptor precludes recovery in an action by the purchaser against the seller for a defect in real estate where three factors are present. First, the condition or defect must be open to observation or

[19] *Id.* at § 4735.72.
[20] *Id.*
[21] *Id.*
[22] Roth v. Yonts, 1999 Ohio App. LEXIS 3879 (5th Dist. 1999).
[23] Schmeidebusch v. Rako Realty, Inc., 2005 Ohio 4884 (5th Dist. 2005).
[24] OHIO REV. CODE ANN. § 5302.30 (2007).
[25] 519 N.E.2d 642 (Ohio 1988).

discoverable upon reasonable inspection. Second, the purchaser must have a full and unimpeded opportunity to examine the premises. Finally, the seller must not have acted fraudulently.[26] Caveat emptor, however, does not preclude recovery for known latent defects - that is, defects that are not open to observation or discoverable upon reasonable inspection. Though *Layman* did not involve a broker, courts have applied caveat emptor in cases involving brokers.[27]

Courts have liberally construed the scope of whether a defect is open to observation or discoverable upon reasonable inspection. For example, in *Layman*, the court found that a slightly bowed basement wall with steel beams placed in front of it as support was open to observation.[28] Likewise, in other cases, courts have found defects open to observation or discoverable upon reasonable inspection where roof tiles were made of asbestos after the seller informed the buyer in good faith that the tiles were made of slate,[29] where an open lot was advertised as being for sale when only half of the lot was actually for sale,[30] and where a section of the property for sale already had been conveyed to the state in order to complete part of an interstate.[31] In cases such as these, courts consistently have held that, if aware of a possible defect, the buyer has a duty either to make further inquiry of the owner, who is under a duty not to engage in fraud, or to seek the advice of someone with sufficient knowledge.[32] A buyer may not sit back and then raise his lack of expertise when a problem arises.[33]

If a court finds that a defect is open to observation or discoverable upon reasonable inspection, the doctrine of caveat emptor will apply if the buyer had a full and unimpeded

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[26] *Id.* at 644.
[27] *See* Lewis v. Basinger, 2004 Ohio 6377 (7th Dist. 2004); Duman v. Campbell, 2002 Ohio 2253 (8th Dist. 2002); Buchanan v. Geneva Chervenic Realty, 685 N.E.2d 265 (9th App. Dist. Ohio 1996).
[28] *Layman*, 519 N.E.2d at 644.
[29] Kearns v. Huckaby, 2006 Ohio 5196 (12th Dist. 2006).
[30] Schmiedebusch v. Rako Realty, Inc., 2005 Ohio 4884 (5th Dist. 2005).
[31] Parahoo v. Mancicni, 1998 Ohio App. LEXIS 1630 (10th Dist. 1998).
[32] *See* Tipton v. Nuzum, 84 Ohio App. 3d 33, 38 (9th Dist. 1992); Eiland v. Coldwell Banker Hunter Realty, 122 Ohio App. 3d 446 (8th Dist. 1997).
[33] *See Tipton*, 84 Ohio App. 3d at 38.

opportunity to examine the premises. Courts have determined that this condition is met by including an inspection clause in the land sale contract.[34] Because of this analysis, most courts have refrained from finding that an inspection was impeded. In *Moreland v. Ksiazek*, the court found that the buyer had a reasonable opportunity to inspect a garage attached to the house even though the garage was locked and the buyer could not find the key. In coming to this conclusion, the court relied on the buyer's expression of being comfortable with his inspection of the premises and his knowledge that he was buying an old house and an old garage.[35]

The defense of caveat emptor will not apply if the seller or seller's agent acts fraudulently in regards to a latent defect. Fraudulent misrepresentation occurs when the seller or seller's agent makes (1) an actual or implied misrepresentation, (2) which is material to the transaction, (3) made with knowledge that the statement is false, (4) with the intent to mislead another, (5) who relies on the misrepresentation, (6) and with resulting injury.[36] A misrepresentation of a material fact can occur through either a statement or actions by the seller. A fact is material to the transaction if it affects the purchaser's decision to buy the property.

The seller or seller's agent has no duty to conduct an inspection of the property prior to offering it for sale but rather has a duty to honestly answer questions to the best of his/her knowledge.[37] However, if the seller has knowledge of a material defect, the seller must disclose that defect on the mandatory residential property disclosure form.[38] Likewise, if the seller's agent has knowledge of a material defect, the agent must disclose the defect to the buyer.[39] In situations where a seller misrepresents a material defect to the seller's agent, the agent is liable only if the agent has actual knowledge that the information is false or if the agent acts with

[34] *See*, *e.g.*, Burns-Boggs v. Howerton, 2006 Ohio 4002 (2d Dist. 2006).
[35] Moreland v. Ksaizek, 2004 Ohio 2974 (8th Dist. 2004).
[36] *Id.* at *39.
[37] Nunez v. J.L. Sims Co., 2003 Ohio 3386 (1st Dist. 2003).
[38] OHIO REV. CODE ANN. § 5302.20 (2000).
[39] *Id.* at § 4735.67.

reckless disregard for its truth.[40] Reckless disregard is having a high degree of awareness of the probability of falsity of facts or having serious doubts as to the truth of the statement.[41]

In order for a buyer to claim fraudulent misrepresentation, the buyer must show that the buyer relied on the misrepresentation. Courts refuse to find reliance in situations where the buyer acts unreasonably. For example, if a buyer has reason to believe that there is a material defect, the buyer cannot claim reliance.[42]

An "as is" clause in a contract further extends the protection of caveat emptor for sellers or sellers' agents. In Jacobs v. Racevski, 663 N.E. 2nd 653, (1995), the Ohio appeals court said that if an "as is" clause is included in a real property sale agreement, the buyer is foreclosed from claiming fraudulent non-disclosure of a latent defect.[43] In such a situation, a seller or seller's agent is only liable if he/she makes an affirmative fraudulent misrepresentation about a latent defect. That is, the selling party must make an actual false statement regarding a latent defect.[44] The selling party has no duty to inform the buyer of any known latent defects, because the "as is" clause places the burden of discovering latent conditions on the buyer.[45]

C. Other States' Laws Regarding Broker Liability

Because of Ohio's adherence to caveat emptor, few states offer as much protection to a real estate broker as Ohio. Many states have mandatory disclosure laws for the seller.[46] Most of

[40] *Id.* at § 4735.68.
[41] Tanzillo v. Edwards, 2007 Ohio 497, *16 (10th Dist. 2007).
[42] *See Duman*, 2002 Ohio at 2253 (finding that observable water spots on the ceiling showed evidence of leaky plumbing, even though seller stated otherwise); *see also Burns-Boggs*, 2006 Ohio at 4002 (finding that visible evidence of termite damage precluded recovery even when residential disclosure form stated that seller was unaware of termite damage).
[43] See also, Kaye v. Buehrle, 457 N.E. 2nd 373 (Ohio Ct. App. 1983), Lance v. Bowe, 648 N.E. 2nd 60(Ohio Ct. App. 1994)
[44] *Duman*, 2002 Ohio at 2253.
[45] *Id., It should be noted that most jurisdictions hold that an "as is" clause does not preclude an action based upon nondisclosure. I would not be surprised to see some Ohio courts adopt this view. (See Disclosure Duties in Real Estate Sales and Attempts to Reallocate the Risk, 34 Conn. L. Rev. 1 (Fall 2001).*
[46] See Appendix Table 2.1.

these states also require a seller's broker to disclose known facts material to the transaction to the buyer. California has gone as far as requiring the broker to make a physical inspection of the property and disclose all defects.[47]

Ohio offers a very broker-friendly environment in comparison to almost every other state.[48] One protection other states provide that is not listed in the Ohio statute is a limitation on actions specifically regarding claims against a broker. Several states have enacted short-term statutes of limitations for claims against brokers. For example, an action for breach of duty in California must be brought within two years,[49] and an action in Connecticut must be brought within three years regardless of the time the breach of duty was discovered.[50] A similar statute of limitations would benefit brokers in Ohio.

[47] CAL. CIV. CODE 2079 (2007).
[48] Appendix for Chapter 2 includes a table of statutory duties and disclosures imposed upon real estate licensees of each state.
[49] CAL. CIV. CODE § 2079.4 (2007).
[50] CONN. GEN. STAT. § 20-329(y) (2007).

Chapter 3: Liability Risks to Brokers

The United States tort system has estimated costs of close to $300 billion dollars, or approximately $1000 per person in the United States.[1] More than one dollar for every fifty in the economy is tied up in liability costs.[2] These costs include (1) actually incurred losses, (2) legal defense costs, and (3) administrative expenses, which reflect costs other than defense costs incurred by insurers in the administration of tort claims.[3] Accordingly, liability risk is one of the more significant risks that a real estate business faces. This chapter focuses on assessing liability risks facing real estate firms.

Risk assessment consists of two steps. Step one identifies the risk and associated uncertainties. Step two evaluates the potential frequency and severity of losses and analyzes how the risks and associated uncertainties may affect a firm's performance.[4]

Identifying risks and associated uncertainties requires a complete analysis of all potential risks.[5] To do this, a risk manager needs to thoroughly know and understand the goals and functions of an organization.[6] A risk manager can obtain knowledge of an organization through inspections, interviews, and examinations of internal records and documents.[7] Risk

[1] 2006 UPDATE ON U.S. TORT COST TRENDS, 13, app. IA (Towers Perrin, 2006). Actual estimates were $260 billion dollars in 2005 and expected tort costs were expected to reach $314 billion dollars in 2007. *Id.*
[2] *Id.*
[3] INTERNATIONAL INSURANCE FACT BOOK 2005, 131 (Ins. Info. Inst. 2005). Defense cost represented 14 percent of first party benefits, insurance company administration costs represented 21 percent of first-party benefits, 22 percent went to actual economic loss, 24 percent for noneconomic loss and 19 percent went to plaintiff's attorneys. *Id.*
[4] *See* GEORGE REJDA, PRINCIPLE OF RISK MANAGEMENT AND INSURANCE 43 (10th ed., Pearson Educ. 2008). *See also* SCOTT HARRINGTON & GREGORY NIEHAUS, RISK MANAGEMENT & INSURANCE 31 (2d ed., Irwin 2004). This description of the process varies little among risk management texts.
[5] *See* EMMETT VAUGHAN & THERESE VAUGHAN, FUNDAMENTALS OF RISK AND INSURANCE 24 (9th ed., Wiley & Sons 2003). Potential risks include (1) property risks, (2) liability risks, (3) business income risks, (4) human resource risks, (5) crime risks, (6) employee benefit risks, (7) foreign risks, (8) market reputation and public image of the company, and (9) failure to comply with government laws and regulations. Rejda, *supra* note 4, at 44. Although this chapter is concerned with liability risks, it is important to note that all of these risks represent potential sources of liability. Accordingly, liability risk is an unavoidable ingredient in managing a real estate firm.
[6] *Id.*
[7] *Id.*

identification is particularly difficult because it is "virtually impossible to know when it has been done completely."[8]

After identifying significant risks, a risk manager should analyze the potential effect of each risk. To do this, a risk manager should attempt to obtain information measuring the frequency, severity, and expected losses associated with the risks.[9]

Frequency can be divided into two categories: frequency of exposure and frequency of loss. Frequency of exposure measures the number of times a situation arises where a potential risk may be involved. Frequency of loss measures the number of losses occurring in a certain period of time. When a loss distribution is stable and historical data is available on a large number of exposures, then the probability of a loss per exposure can be estimated by dividing the number of losses by the number of exposures. In some cases, risk managers can use industry data to determine frequency of loss. However, in situations where historical data is unavailable, frequency of risk becomes difficult to quantify. In such situations, a risk manager may need to make a subjective judgment about the frequency of a risk.[10]

Severity of risk measures the dollar magnitude of loss per occurrence. Assuming a stable loss distribution, the standard estimation of severity is the average cost of loss per occurrence. Often, risk managers are interested in severe losses. Severity of risk is often thought to be more important than frequency because one occurrence of a very severe risk can put an organization out of business. Though a precise estimate of the expected severity of risk may not be available, it is important that risk managers estimate the range of severity for each significant risk.[11]

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[8] *Id.*
[9] *Id.*
[10] Harrington, *supra* note 4, at 48.
[11] *Id.* at 49.

Expected loss is an estimate of how much each risk will cost a firm. When the frequency of loss is independent of the severity of risk, the expected loss associated with the risk is the product of the two. Accurate estimates of a real estate firm's expected losses can help a risk manager determine whether insurance will increase firm's value.[12] Since insurance companies usually assume independence in calculating their expected loss per risk, a risk manager can sometimes infer the expected loss based upon rate quotes given by various insurance carriers.

A. Sources of Frequency and Severity Data on the Liability Risk of Real Estate Licensees

In identifying the sources of real estate firm liability, three data sources were investigated:

1. Ohio appellate cases regarding brokers and brokerages;
2. E&O Claims data;[13] and
3. Complaints filed against Ohio brokers and brokerages from 2002 to 2007 in Cuyahoga, Franklin, and Lucas counties.

Each source was necessary because no one source was completely free of defects from a research standpoint. For example, Ohio appellate cases offered the written record of each case as it went through the litigation process in Ohio; however, the cases provided only the issues and aspects pertinent to the appeal which was filed. Further, about half of the cases were remanded to the trial courts, meaning that the final outcome (amount recovered) was not given in the appellate record. Because of this, it was difficult to know the average severity of the outcome in the appeals cases.

[12] *Id.*

[13] This data was provided by Cindy Grissom, from the Rice Insurance Services Company, LLC. It should be noted that this is the same data source used by JAMES E. LARSEN & JOSEPH W. COLEMAN, E&O INSURANCE: THE EXPERIENCE OF STATES WITH MANDATORY PROGRAMS FOR REAL ESTATE LICENSEES (Ohio Dept. of Commerce 2004). Great appreciation is given to Rice Insurance Services Company, which is by far the largest provider of mandatory E&O coverage in the nation.

Likewise, E&O claims data were helpful in assessing the magnitude of the severity of potential lawsuits but not in assessing frequency data. This is because insurance companies usually code cases with a single allegation or issue even though a claim may contain multiple allegations and issues. [14]

Finally, complaints filed against real estate brokers and brokerages provided a good outline for the frequency of liability risks;[15] however, many of these claims were dismissed or settled prior to trial.[16] Consequently, the amounts of damages actual imposed were generally unknown. The cases are only useful in assessing the frequency data with regard to the potential allegations. In reality each case contains multiple issues and allegations.

B. Overall Frequency of Loss

The frequency of claims against real estate licensees has been examined in a leading Alabama study (the "Zumpano Report").[17] The Zumpano Report examined the frequency of claims against real estate licensees in the states of Alabama, Kentucky, Louisiana, Mississippi, and Tennessee. It reported that claims against real estate licensees ranged from 8.68 claims per 1,000 licensees per year in Alabama to 2.64 claims per 1,000 licensees per year in Louisiana. The salient data from the study is shown in Table 3.1.

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[14] Discussions with claims officers indicated that the allegation coding system is based upon the claim information at the time the claim is opened. Often, this is before formal litigation has commenced. For actuarial simplicity, usually only a single type of claim is entered. This simplifies the actuarial calculations since the mean expected loss is simply the frequency of the type of loss times the average severity. However, this process distorts the actual distribution of types of behavior that lead to liability risks.

[15] Complaints typically list several legal theories, including as fraud, negligence and misrepresentation. Additionally, many complaints raise multiple defects, such as flooding, termite damage, and foundation problems.

[16] Given that the average claim reserve for these cases is around $10,000, it is not surprising that many of these cases never go to trial.

[17] LEONARD V. ZUMPANO & KEN H. JOHNSON, REAL ESTATE BROKER LIABILITY: AN INTERSTATE COMPARISON 5-6, (Ala. Real Estate Research & Educ. Ctr. 1999) [*hereinafter* Zumpano Report]. It was not possible to directly compare the frequency data in the Alabama study with the data in the present report because of the ambiguity of the definition of "claim." As explained later, the present data contained claims where there is no claim reserve set up. Some insurance companies may not classify this situation as a claim for actuarial purposes.

The Zumpano Report shows an interesting trend in claims reported. Prior to the enactment of seller disclosure laws, the trend in E&O claims was rising. The Zumpano Report claims that its data supports a marked decline in the number of E&O claims where seller disclosure was passed.[18]

Table 3.1: Total Claims per 1,000 Licensees Reported in the Zumpano Report

Year	Kentucky	Louisiana	Mississippi	Tennessee	Alabama
1989	3.12				
1990	5.17	0.05			
1991	5.91	0.14		4.55	
1992	10.99	0.69		5.19	
1993	10.98	1.58	1.33	7.36	3.07
1994	11.92	5.17	3.41	9.63	8.39
1995	6.47	9.12	9.04	13.89	10.74
1996	7.76	4.96	6.06	10.59	6.32
1997**	3.32	7.49	4.43	5.77	5.82
1998**	3.53	7.01	2.73	2.04	1.95

**** Not final data**

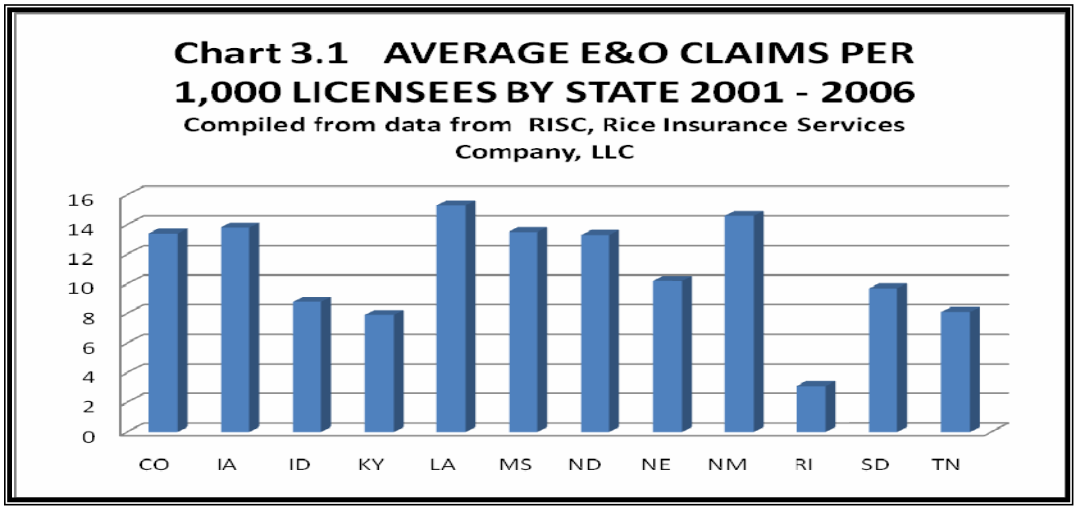
Comparing the Zumpano Report to E&O data compiled by Rise Insurance Services Company, LLC ("RISC") is useful. RISC provides E&O coverage for real estate agents in states where E&O coverage is mandated.[19] The data provided by RISC was used to estimate the frequency of claims against Real Estate Licensees in the twelve states in which RISC does business. The frequency ranged from 15.3 claims per 1,000 agents in Louisiana to 3.1 claims per 1,000 agents in Rhode Island. Because the incidents of Rhode Island claims were so low, the state should be considered an outlier when estimating frequency. The average number of claims

[18] *Id.* at 54.
[19] The twelve mandated states are Colorado, Idaho, Iowa, Kentucky, Louisiana, Mississippi, Nebraska, New Mexico, North Dakota, Rhode Island, South Dakota, and Tennessee.

over the 2001 and 2006 period is 10.97 claims per 1,000 agents. The weighted average is essentially the same with 10.94 claims per 1,000.

RISC often counts a formal complaint or threat of litigation as a claim even if it believes that the claim is so weak it carries no possibility of liability. In these situations, RISC will not set up a claim reserve.[20] The incidents of claims with claim reserves were 4.85 claims per 1,000 agents. This is important, because the frequency of claims is much different when only counting the claims with sufficient merit to warrant a claim reserve. In chart 3.1, the rate of E&O claims per 1,000 licensees is shown, including when no claim reserve was set up. In chart 3.2, the rate of E&O claims per 1,000 licensees is shown, but it excludes the claims where no claim reserve was set up.

Chart 3.1: Average E&O Claims per 1,000 Licensees by State 2001-2006



[20] The average claim reserve from 2001 to 2006 from the 12 mandatory states was $15,882. The lowest amount was Iowa with an average reserve of $9,957. The highest amount was Colorado with $28,469. There is a high correlation (.74) between the amount of the claims reserve and the average housing prices in the states. Other factors such as the legal environment also affected the amount of the claim reserves. Using housing prices and legal environment, I was able to predict 78% of the variance in claim reserves. If it is assumed this is a reasonable model, then the claim reserve for Ohio would be $16,973.

Chart 3.2: Average E&O Claims with Payment or Reserve per 1,000 Licensees by State, 2001-2006

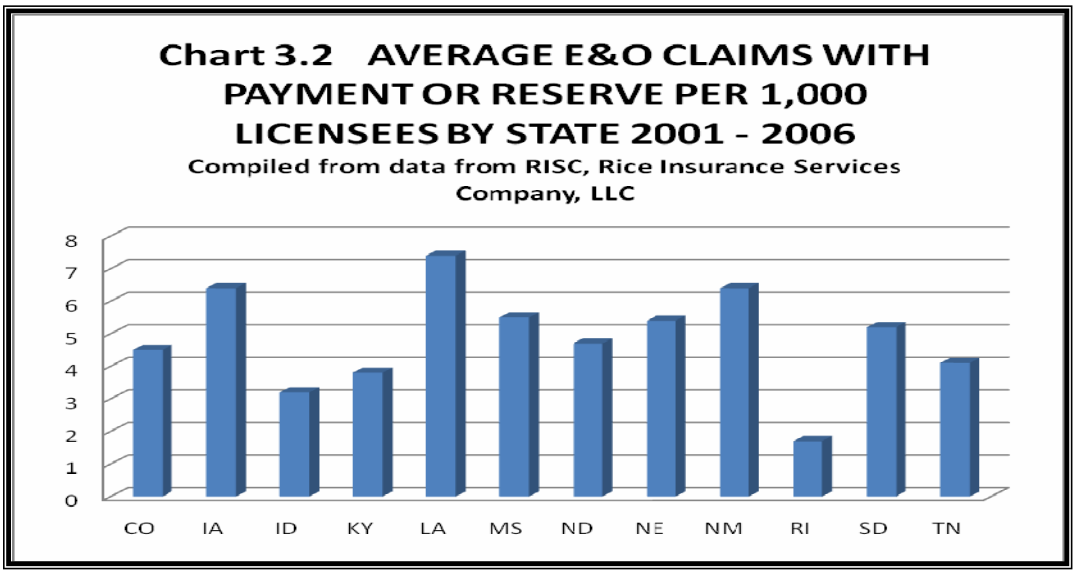
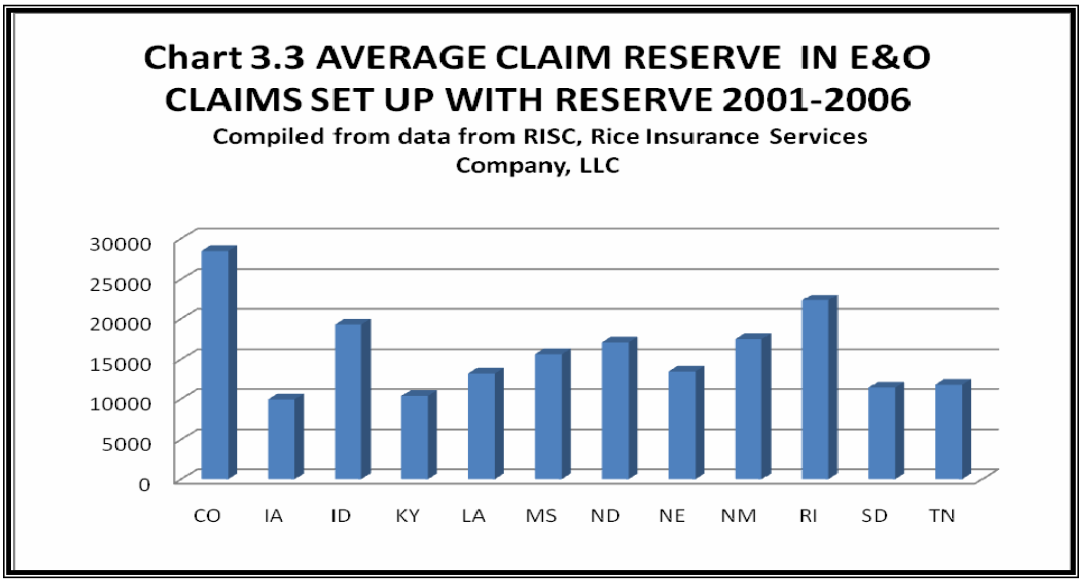


Chart 3.3: Average Claim Reserve in E&O Claims Set up with Reserve 2001-2006



C. Frequency of Claims against Real Estate Licensees

In order to analyze the trend in the frequency of real estate cases, I analyzed all real estate law suits in Ohio which resulted in appeals that were recorded in the LexisNexis database since 1900. Using a screen of real estate agent or real estate broker, I obtained a total of 1,857 cases since 1900, 1,568 cases since 1950 and 1,365 cases since 1975. For each of these periods, the initial screen represented the universe of Ohio appeals cases filed against real estate professionals. I analyzed the number of cases to determine if there is a trend in the frequency distribution.[21] The regression analysis I applied to loss frequency data was:

$$\mathbf{FREQUENCY = b_0 + b_1 Time + e}$$

The regression output for the intercept, $b_{0,}$ represented the expected value for Y at the beginning of the period. Because the variable of interest was the frequency of the cases, FREQUENCY was used as the Y variable. This is the standard technique for determining if there is an upward trend or a downward trend in frequency.[22] If the severity of the loss is stable over time, the estimation of frequency can be multiplied by the expected severity of losses in order to get an estimation of expected losses.

In particular, I was interested in the frequency distribution of cases and losses based on dramatic shifts in the legal environment in Ohio. In December 1992, Ohio passed seller disclosure laws which took effect in July of 1993. Also, significant legislation was passed in 1996 dealing with the responsibilities of the licensees and brokers in real estate transactions.[23]

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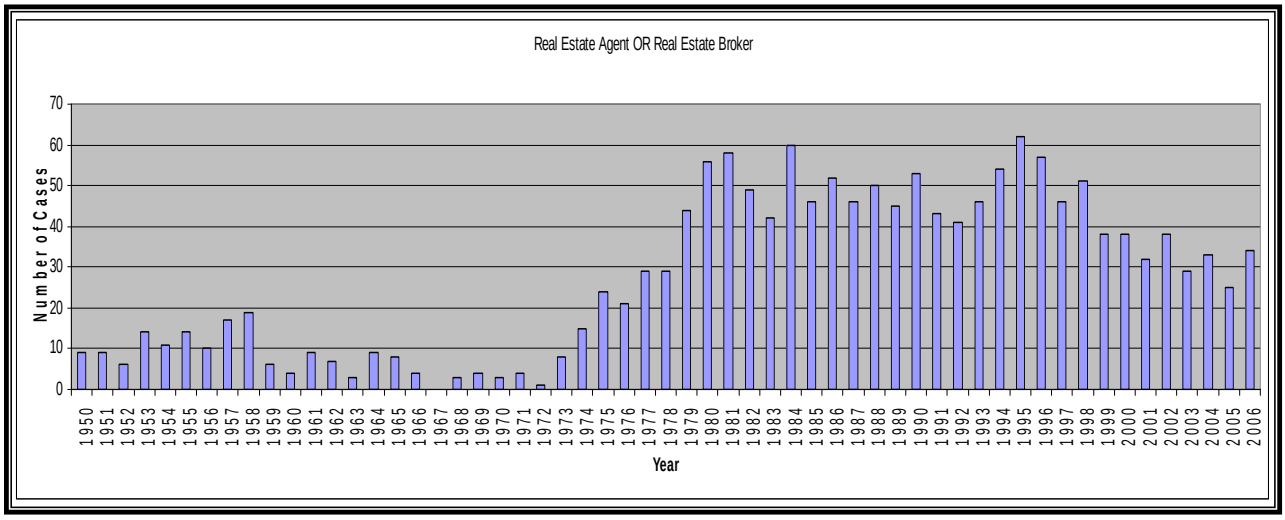
[21] Trend refers to a systematic movement of a variable that persists over a period of time. A basic trend equation is written as: **$Y = b_0 + b_1 Time + e$.** AARON C. JOHNSON, MARVIN B. JOHNSON & RUEBEN C. BUSE, ECONOMETRICS: BASIC AND APPLIED 340 (MacMillan 1987).

[22] *Id.*

[23] *See* OHIO REV. CODE ANN. § 4735.51 *et seq.* (2007).

Because this legislation occurred at about the same time as the effect of the seller disclosure laws, it is impossible to disentangle its effects from the seller disclosure legislation in the appellate cases. Consequently, the division of the time trend in 1995 is open to debate although it follows from the above discussion.[24]

Chart 3.4: Number of Cases Involving Real Estate Licensees or Brokers



Analyzing the total number of cases involving real estate professionals in Ohio appellate courts shows some interesting trends. Chart 3.4 is a histogram of cases filed against real estate professionals since 1950. A trend regression before and after 1995 indicates a statistically significant upward trend in the number of cases by about 1.26 cases per year before 1995.[25]

[24] Other factors may also affect the amount of appellate case during this time frame. For example, an increased number of home inspections were occurring during this time. Also, throughout the 1990s, Ohio continuously strengthened its educational requirements for licensees.

[25] Regression analysis indicated that this regression coefficient was statistically significant at the <.001 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.1.

Since 1995 there has been a downward trend of 2.8 cases per year.[26] This may show evidence of an effect by the disclosure legislation and the other factors discussed above.

Table 3.2: Percentage of Commission Cases over Total Number of Cases

TIME PERIOD	REAL ESTATE AGENT	REAL ESTATE BROKER
1980 – 1989	34%	50%
1990 – 1999	30%	38%
2000 – 2006	32%	38%
1980 – 2006 (Entire Period)	**32 %**	**42%**

Before analyzing potential allegations against real estate professionals, it is important to realize that real estate professionals are both defendants and plaintiffs in litigation. The overwhelming numbers of cases where real estate professionals are plaintiffs involve the issues of commissions. Accordingly, subtracting the number of commission cases from the total number of cases shows the amount of appellate cases involving real estate professionals as potential defendants.

D. Frequency of Legal Theories

The vast majority of claims against real estate licensees are brought by buyers who have problems with the condition of the property. One study found that 76 percent of all claims

[26] Regression Analysis indicated that this regression coefficient was statistically significant at the <.001 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.1.

against real estate licensees had something to do with the condition of the property sold.[27] Using a data base which was with one allegation per suit, they found that 49 percent of the suits were coded as claims of misrepresentation, 18 percent were coded as claims of failure to disclose hidden latent defects, and 9 percent were coded as based upon fraud.[28] In reality, the claims data used in the report may be somewhat misleading because most court cases filed against real estate licensees allege multiple causes of action.[29] For example, in many cases there are allegations of intentional misrepresentation, negligent misrepresentation, and fraud; yet the claims record might code this case simply as fraud. Such coding simplifies the actuarial analysis, but can lead to somewhat misleading conclusions.

An initial review of Ohio appellate cases involved trying to classify the cases by legal theory. Among the legal theories were fraud, misrepresentation, negligence, breach of contract, concealment, breach of fiduciary duty and breach of good faith. In most of the appeals cases examined, the plaintiff alleged a number of theories against the defendant. For example, many appellate cases alleged both fraud and misrepresentation as grounds for the suit.[30] Consequently, when breaking down the cases, the percentages of legal theories involved in cases total significantly higher than 100 percent. As mentioned earlier, many insurance claims data bases only code one legal theory which leads to misleading conclusions concerning the cause of action or defects alleged.

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[27] LEONARD ZUMPANO & KEN WILLIAMS, LEGAL LIABILITY IN ALABAMA AND THE REAL ESTATE SALESPERSON: A RESEARCH REPORT 25 (Ala. Real Estate Research & Educ. Ctr., U. of Ala. 1998).

[28] *Id.*

[29] Dr. Moore is drawing on his experience of the head of claims at Preferred Risk Life Insurance in making this assessment.

[30] The tort of fraudulent inducement has the following elements: (1) an actual or implied false representation concerning a fact or, where there is a duty to disclose, concealment of a fact, material to the transaction, (2) knowledge of the falsity of the representation or such recklessness or utter disregard for its truthfulness that knowledge may be inferred, (3) intent to induce reliance on the representation, (4) justifiable reliance, and (5) injury proximately caused by the reliance. Yo-Can, Inc. v. The Yogurt Exchange, Inc., 778 N.E.2d 80 (Ohio Ct. App. 2002). Negligent misrepresentation occurs when "[o]ne who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions…[and the other has a] pecuniary loss caused to them by their justifiable reliance upon the information…" Delman v. Cleveland Hts. 534 N.E.2d 835 (Ohio 1985).

Fraud was the most common legal theory alleged in the Ohio lawsuits. Out of 1365 appellate cases since 1975, allegation of fraud appeared in 482. This is 35 percent of all cases. Allegations of fraud occurred in 178 of the commission cases, or about 29 percent. Allegations of fraud occurred in non-commission cases in 304, or about 41 percent of the cases. This is not at all surprising, given the relatively high standard of proof necessary to overcome the presumption caused by Ohio's caveat emptor doctrine.

In E&O claims data, fraud was the most common basis of the claim. This is troublesome, because fraud is not covered under most real estate E&O policies. In most cases where fraud was alleged, alternative theories such as breach of contract or negligent misrepresentation may be present. Because the complaint will proceed partly on grounds other than fraud or some other intentional act, the insurance company will have a duty to defend. However, if the basis of a judgment is fraud or some other intentional act, the insurance company will have no duty to indemnify.

The second most common allegation was misrepresentation, which appeared in 333 Ohio appellate cases. Eighty-seven cases, or about 14 percent of the commission cases, contained this allegation. Cases involving either fraud or misrepresentation totaled 551 from 1975 to 2006, representing about 46 percent of the non-commission cases. Almost every property condition lawsuit within the last five years had an allegation of fraud or misrepresentation.

The pattern of cases involving allegations of fraud or misrepresentation was quite interesting. The number of fraud or misrepresentation cases peaked in 1996 with a total of 31 cases. Between 1975 and 2006, the lowest number of cases occurred in 1980 and 2001, with 11 cases. As shown in Chart 3.5, a declining trend started in the mid-1990s. The trend before that appears a little complicated. Starting in the early 80s, one can observe acceleration in the

number of cases, but the acceleration trend looks stochastic. With the effect of the Seller Disclosure Statement in the mid 1990s, and a refinement of the legal role of agents, buyers, and sellers in the significant 1996 legislation, it is not surprising to note a descending trend in the number of cases in the mid 1990s.

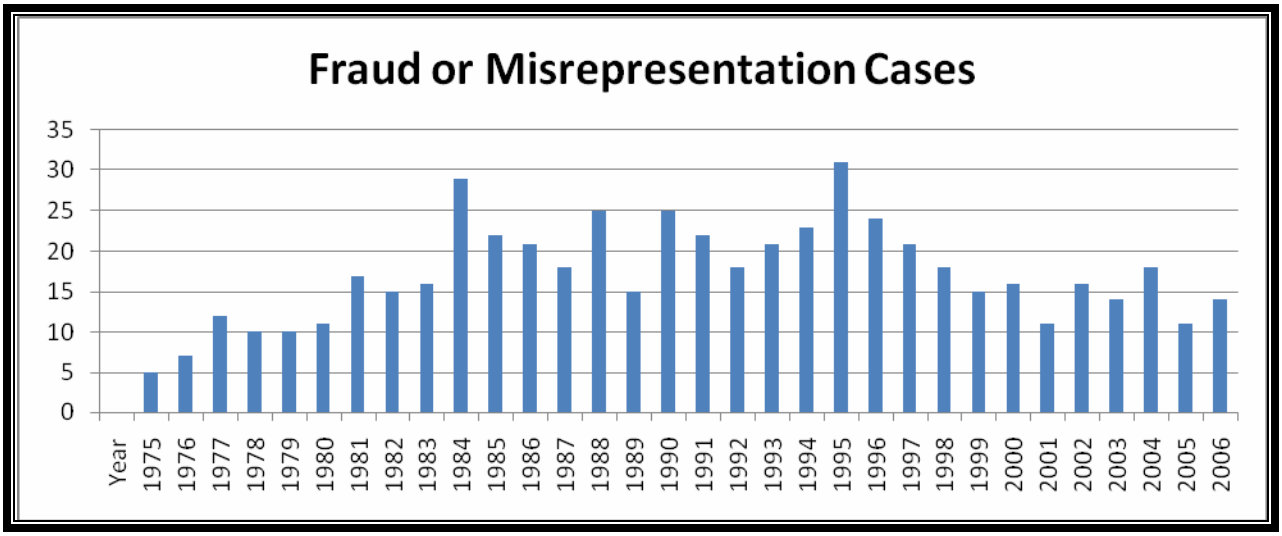
The percentage of fraud or misrepresentation cases since 1980 remained constant compared with the total number of cases during this period of time. Examining the percentage of fraud and misrepresentation cases divided by the total number of cases (including commission cases) and as a percentage of total cases reveals that fraud or misrepresentation cases remained fairly constant. One possible conclusion is that there does not appear to be a discernable change in the percentage of cases associated with this type of property condition case.[31] It is about 74 percent of the cases when the commission cases are removed from the sample[32].

A regression analysis using the number of cases as the Y coefficient is shown in Appendix Table 3.3. The regression model shows an upward trend of about one case per year (actually .89) up until 1996.[33] Thereafter, the number of cases declines by about 1.2 cases per year.[34] It is interesting to observe that the 2.8 cases per year rate of decline found in the regression of total cases appears to be only partially explained by the decline in cases alleging fraud or misrepresentation. A decline in commission cases is another source. Another potential cause of the decline might be that more claims are settled, resulting in fewer lawsuits.

[31] It is important to remember that almost all property condition cases contain allegation of fraud or misrepresentation.
[32] This is around 40 percent of total cases, including commission cases.
[33] Regression analysis indicated that the regression coefficient was statistically significant at the <.001 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.3.
[34] Regression analysis indicated that this regression coefficient was statistically significant at the .004 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.3.

The frequency of fraud and misrepresentation claims filed in the selected Ohio trial courts was comparable to the frequency found in the appellate cases.[35] Fifty-nine percent of all cases involved an allegation of either fraud or misrepresentation.[36] In 29 percent of the cases, there was an allegation of both fraud and misrepresentation. Twelve percent had an allegation of fraud, but not misrepresentation. Misrepresentation is actually the most common allegation in claims filed in the courts of common pleas, occurring about 45 percent of the time. The overall allegation of fraud was made in 43 percent of all claims.

Chart 3.5: Number and Percentage of Fraud or Misrepresentation Cases Regarding Real Estate Brokers or Licensees



Another legal theory advanced is concealment. In appellate cases against real estate licensees, concealment was alleged 189 times from 1975 to 2006. This represented

[35] The frequency of legal theories and defects in the non-commission cases can be found in Appendix Table 3.16 in Appendix for Chapter 3. A complete list of all the cases surveyed in the superior court cases can be found at the end of Appendix for Chapter 3 under the title "Complaint Allegation Descriptions for Three Large Ohio Counties."

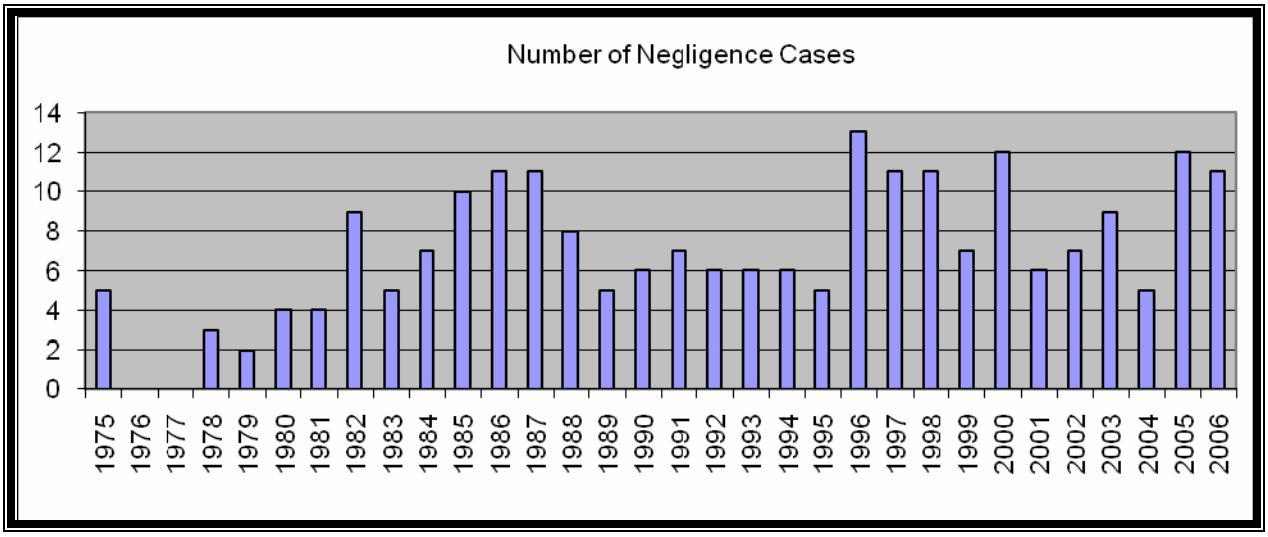
[36] Fraudulent concealment or fraudulent misrepresentation was coded under the category of fraud for this portion of the study. Negligent misrepresentation was coded as misrepresentation. In general the results are consistent with the general belief that about 2/3 of all cases filed against real estate brokers involved failure to disclose material defects. See Zumpano, *supra* note 27.

approximately 14% of the cases. Of these cases, 45 involved commissions as an issue, which means the large majority (76%), are non-commission cases. Concealment was alleged in 19 percent of the non-commission cases. A regression analysis indicated that the frequency of the concealment cases increased by .395 cases per year from 1975 to 1995.[37] The concealment cases declined by 0.577 cases per year in the 1995- 2006 period.[38] This supports the proposition that a large shift in the property condition litigation occurred in the mid 1990s. Concealment/Failure to disclose was an issue in about 23 percent of the claims filed in the selected Ohio trial courts. In 80 percent of the failure to disclosure/concealment cases, there was also an allegation of fraud or misrepresentation.

Negligence was a legal theory in 224 appellate cases involving real estate licensees. These represented about 16 percent of the cases. Of these, 90 were cases where the commission was an issue, and 134 did not involve commission as an issue. There was a statistically significant increase in negligence cases of about .23 cases per year from 1975 to 1995.[39] However, there is no trend in the data from 1995 to 2006.[40]

[37] Regression analysis indicated that this regression coefficient was statistically significant at the <.001 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.4.
[38] Regression analysis indicated that this regression coefficient was statistically significant at the .007 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.4.
[39] Regression analysis indicated that this regression coefficient was statistically significant at the .03 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.5.
[40] Regression analysis indicated that this regression coefficient was not statistically significant. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.5.

Chart 3.6: Number of Negligence Cases



Breach of contract was a legal theory in 299 appeals cases involving real estate licensees. This represented about 22% of the cases. 123 were cases involving commission, which means that commission cases represented 41% of the breach of contract cases. Breach of contract cases increased about .44 cases per year from 1975 to 1995.[41] There was a decrease of .53 cases per year beginning in 1995.[42] Consequently, there seems to be a shift in the trend of breach of contract cases in the mid 1990's, indicating that events such as the Seller Disclosure Legislation, Role Definitional Statues and increased licensee education may have had a role in decreasing the number of breach of contract cases. In claims filed in the selected Ohio trial courts, breach of contract is alleged in about 40 percent of the claims. In about 7.5 percent of the cases, the complaint contains all three allegations: fraud, misrepresentation, and breach of contract. An important point to realize is that these complaints proceed upon multiple legal theories. In E&O data, breach of contract represented the third most common claim against real estate licensees.

[41] Regression analysis indicated that this regression coefficient was statistically significant at the <.001 level.
[42] Regression analysis indicated that this regression coefficient had a p value of .084, which is only marginally statistically significant.

Table 3.3: Legal Theories in Selected Ohio Trial Courts

All Cases (2002-2006)	Percentage of Cases Containing Issues
Fraud	43.0%
Negligent Misrepresentation	44.9%
Breach of Contract	39.3%
Failure to Disclose/Conceal	23.4%
Breach of Fiduciary Duty	21.5%
Civil Conspiracy	3.7%

Breach of Fiduciary Duty was listed as an allegation in 82 cases involving real estate licensees. Fifty-one were commission cases, which represents 62% of the Breach of Fiduciary Cases. 31 were non-commission cases. Breach of good faith was listed as an allegation in only 2 of the appeal cases against real estate licensees in the 1975 to 2006 period. Breach of fiduciary duty was alleged in 21.5 percent of the claims in the selected Ohio trial courts. Breach of duty represented the second most common allegation in E&O data.

Unfortunately, the E&O frequency data kept by many insurance companies in claims data files has been coded so that the expected value of the claims can be easily calculated. Only one type of claim typically is coded into each file. The expected value of the claim is then the severity times the frequency, which makes actual calculation of the expected value easier for the company. Thus, when examining the general frequency of E&O claims, one must remember that the data is distorted because of this process. Most claims are based upon multiple legal theories and usually more than one defect or alleged procedural deficiencies form the basis of the claim.

Table 3.4: Top Five E&O Frequency Classes – Average Claim

Allegation	Frequency Rank	Average Claim
Fraud	**1**	**$11,915**
Breach of Duties	**2**	**$12,006**
Breach of Contract	**3**	**$12,151**
Negligence	**4**	**$12,520**
Consumer Protection Act	**5**	**$10,837**

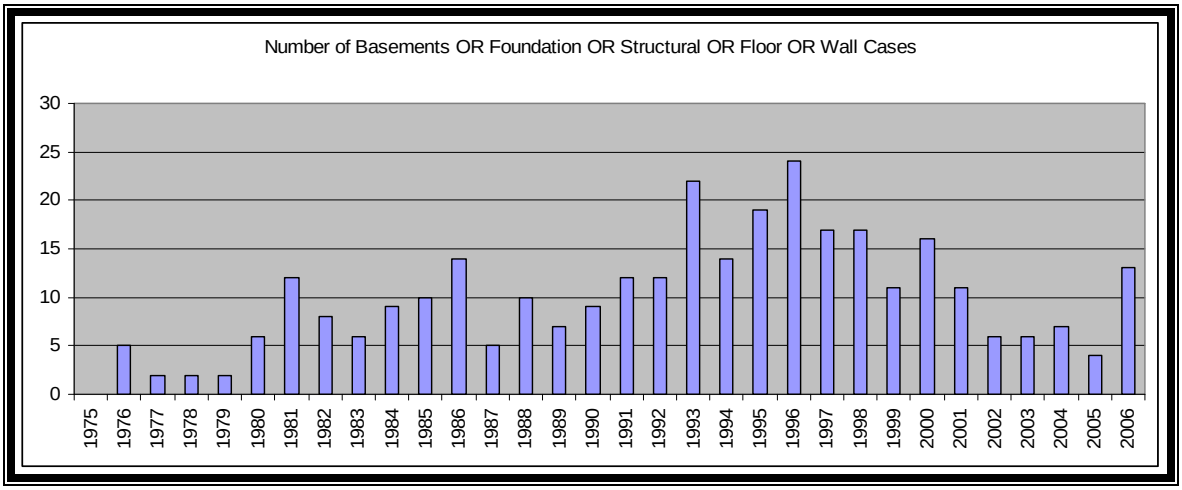
Source RISC LLC, claims data (2007)

E. Frequency of Defect Allegation

The largest source of allegations concerning defects involved the actual structure of the residence.[43] Issues with basements, foundations, floors and walls represented 42 percent of all non-commission appellate cases between 1975 and 2006. A regression involving these issues related to the structure of the residence indicates that from 1975 through 1995, there was an increase of .73 cases per year.[44] However, from 1995 to 2006, the number of cases was falling by 1.37 cases per year.[45] The change in the trend in the mid 1990s is readily apparent. Unfortunately, our statistical methodology does not allow us to disentangle the reasons for the shift in the frequency of appellate cases. However, the Zumpano Report suggests that the seller disclosure legislation has played an important role in curtailing these claims.[46]

[43] To some extent, the source of potential defect liability is related to the part of the country in which the housing is located. For example, the number one cause of claims against real estate licensees in Alabama was termites whereas basements represent a relatively small percentage of the claims against real estate agents. *See* Zumpano, *supra* note 27.
[44] Regression analysis indicated that this regression coefficient was statistically significant at the <.001 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.6.
[45] Regression analysis indicated that this regression coefficient was statistically significant at the .002 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.6.
[46] Zumpano, *supra* note 27, at 25.

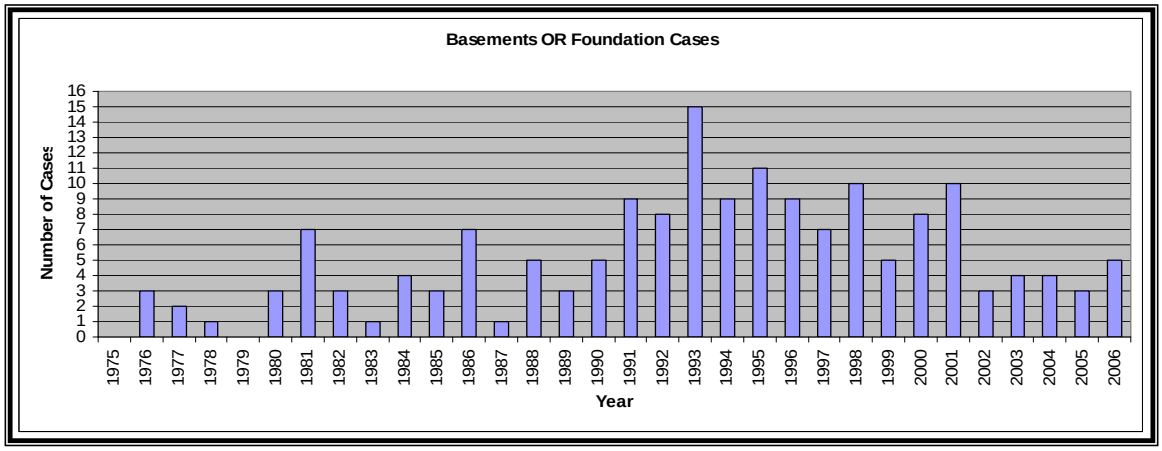
Chart 3.7: Number of Major Structural Cases



The largest subset of structural defect lawsuits in Ohio appellate cases involved basements or foundations. Basement or foundation cases represented 22 percent of all non-commission cases in the appeals database.[47] The regression model indicates a statistically significant increase in the number of case until 1995 of about .48 cases per year.[48] A downward trend, starting in the mid 1990's, eventually reached 5 cases in 2006. A statistically significant regression showed a decline of .61 cases per year.[49] Note that the trend, showing a decrease in cases after the mid-1990s, is very similar to the pattern found in the previously discussed fraud or misrepresentation cases involving real estate licensees and is similar to the trend in the overall structural cases above. Similar to the data in the appellate cases, the most common defect allegations filed in the selected Ohio trial courts deal with basements or foundations. Basements were listed in the complaint as problems in 21 percent of the claims, while foundation issues were about 11 percent of the claims. Approximately 5.6 percent of all cases had an allegation of both foundation and basement defects.

[47] In is important to note that is more than half of 42 percent structural cases discussed above.
[48] Regression analysis indicated that this regression coefficient was statistically significant at the <.001 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.7.
[49] Regression analysis indicated that this regression coefficient was statistically significant at the .005 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.7.

Chart 3.8: Number of Basement or Foundation Cases



It is interesting to note that basement/foundations were the largest source of surprises to Ohio home buyers before the introduction of seller disclosure legislation.[50] Even after the passage of seller disclosure legislation, basement problems were tied as the top source of surprises.[51] Consequently, real estate professionals should expect that basements and foundations will represent the largest source of their potential liability.

In examining allegations involving the roofs of the homes separately from the rest of the structural defects,[52] one would expect to see a decline in these cases after 1995, as with other structural cases. But there was no such decline. There were 72 cases involving issues concerning the roof between 1975 and 2006, representing about 10 percent of all cases not involving commission. Analysis indicates that no decline in the number of cases had occurred since the mid 1990s.[53] The reason for this lack in decline may be that the amount of new information that

[50] See Gary Moore & Geral Smolen, *Real Estate Disclosure Forms and Information Transfer*, 28 REAL ESTATE LAW J. 319, 329-30 (2000).
[51] *Id.*
[52] Some of the roof cases involved allegations concerning other structural defects. We separated the roof from the rest of the structure because of the anomalous pattern we found in the frequency data that was inconsistent with the rest of the structural issues.
[53] The regression analysis from 1975 to 1995 indicated a statistically significant increase, however, the regression analysis from 1995 to 2006 indicated no statistically significant trend. See Appendix for Chapter 3, Table 3.8.

is being passed by seller disclosure forms is not substantially greater than before the legislation. It is relatively easier for the average buyer to identify a roof that is in need of repair than to identify other types of residential defects. Moreover, the quality of the information that is disclosed on the disclosure form about the roof is not substantial. In analyzing complaints filed in the selected Ohio trial courts, the second most common defect was roofs, occurring in about 10 percent of the cases. This number was comparable to the number found in the appeals data.

Mechanical systems, such as plumbing, heating, and air conditioning, were a cause of complaint in numerous cases. A total of 96 cases were associated with mechanical systems in the 1975 to 2006 period.[54] Plumbing was an issue in 60 cases from 1975 to 2006, representing about eight percent of the non-commission cases. Heating or air conditioning was an issue in 52 cases from 1975 to 2006, representing about seven percent of all the non-commission cases. Electrical systems were an issue in 16 cases over the 1975 to 2006 period, representing about two percent of the non-commission cases. Many cases alleged multiple defects with various mechanical systems. Regression analysis on the mechanical systems cases indicated an upward trend from 1975 to 1995, and a downward trend from 1995 to 2006. However, the trends were statistically insignificant. Mechanical systems also represented a significant percentage of claims in complaints filed in the selected Ohio trial courts. Electricity was a problem in 5.6 percent of all those complaints; heating/air conditioning was a problem in 4.7 percent of all complaints; and plumbing was a problem in 4.7 percent of the complaints.

Water and water waste systems represented a potent source of liability for the real estate professional. There were 33 appellate cases involving the issue of either septic tanks or sewer systems in the 1975 to 2006 period. The frequency trend was consistent with a change in trend in 1995. There was a slight gain in the number of sewer or septic tank cases in the 1975 to 1995

[54] Mechanical systems include plumbing, heating, air conditioning or electricity.

period, but a statistically significant decline between 1995 and 2006.[55] Water and well cases represented a potential source of liability to real estate agents. The number of cases per year increased from about two in 1975 to about six in 1995. Although the number trended downward after 1995, it was not statistically significant.[56] Sewer and septic tank cases were relatively frequent in complaints filed in the selected Ohio trial courts. Sewer issues were present in 7.5 percent of all those cases, and septic tank issues in 3.7 percent of all cases.

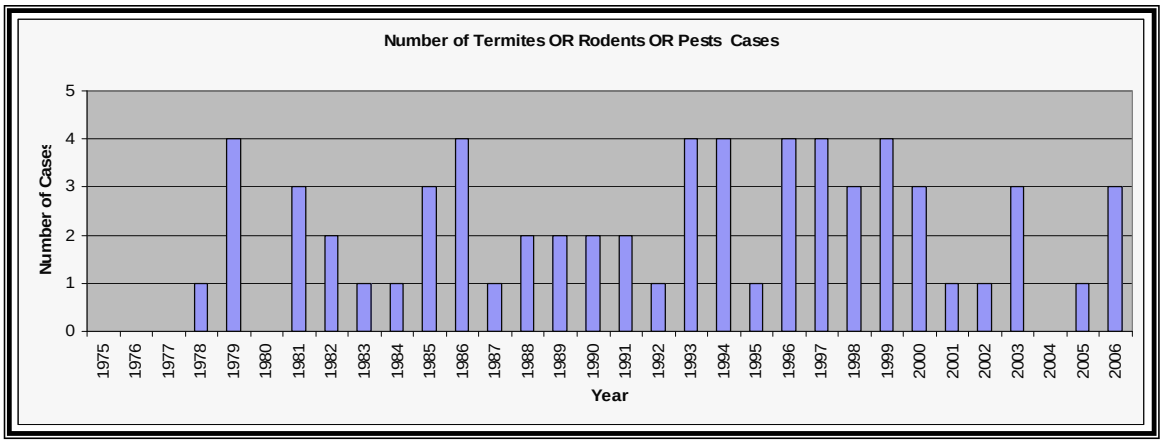
Termites, rodents or pests represented a significant number of Ohio appellate cases. Sixty-five cases involved termites, rodents or pests from 1975 through 2006. The trend has a sign that is consistent with a shift in liability, but the coefficients are not statically significant.[57] There may have been a shift downward in the pattern, but it is not a smooth linear function. No cases involving termites, rodents or pests occurred in 1980 or 2004, while the highest point of four cases was observed six times in the last 26 years and five between 1993 and 1999. The trend seems to go down after the last peak in 1999, showing a discontinuity since 2000. Termites and wood boring insects were a problem in only two percent of the complaints filed in the selected Ohio trial courts. This number is similar to that found in the appellate cases.

Flooding and drainage was also a significant source of potential liability. There were 56 cases involving drainage or flooding over the 1975 to 2006 period, representing about six percent of the non-commission cases. There was a statistically significant upward trend from 1975 to 1995.[58] However, the trend coefficient had the correct sign from 1995 to 2006, but was not

[55] Regression analysis indicated that the increase was marginally significant at the.107 level and the decline was statistically significant at the .002 level. The details of the regression can be found at the end of the paper in Appendix for Chapter 3, Appendix Table 3.9.
[56] See Appendix Table 3.10 in Appendix for Chapter 3.
[57] Neither the 1975 to1995 period nor the 1995 to 2006 period had statistically significant coefficient at the .05 level. See Appendix Table 3.11 in Appendix for Chapter 3.
[58] The increase was statistically significant at the .001 level. See Appendix Table 3.12 in Appendix for Chapter 3.

statistically significant.[59] Flooding and drainage was involved in 56 cases from 1975 to 2006. In complaints filed in the selected Ohio trial courts, flooding problems related to 5.6 percent of all claims.

Chart 3.9: Number of Termites or Rodents or Pests Appellate Cases



Another large potential source of liability is when there is a disparity between the actual size of the house or property and the size listed on the multiple listing. There are various reasons for the discrepancies, but they do from time to time occur. There were 59 cases involving boundaries or encroachment cases, which represent eight percent of the non-commission cases from 1975 to 2006. There is a statistically significant decline in the number of boundaries or encroachment cases in the mid 1990s.[60]

Unanticipated legal entanglements represented a substantial source of liability for Ohio real estate licensees. There were a total of 140 cases involving zoning, code violations, tax assessment, or homeowners associations. There is a marginally statistically significant downward

[59] The decrease was not statistically significant. See Appendix Table 3.12 in Appendix for Chapter 3.
[60] The decline was significant at the .017 level. See Appendix Table 3.13 in Appendix for Chapter 3.

trend in the frequency of these cases after 1995.[61] This may indicate that the disclosure legislation, increased education, and role definition statutes had an effect. It is hard to attribute the decline in this item to an increased number of professional home inspections. In complaints filed in the courts of common pleas, conveyance and marketable title issues represented a hefty 7.5 percent of all claims. Interestingly, escrow claims represented 6.5 percent of all complaints.

One very interesting trend was the trend in liability for hazardous substance such as asbestos, radon or lead paint. There were only nine appellate cases involving these three substances. They represent less than one percent of all cases. The trend did not have a declining sign after 1995 and was not statistically significant. This may be because there is so little knowledge concerning these hazards that disclosure of what little knowledge a seller has is of no marginal consequence. A larger source of concern was cases where environmental issues cropped up. There were 31 cases involved in environmental issues from 1975 to 2006. There is a statistically significant increase in the 1975 to 1995 period, and a marginally significant decrease from the 1995 to 2006 period.[62] One appellate case involving a landfill produced a large liability for the seller. It is not the frequency of these cases that should alarm a real estate licensee, but rather the fact that the liability is large and pollution is an excluded risk under the standard E&O real estate coverage. The number of allegations involving lead paint in complaints filed in the selected Ohio trial courts continued to be less than impressive. It represented less than 2 percent of the total.

[61] The P-value on the decline was .063. See Appendix Table 3.14 in Appendix for Chapter 3.
[62] The P-value on the increase from 1975 to 1995 was .043, and the P-value on the decrease during the 1995 to 2006 period was .056. See Appendix Table 3.15 in Appendix for Chapter 3.

Table 3.5: Frequency of Issues Alleged in Selected Ohio Trial Courts

All Cases (2002-2006)	Percentage of Cases Containing Issues
Foundation	11.2%
Basement	21.5%
Size/Boundary	3.7%
Flooding	5.6%
Sewer	7.5%
Septic Tank	3.7%
Termites	1.9%
Plumbing	4.7%
Electricity	5.6%
Heat/AC	4.7%
Roof	9.3%
Hazardous Materials/Lead Paint	1.9%
Porch	1.9%
Zone	1.9%
conveyance/ marketable title	7.5%
Miscellaneous	42.1%
Punitive Damages	40.2%
Ohio Consumer Protection Act	0.9%
Escrow repayment	6.5%
Commission	7.5%

F. Frequency of Request for Punitive Damages

Although punitive damages cannot be the legal basis for a suit, it is important to examine the incidence of requests for punitive damages. In general, legal theories must involve

intentional or reckless conduct in order to lead to punitive damages.[63] Consequently, punitive damages are not available for mere breach of contract or negligence.[64] A higher degree of culpability such as fraud or concealment is usually required.[65] Complainants asked for punitive damages in 145 appellate cases between 1975 and 2006. From 1975 to 1995, there is no statistically significant trend in the number of punitive damages cases.[66] On average, there were about five cases per year involving punitive damages. However, there was a distinct trend in these cases after 1995. There was a statistically significant decrease of .465 cases per year after 1995.[67] Indeed, there was only one punitive damage case in 2005 and one in 2006.

Punitive damages are of the greatest concern to many real estate licensees because of the potential magnitude of the damages. The Ohio Supreme Court recently reiterated that "[in] an action to recover damages for a tort which involves the ingredients of fraud, malice, or insult, a jury may go beyond the rule of mere compensation to the party aggrieved, and award exemplary or punitive damages."[68] Although punitive damages are allowed in Ohio, it should be noted that the legislature has limited punitive damages to twice the total amount of compensatory damages.[69] In about 40 percent of all the complaints filed in superior court in the three counties surveyed, the plaintiff asked for punitive damages. This is a significant percentage. Generally, E&O coverage does not cover punitive damages, so this is a potentially worrisome issue.

[63] *See* Preston v. Murty, 512 N.E.2d 1174, 1175 (Ohio 1987) (stating that "Ohio courts, since as early as 1859, have allowed punitive damages to be awarded in tort actions which involve fraud, malice, or insult.").
[64] *Id.*
[65] *Id.*
[66] The r-squared statistic was .001, indicating no relationship between time and the number of punitive damages cases over this period.
[67] The r-squared statistic was .356, and the P-value on the regression coefficient was .041.
[68] *See* Zappitelli v. Miller, 868 N.E.2d 968, 968 (Ohio 2007). It should be noted that the Ohio Supreme Court allows the recovery of attorneys' fees in these cases.
[69] Ohio Rev. Code Ann. § 2315.21(2007).

G. Severity of Liability Risks

The average funded claim against a real estate licensee is about $15,000. This amount could be paid by many real estate firms without severe difficulty. Consequently, there is the temptation to self insure the risk. However, when one examines the largest exposures as shown by the judgment amount in appellate cases, one realizes that the exposure is probably large enough so as to justify the investment in coverage. This can be done by transferring the risk to an insurance company. A review of the appeals case data for the most recent years reveals a number of large judgment cases. The four largest appellate cases are listed in Table 3.6. The average judgment amount in these cases is around $600,000. This is clearly an amount large enough to devastate many local real estate firms. Very few firms would absorb the loss of this magnitude without serious effects on their ability to do business. Consequently, the liability risk represents a relatively low frequency, high severity risk which is appropriate to transfer to an insurance company.

Table 3.6: Large Judgments Against Real Estate Brokers or Agents

CASE	JUDGMENT AMOUNT	BRIEF SYNOPSIS
Clemente v. Gardner, 2004 Ohio 2254 (2004).	$703,766	Case alleged a fraudulent inducement and negligent misrepresentation with regard to a property that had previously been a solid waste landfill.
Weidle v. Leist, 2004 Ohio 4693 (2004).	$461,325	Loss Profit due to Real Estate Agent's Breach of Contractual and Fiduciary Duties.
Allen v. Niehaus, 2001 Ohio 4021 (2001).	$737,000	A fraud arising out of a purchase of a piece of land which was subject to landside conditions; the condition was concealed and not disclosed by the sellers. The sellers had previously spent money stabilizing the structure on the property but the stabilization was not successful.
Moore v. Daw, 2002 Ohio 6604 (2002).	$535,920	Significant termite damage undisclosed by the seller

E&O data is particularly instructive as to the magnitude of the liability that the real estate professional faces. It is important to realize that the claim reserve is the amount the company believes it will pay on the claim for both defense costs and the required indemnification under its insurance contract. The severity data is quite interesting, because it gives an idea of the magnitude of some of the more severe types of claims that can be filed against real estate agents. The largest type of claim in terms of severity is misrepresentation of an option to buy at $170,601.

Interestingly, this represents a more exotic type of real estate practice than is common for most real estate agents. An option to buy is a derivative and is potentially legally complicated. Real estate agents should not proceed with such instruments without the express presence of legal counsel on both sides of the deal. The second cause of action is breach of duty or power of attorney at $52,747. Once again, this is a situation that may not be typical. Power of attorney potentially creates a fiduciary relationship well beyond the normal duties of the real estate agent. Third highest claim is for non-disclosure of a land fill, at $49,206. Old landfills represent tremendous liability to the buyer and the seller of land under federal superfund legislation. Because of the magnitude of liability under the pollution legislation, it is not surprising that this category of claim should rise to the top in terms of severity. Even if the real estate licensee is ultimately held not to be responsible in one of these cases, the potential defense costs are extremely high. It should be noted that one of the four largest judgments in cases involving Ohio Real Estate Licensees was for non-disclosure of a solid waste landfill.[70]

[70] Clemente v. Gardner, 2004 Ohio 2254 (2004). At $703,766, this was the largest judgment amount involving appeals cases found in the Lexis Nexis database. Although the judgment was dismissed against the real estate agent, one would suspect that the actual defense costs were huge.

Table 3.7: E&O Top 40 Plus Commission Cases in Severity –Average Claim

Allegation	Severity Rank	Percent of Total Cases	Average Claim Reserve
Misrep. Option to Buy	1	0.03	$170,601
Breach of Duty/Power of Atty.	2	0.01	$52,747
Non-Discl. of Land Fill	3	0.03	$49,206
Non-Discl. Potential Buyer	4	0.05	$42,604
Misrep Financials of Business	5	0.24	$40,485
Violation of RICO	6	0.18	$35,917
Non-Discl. Development/Rd. Widen	7	0.15	$35,116
Mortgage Fraud/Predatory	8	0.15	$34,515
Violation of RESPA	9	0.11	$27,106
Non-Discl. Strip Mining	10	0.01	$24,000
Conversion	11	0.5	$22,303
Non-Discl. of Relationship	12	0.18	$21,855
Failure to Supervise	13	0.52	$20,160
Misrep Infestation	14	0.23	$19,507
Misrep Water Damage	15	0.29	$17,161
Failure to Submit Offer/Accept	16	0.4	$16,042
Misrep Financials of Buyer	17	0.41	$15,968
Misrep Lot Being Buildable	18	0.35	$15,309
Misrep Soil	19	0.05	$15,221
Misrep Structural	20	0.74	$15,171
Failure to Col/Pay Earnest/Tax	21	0.08	$14,295
Appraisal Malpractice	22	1.26	$14,051
Misrep Value of Property	23	1.18	$13,163
Environmental Contamination	24	0.71	$13,086
Negligence	25	5.57	$12,520
Breach of Contract	26	6.05	$12,151
Misrep of Road	27	0.14	$12,129
Breach of Duties	28	10.26	$12,006
Fraud	29	11.01	$11,915
Misrep of Interest Rate	30	0.02	$11,681
Non-Discl./Misrep. Mold	31	1.66	$11,549
Specific Performance	32	1.04	$11,416
Negligent Supervision	33	0.17	$11,380
Failure to Put Listing in MLS	34	0.07	$11,297
Misrep Number Legal Bedrooms	35	0.14	$11,239
Failure to Maintain Property	36	0.19	$11,164
Misrep Restrictions	37	0.37	$10,873
Consumer Protection Act	38	3.37	$10,837
Non-Discl. Agency	39	0.29	$10,300
Escrow Dispute	40	0.15	$10,192
Commission/Fees Dispute	41	0.68	$10,059

Claims data, 2007

H. Expected Loss Due to Liability Risk

According to earlier estimates, the expected claims reserve over the 2000 to 2006 period was about $15,000. There was approximately a .005 chance that a licensee would incur a claim with a reserve in any given year. This means that the expected value of the direct loss was about $75.00 over this period. In addition, there was about a .01 chance that there would be a claim filed. If we consider that the cost of setting up, reviewing, accounting for and finally resolving any claim at about $2000 per claim, this would add about $20 of indirect claim expenses. This means that the expected value of the direct and indirect costs of the claims was about $95 dollars. With average mandatory premiums running in the $140 to $170 range during this period, it is clear that E&O insurance makes sense in an average situation. It can keep the overhead down to a very manageable amount. [71] If sales expenses associated with each policy are in the $50 to $100 range (as might be expected when the policies are sold on an individual basis), then one would expect that, individually, market products would sell in the $225 to $275 range over the 2000 to 2006 period.

I. Conclusion

The chapter examined the risk associated with being a real estate licensee. I found that there is a small but significant possibility of a lawsuit. The allegations in a suit typically will be fraud, negligent misrepresentation, or concealment. In order to overcome the caveat emptor defense, it is usually necessary to allege fraudulent behavior. However, as will be explored in the next chapter, fraud is not covered by the typical insurance policy. On the other hand, negligence is included in E&O coverage. Thus, there usually will be a negligence claim so that

[71] It is clear that significant marketing expenses can be avoided with mandatory coverage.

the defendants' insurance coverage is triggered. Consequently, it is not surprising that Ohio complaints usually allege multiple grounds for the suit. As found in previous studies, the suit typically will have to do with the condition of the property. In Ohio, the most significant defect allegation is for structural defects. The most common structural defect is in the foundation or basement. In a significant number of cases, there is a request for punitive damages.

A shift in the pattern of liability appears to have occurred in the middle 1990s. A number of statistically significant shifts in the frequency of appellate cases exhibit that until the mid 1990s the number of cases was rising. After the mid 1990s, the frequency of the cases was falling. The pattern was fairly general, but there were exceptions. For example, there was no shift in the frequency of roof cases. This may have been because the seller disclosure statement was deficient in this area. The reasons for these trends appear to be related to implementation of seller disclosure laws, agency, and role definitional legislation passed in the mid 1990s, as well as significant increase knowledge of agents caused by increased standards of education. The timing of the shift in liability frequency appears to be consistent with this supposition.

The liability risk associated with real estate licensees is a classic situation where the probability of a liability claim is small and the severity of the claim is relatively severe. Consequently, this is a situation where the risk management remedy of transfer would seem to be the correct solution. Consequently, one would expect that insurance contracts and other transfer would be the most effective method of dealing with the liability risk. This would be true, except for the fact that some of the most frequent types of liability claims such as fraud or concealment typically are not covered by insurance contracts. The next chapter examines the potential of insurance contracts as a remedy for the liability situation.

Chapter 4: Insurance Coverage as Risk Management for the Liability Risk

Management of risk is one of the most important issues in the planning, organization, and management of any business enterprises including real estate enterprises. Risk is present in all business activities but it can be managed. Risk can be defined as an event or action that may occur which will adversely affect the organization's objectives and goals.[1] The goal of risk management is to enhance an organization's effectiveness while safeguarding the assets and economic health of the organization.

Liability risk is one of the most difficult risks to manage. To understand why, it is important to understand the dual nature of risk. Because risk and return are related, all economic activities incorporate an element of risk. The goal for risk management is not simply to prevent or mitigates losses but also to advance or optimize gains. In some situations, a firm will purposely increase liability risk because the opportunity for gains far exceeds the increased expected loss caused by the potential liability. For example, for some real estate firms it might make sense to increase the scope of their activities to include property development even though this may substantially increase the possibility of litigation against the firm.

Proper risk management uses the techniques of analysis and measurement to insure that risk are properly identified, classified, monitored and communicated to all relevant stakeholders in the real estate enterprise.[2] Risk control consists of selecting appropriate techniques for treating loss exposures and implementing and monitoring a risk management program. This

[1] *See also* EMMETT VAUGHAN & THERESE VAUGHAN, FUNDAMENTALS OF RISK AND INSURANCE 3 (9th ed., Wiley & Sons 2003) (defining risk as "a condition in which there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for."); GEORGE REJDA, PRINCIPLE OF RISK MANAGEMENT AND INSURANCE 3 (10th edition, Pearson Education 2008) (defining risk as "uncertainty concerning the occurrence of a loss.").

[2] *Id.* at 43. *See also*, SCOTT HARRINGTON & GREGORY NIEHAUS, RISK MANAGEMENT & INSURANCE 31 (2d ed., Irwin 2004) (stating that "there are five steps in the risk management process: (1) identify all significant risks that can cause loss; (2) evaluate the potential frequency and severity of losses; (3) develop and select methods for managing risk; (4) implement the risk management methods chose; and (5) monitor the suitability and performance of the chosen risk management methods and strategies on an ongoing basis.")

chapter, focuses mainly on liability risk transfer, specifically E&O insurance policies as the first line of defense against the liability risk.

A. The E&O Insurance Policy

Most real estate agents believe that the first line of defense against the liability risks discussed in Chapter 4 is the licensee's E&O insurance policy. E&O coverage is mandatory in a number of states, and in states where it is not mandatory the majority of agents have the coverage.

An E&O insurance policy will pay on behalf of the insured damages in excess of the deductible which the insured becomes legally obligated to pay for any negligent act, error, and omission arising out the insured's professional services, as long as the claim is made during the individual policy period.[3] This type of policy is called a "claims-made" policy, because the claim for the risk insurance must occur while the policy is in effect. Extension of the coverage for a period outside the original coverage period may be made for an additional premium.[4]

Unfortunately, in order to keep the basic E&O policy affordable, most E&O policies have numerous exclusions to coverage. Exclusions are a basic part of any insurance contract so as to limit the peril insured to those risks which the insurance company contemplated. The perils in the exclusion section are excluded from the insurance contract either because they are not insurable or because the basic premium contemplated the exposure and the coverage must be obtained through the purchase of additional coverage[5]. Among these exclusions are

A. fraudulent, dishonest, criminal, malicious, or willful acts committed by the Insured,

[3] This is a summary of some typical exceptions. The standard mandatory Kentucky E&O insurance policy provided by RISC insurance can be seen at www.risco.com (2007) Thanks to Mary Jefferson and Catherine Williams at Victor O. Schinnerer & Co. for their assistance and permission to reference their policy.
[4] *Id.*
[5] See Vaughan, *supra* note 1, at 172 for an economic explanation of the rationale for exclusions.

B. Insured's insolvency

C. the failure to pay, collect or return insurance premiums, escrow monies, earnest money deposits, security deposits, tax money or commissions;

D. employment disputes;

E. bodily injury, sickness, disease, mental anguish, pain or suffering, emotional distress or death of any person;

F. destruction or loss of use of tangible property;

G. unfair competition or wrongful taking of intellectual property;

H. libel, slander, defamation of character, disparagement, detention, humiliation, sexual harassment, false arrest or imprisonment, wrongful entry or eviction, violation of the right to privacy or malicious prosecution, personal injury or other invasion of rights to private occupancy;

I. discrimination on the basis of any unlawful discrimination category;

J. Professional Services relating to property developed or constructed by, or more than 10% owned by, or purchased or attempted to be purchased by an Insured or by the spouse of an Insured or their agents

K. Violation of the retirement or securities laws.

L. failure by an Insured to provide or maintain insurance;

M. the Insured's activities as a lawyer, title agent, mortgage banker, mortgage broker or correspondent, escrow agent, construction manager, property developer or insurance agent;

N. activities involving property in which any Insured has, or had, a direct or indirect interest in the profits or losses;

O. liability assumed by any Insured under any contract, indemnity agreement, hold harmless clause or other similar agreement

P. Pollution

Q. Mold.

R. damage expected or intended by the Insured;

S. disputes over commissions initiated by the Insured.

T. negligent acts, errors or omissions committed or alleged to have been committed either (1) prior to the date the Insured received an active real estate license or (2) subsequent to the effective date of suspension, revocation or inactive status of the Insured's real estate license;

U. any fines, penalties, assessments, punitive damages, exemplary damages or multiplied damages, or matters deemed uninsurable under applicable law;

V. misappropriation or commingling of funds or other property; or

W. Activities as an appraiser.[6]

It is distressing that the most common allegation against real estate licensees – fraud – is the first exclusion under the standard E&O coverage. However, this should not be surprising. Since fraud is an intentional act, it would violate the general principles of an ideally insurable interest to insure it. This fraud or willful behavior exception is not unique to the real estate E&O policy. In general, no insurance policy insures an act which is willful because in order to estimate the risk a stable estimate of the exposure distribution is needed. Insuring willful behavior eliminates the elements of randomness from the risk and actually changes the probability distribution. In such a situation it is impossible to estimate the risk parameters of the exposure.

A related issue is the exception from coverage of punitive damages. Punitive damages are only available where there is fraudulent or intentional behavior. Consequently, the same logic holds with regard to the possibility of an insurance company issuing a policy which will cover punitive damages. Since the actions leading to punitive damages are intentional and since covering intentional acts actually changes the exposure distribution, insurance companies do not issue policies covering punitive damages. This creates quite a hole in the coverage. In 43 percent of the complaints filed in the courts of common pleas, the complainant requested punitive damages. However, since punitive damages are exempted from E&O coverage, it is virtually impossible to insulate the real estate licensees from this particular liability using insurance. The ideal situation would be to negotiate for an insurance policy that covers punitive damages, but

[6] This is a simplified version of some of the standard language. A more complete and standard list can be seen at mandatory Kentucky E&O insurance policy provided by RISC insurance at www.risco.com (2007) Thanks to Mary Jefferson and Catherine Williams at Victor O. Schinnerer & Co, one of the leading firms in this area, for their assistance and permission to reference their policy.

since punitive damages are normally associated with intentional or reckless conduct, such a policy would be counter to the general principles of insurance.[7]

Another area of concern is actions of real estate licensees that are related to their business as a real estate professional, but to some extent, branch into entrepreneurship. For example, professional services (relating to property developed or constructed by or more than 10 percent owned by, or purchased, or attempted to be purchased by an insured or by the spouse of an insured or their agents) are not covered. Some of the largest judgments against real estate licensees involve the licensees' own efforts relating to properties where they had a potential economic interest. For example, in *Allen v. Niehaus*, an action for fraud arose from the purchase of a house by two real estate licensees. After failed attempts to rectify a landslide condition, the licensees then sold the house without disclosing their attempts to fix the problem. When the house continued to slide down the hill after the sale, the real estate licensees found themselves liable to the buyer for $737,000.[8]

This loss probably would not have been covered under their E&O policy for a number of reasons. First, this was an allegedly fraudulent act. Second, it involved the development of their own property. Finally, it involved activities relating to property in which the insured had a direct or indirect interest.

Similarly, in *Moore v. Daw*, a jury found that a real estate agent failed to properly disclose to another real estate agent an extensive infestation of termites in a property owned by a deceased relative.[9] Many appeals followed. Although the exact insurance coverage in these cases is not disclosed, a theoretical problem with insurance coverage is illustrated by the facts in *Moore*. The case had an extensive litigation history, and if the duty to defend was not separated

[7] Vaughan, *supra* note 1.
[8] Allen v. Niehaus, 2001 Ohio 4021 (2001).
[9] Moore v. Daw, 1996 Ohio App. LEXIS 3763 (1996).

from the duty to indemnify most of the limits of coverage could have been exhausted prior to judgment.

B. Endorsements

Some exceptions to coverage on an E&O policy can be eliminated by endorsements. Endorsements represent additional coverage for an additional premium. In most cases, however, an exception is not completely removed by an endorsement. Rather, additional coverage is provided to lessen the impact of the exception. Many real estate licensees will find these coverages useful. A number of optional coverages are often available to supplement the basic real estate E&O policy.[10] Among the optional coverages available for additional premium are:

1) Additional limits of liability
2) Appraisal endorsement
3) Conformity endorsement
4) Limited Expenses Coverage Environmental Endorsement
5) Optional extended reported period endorsement
6) Limited Claim expenses for fair housing endorsement
7) Franchise endorsement
8) Limited claim expenses for real estate regulatory complaints.[11]

The increased limits of liability typically allow an increase in the limits of liability per claim from a low number such as $100,000 to a higher limit of $300,000 or $500,000. The aggregate amount per licensee may be adjusted.[12] Increasing the limit of liability is probably a good idea for most agents, especially because most professionals carry higher coverage (such as $300,000 liability coverage) on their cars than on their businesses.

[10] *See, e.g.*, 2007 Kentucky Real Estate E&O Optional Coverages, http://www.risceo.com/Kentucky/ky_home.htm, (last visited Sept. 13, 2007).
[11] *Id.*
[12] *Id.*

An appraisal endorsement typically deletes the exclusion for appraisal services and includes real estate appraisal services as a licensee.[13] This provision is one of the few that completely eliminates an exception to coverage. Since most real estate agents are involved in a market analysis from time to time, this endorsement would be useful to almost anyone in the profession.

A conformity endorsement allows protection for real estate licensees operating in more than one state. Many licensees in border areas, such as Toledo or Cincinnati, have need for this type of endorsement.[14]

A limited expense coverage environmental endorsement covers risks which are typically more frequent but usually not great in terms of severity. Among the endorsements are a mold or pollution endorsement under the environmental endorsement, a fair housing endorsement, and a regulatory complaint endorsement. Typically, the covered expenses are limited to around $2500 per claim.[15]

Franchise endorsements eliminate the exception of activities involving property syndication, limited partnerships or real estate investment trusts in which the insured had a direct or indirect interest in the profits. Most real estate firms should purchase and their licensees should probably purchase a franchise endorsement.[16] Since the scope of these provisions may vary from company to company it is probably important to have the company or agent attorney review the franchise endorsement.

Good risk management practice is to review all of the offered endorsements from an E&O provider to see if the endorsements should have a role in risk management plans. In most

[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*

cases, the endorsements are extremely reasonable in price and represent a needed area of coverage. As in most insurance situations, the most basic coverage is rarely the best.

C. Duty to Defend vs. Duty to Indemnify

It is a well established principle in Ohio insurance law that an insurance company's duty to defend a case is often greater than its duty to indemnify.[17] There is an essential difference between the duty to defend and the duty to indemnify. The duty to defend depends upon the allegations in the underlying complaint, whether they be true or not.[18] An insurer's duty to defend is separate and distinct from its duty to indemnify, because the duty to indemnify may be a function of the ultimate outcome in the case.[19] Simply stated, if any part of a claim is covered, then the insurance company has a duty to defend the entire lawsuit even though the result may be that a portion of the lawsuit is not covered.[20] Once a duty to defend is recognized, speculation about an insurer's ultimate obligation to indemnify is premature until facts excluding coverage are revealed during the defense of the litigation.[21]

In many cases, a real estate licensee's E&O coverage is required to defend the licensee because the lawsuit usually contains at least one claim that is not excluded, such as breach of fiduciary duty or negligent nondisclosure. However, fraud and other intentional acts are typically excluded from coverage in the standard real estate licensee E&O coverage. At the end of the trial, if it is found that the licensee engaged in fraudulent behavior, there may be no duty on the part of the insurance company to pay the judgment. An insurance company must give notice to the insured of its reservation of its rights under the contract, but an insurance company may

[17] Motorist Mutual Ins. Co. v. Trainor, 294 N.E.2d 874 (Ohio 1973).
[18] *Id.*
[19] Erie Ins. Exchange v. Colony Development Corp., 2001 Ohio App. LEXIS 2589, *6 (10th D. 2006).
[20] *Id.*
[21] Natl. Eng. & Contracting Co. v. United States Fiduciary & Guar. Co., 2004 Ohio 2503 (10th D. 2004).

defend in good faith without waiving its right to assert at the later time its policy defenses such as its exclusions.[22]

This situation is not without its problems. First, there is the potential of a conflict of interest in the defense of the claim. Second, in some policies, the policy limits include both the cost of defense and the cost of the indemnification.[23] A $100,000 policy may provide for the defense, but there might not be anything left to pay the judgment. Third, some insurance policies provide for a defense, but require reimbursement of the defense costs if the judgment is for a cause other than a covered claim.[24] Although this provision is rarely, if ever, found in a real estate E&O policy, it is clear that it is necessary to thoroughly analyze E&O insurance in order to assess the actual protection provided by the E&O coverage in Ohio.

D. Conclusions

Fraud is the number one grounds for suits against real estate licensees in Ohio. Most of these fraud cases are associated with misrepresentation of the condition of the property which is the subject of a sale. Unfortunately, the most common E&O policy excludes fraud from coverage. Additionally, about 40 percent of the complaints request punitive damages, while punitive damages are also excluded from most E&O policies. There are significant holes in E&O coverage, which means that insurance is not the sole answer to the problem of real estate licensee liability. Rather, a comprehensive risk management plan should be in place to protect the agents and brokers of the state's real estate professionals.

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[22] *Motorist Mutual Insurance Co*., 294 N.E.2d at 874.

[23] Discussions with some E&O insurance agents about the existence of these policies reveal that they do exists although it is more common for the duty to defend to be separate from the policy limits.

[24] *See* Danis v. Great Amer. Ins. Co., 823 N.E.2d 59 (Ohio Ct. App. 2d D. 2004) (upholding a clause stating that "in the event it is finally established that the Insurer has no liability under the Policy for such Claim, the Company and Insured Persons will repay the Insurer upon demand all Costs of Defense advanced by virtue of this provision."). *See also,* Hybud Equip. Corp. v. Sphere Drake Ins. Co. 597 N.E.2d 1096 (Ohio 1992) (stating that the "rule of strict construction does not permit a court to change the obvious intent of a provision just to impose coverage.").

Chapter 5: Additional Risk Management Practices by Real Estate Firms

The risk management paradigm consists of four steps: (1) identifying risks, (2) analyzing and prioritizing risks, (3) developing a plan to deal with each risk, and (4) tracking the risks and taking any additional steps to control each risk.[1] Previous chapters identified the risks and analyzed and prioritized the risks to real estate firms. We also identified strategies of risk management that should be examined at the institutional level in Ohio. This chapter looks for strategies that can be implemented at the firm level.[2]

A. Risk Management Procedures

Two choices are available for brokerages as part of a risk management program: risk control or risk finance.[3] Four methods of risk control exist – exposure avoidance (not engaging in the activity), loss prevention (lowering the frequency of the risk), loss reduction (lowering the severity of the risk), and loss segregation (separating the effects of the risk by localizing the effects to smaller economic entities).[4] Risk financing consists of risk transfers (such as insurance) and risk retention.[5]

Proper risk management plans in a real estate firm should be outlined in a firm's policies and procedures manual. Brokerages with written comprehensive policies and procedures

[1] *See, e.g.*, EMMIIT VAUGHAN & THERESE VAUGHAN, FUNDAMENTALS OF RISK AND INSURANCE, 23-30 (9th ed., John Wiley & Sons, 2003).
[2] An outstanding reference for ideas at the firm level is "Real Estate Brokerage Essentials, Managing Legal and Business Issues" by the National Association of Realtors. Anyone trying to implement a risk management program at the firm level should not be without this exceptional treasure of ideas. *See generally* NAT'L ASS'N OF REALTORS, REAL ESTATE BROKERAGE ESSENTIALS: MANAGING LEGAL AND BUSINESS ISSUES (3d Ed. 2006) [*hereinafter* Essentials].
[3] The terminology here follows the traditional risk management textbook. Some would classify topics like disclosure and professional inspections as being loss control. However, to the extent these activities represent a transfer of the risk of loss to a third party, they are technically risk financing activities. In reality, they are probably both risk control and risk financing activities.
[4] Risk control deals with affecting the frequency or severity of exposures. Accordingly, some risk transfer (such as seller disclosure) may double as risk control because it may lower the frequency or severity of a risk.
[5] E&O coverage represents an attempt to transfer risk. Seller disclosure and professional inspections may be seen as attempts to transfer the risk.

manuals may receive discounts from their E&O carriers. A policies and procedures manual should include office policies, definition of the contractor relationship, agency policy, anti-trust issues, fair housing issues, seller property condition policies, federal privacy rules, relationships with other professionals, insurance, complaint handling procedures, and dispute resolution procedures.[6] However, a policies and procedures manual by itself will limit few risks. Rather, each licensee must play an essential part of the risk management process.[7] It is important to make sure that each licensee understands that failure to enforce policies or purposely engaging in practices that contradict the company guidelines compromises the company's legal position.[8]

The real estate agent should divide all potential risks involved in any sale into two types: risk that are common to all sales and risk that are unique to that particular sale. The risks that are common to all sales should be covered in the policies and procedures manual. Risks that are unique to this particular sale may require additional thought and creativity. The licensee must be properly trained in opening and maintaining a documentation file relating to contact with clients that involves both of these types of risks.

The heart of any modern day risk management program for a real estate brokerage is a system that documents the proper flow of information from the seller to the buyer.[9] The most important item in avoiding liability is proper disclosure in writing. Because fraud and misrepresentation are the most common sources of real estate licensee liability, brokerages need a system that documents the disclosure of relevant material facts to the parties of the sale. Properly documented property disclosures transfer much of the liability concerning the condition of the property to the seller. Licensees should be aware that their disclosure records may be

[6] Essentials, *supra* note 2. This reference contains an entire chapter on each of these issues.
[7] LAUREL D. MCADAMS, JOHN CYR & JOAN SOBECK, REAL ESTATE BROKERAGE: A MANAGEMENT GUIDE 325-348 (6th ed., Dearborn Real Estate Educ. 2004).
[8] *Id.*
[9] *See generally*, Essentials, *supra* note 2.

evidence in a future lawsuit. Therefore, documenting and preserving the evidence of the disclosure is almost as important as making the disclosure itself.

B. Implementing Risk Management Programs

In general, the correct risk management technique is an application of cost-benefit analysis. Most of the time, the frequency and the severity of a risk play an important role in the risk management technique selected. For low frequency and low severity risks, risk control is the most common technique.[10] For high severity and low frequency risks, risk transfer is usually the most common method.[11] High frequency, high severity risks are usually avoided, whereas high frequency and low severity risk are either reduced or retained.[12] In general, a risk will either be financed or controlled.

Risk control consists of affecting either the frequency or severity of the risk. The usefulness of risk control devises is demonstrated by the fact that most E&O underwriters and carriers give substantial discounts to firms that have strong risk control programs in place. E&O policy underwriters propose a number of useful risk control devices. For example, Continental Casualty provides a 10% rate credit available to firms which place special emphasis on continuing education and risk management activities and with incurred loss rations of 60% or less. In order to get the risk credit, two of the following three must occur: (1) the firm must use standard contract forms approved by a local board or state professional association; (2) the firm must have in place an in-house policy/procedures manual; or (3) a minimum of 75% of the firm's professionals must complete either an approved state-level format continuing education program

[10] Vaughan, *supra* note 1, at 23-30.
[11] *Id.* For example, most of the risks covered by an E&O policy are, in theory, high severity and low frequency risks.
[12] *Id.*

designed to reduce professional liability, an approved risk reduction seminar held at the NAR Annual Convention, or a RE/MAX risk management seminar.[13]

According to the filings in the Ohio Insurance commissioner's office, the underwriters at Continental Casualty rate an appropriate risk management system on the following criteria:

- Quality of management, financial condition, and years of experience;
- Quality, selection, and training of employees;
- Loss control, data control, internal loss prevention;
- Continuing professional education; and
- Use of standardized contracts. [14]

The weighting of these factors in the underwriting decision can be seen in Table 5.1. It is apparent from the fact that E&O providers incorporate risk management activities into their policies for premium discounts that such risk management activities decrease the frequency and severity of liability risks facing brokerages.

Chapter 3 outlined some of the types of risk that firms face. A policies and procedures manual should have detailed procedures for dealing with each type of risk. Since disclosure is one of the most important element in avoid liability, the procedure manual should have a checklist for the standard disclosures as well as procedures to document that those disclosures

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[13] CONTINENTAL CASUALTY CO., REAL ESTATE PROFESSIONALS E&O PRODUCT MANUAL, *Premium Modification, Risk Management Credit*, Filing No. 06-2120, REA-6, Ed. 04/06 (filed with Ohio Dep't of Ins., Prop. & Casualty Div., July 13, 2006) [*hereinafter* Continental]. Other underwriters suggest that appropriate risk management systems will have mechanisms to control conflicts of interest, provide adequate oversight of agents, properly train agents in initial handling of client including proper screening of clients, and proper file opening procedures. Additionally such a system will closely monitor licensees (including any internal communication), have a well developed office policies and procedures, and have procedures where agents and firm managers strive to be of the highest caliber. ST. PAUL TRAVELERS INS., CLAIMS-MADE, GUIDE RATES, Filing No. 2005-07-0014, 55789 OH Rev. 07-2005 (filed with Ohio Dep't of Ins., Prop. & Casualty Division, received August 1, 2005).

[14] Continental, *supra* note 13. Greenwich Insurance Co. lists four factors important in designing the risk management program:

- Business activities;
- Realtor characteristics;
- Conflict resolution procedures; and
- Business practices.

GREENWICH INS. CO., REAL ESTATE E&O: OHIO ADDITIONAL MODIFICATION FACTORS, Filing No. SERT-6E8PCJ130/00-00/00-00/00 (7/2005 ed., filed with Ohio Dep't of Ins., Prop. & Casualty Div. Dec. 12, 2005)

have been made. Using standardized checklists assures that the sales process is appropriately controlled and fully utilizes the opportunity for buyer inspections.

Table 5.1: Continental Casualty Company Risk Modification Adjustment

Modification	Debit	Credit
Quality of Management, Financial Condition, Years of Experience	0-15%	0-15%
Quality, Selection, and Training of Employees	0-15%	0-15%
Loss Control, Data Control, Internal Loss Prevention	0-15%	0-25%
Continuing Professional Education	0-15%	0-15%
Use of Standard Contracts	0%	0-25%
Use of Home Warranty or Home Protection Plan	0%	0-25%

Source: CONTINENTAL CASUALTY COMPANY, CAN Plaza, Chicago, IL, 60685, "Real Estate Professionals E&O Product Manual, XV, Premium Modification, Loss Experience Modification REA-5, Ed. 04/06,", Filing with Ohio Department of Insurance, Property & Casualty Division, received July 13, 2006, Filing Number: 06-2120 FR

C. Agency Disclosure

As explored in Chapter 2, under Ohio's current legal system, a variety of relationships can exist between licensees and their clients. Unfortunately, the nature of those relationships is not always clearly understood by a firm's clients. When a misunderstanding of a particular relationship causes confusion and it is not quickly addressed, bad feelings and potential legal liability can arise. Thus, it is crucial that all parties have realistic expectations and understandings of the role of a real estate licensee in the real estate transaction.

Historically, licensees have not always communicated the nature of their relationship in a manner that their clients understand. A 2005 survey by the NAR revealed that only 30 percent of

buyers remember receiving disclosures from their agents during the first meeting.[15] The timing of the receipt of the disclosure of agency status has been a problem for a long time. For example, a 1997 report approximated that 25 percent of buyers received the agent status disclosure form the day the offer was made and 12 percent received the form within five days after the offer was made.[16] Substantial effort has been made to resolve these issues since that time. For example, most firms now have a written company policy explaining brokerage relationship with consumers, which is usually summarized in the document they give to buyers and sellers, called "The Consumer's Guide to Agency Relationships"[17]. The written policy insures compliance with the state law governing brokerage relationships.

Ohio has attempted to improve this situation on numerous occasions. The state has long had various required disclosures of agency. A revised Agency Disclosure Statement was promulgated in 2005.[18] The Agency Disclosure Statement discloses who represents the buyer and the seller, and requires a signed consent by the buyer and seller to the disclosed relationship. In addition, the Agency Disclosure Statement contains an extensive disclosure concerning dual agency and the requirements associated with it under the Ohio law[19]. The agency disclosure statement must be signed and dated no later than the preparation of an offer to purchase or a proposal to lease[20]. In 2005, new rules were instituted regarding the timing and content of agency disclosure. Upon first contact with buyers or sellers, licensees now deliver a document entitled *The Consumers' Guide to Agency Relationships* which explains the brokerage's agency

[15] NAT'L ASS'N OF REALTORS, BUYER'S SURVEY (2005).
[16] GARY MOORE, AN ANALYSIS OF THE OHIO LEGISLATION REQUIRING SELLER DISCLOSURE OF PROPERTY CONDITION, Research Report No. 57 (Ctr. for Real Estate Educ. & Research, January 1997)
[17] *See* OHIO REV. CODE ANN. §§ 4735.56
[18] *See* OHIO REV. CODE ANN. §§ 4735.57, §§ 4735.58
[19] The agency disclosure statement is outlined in 4735.57 and 4735.58. The agency disclosure statement may be found at http://codes.ohio.gov/oac/1301%3A5-6-07. Specific content of the disclosure statements specifying the duties of a licensee as a dual agent can be found in 4735.57, section (B).
[20] *See* OHIO REV. CODE ANN. §§ 4735.58 (A)

policy.[21] It is required that the *Consumer Guide to Agency Relationships* be given to a seller by the listing agent before the property is shown or marketed.[22] Buyers should be given the guide before the earliest of the following events: pre-qualifying a buyer, requesting specific financial information from a buyer, showing a property to a buyer (other than at an open house), or working on or submitting an offer.[23]

Additionally, each brokerage creates its own brokerage policy in conformity with rules promulgated by the Division of Real Estate and Professional Licensing.[24] Among the items required under the rules are:

- A listing of the parties to the transaction;
- The location of the real estate involved in the transaction;
- The name of the licensee and the licensee's firm;
- An explanation of the types of agency relationships allowed under Ohio law;
- A disclosure of the legal status of the licensee, including possible dual agency;
- An explanation concerning the relationship of the licensees with other licensees in the same firm;
- A statement that a licensee is required to provide the policy; and
- A statement that "the signature of the client indicates the client's informed consent to the agency relationship and that if the client does not understand the agency disclosure statement, the client should consult an attorney."[25]

Since informed consent to the agency relationship is essential, the licensee should make a note in the transaction documentation file if the client will not acknowledge the receipt of the consumer's guide. The acknowledgement can be on a separate document, but cannot be included

[21] *See* OHIO REV. CODE ANN. §§ 4735.56, §§ 4735.57 and 4735.58 (2007).
[22] *Id*.
[23] *Id*.
[24] *Id*.
[25] *Id*.

in any other contract the buyer or seller signs, such as a listing agreement, a buyer agency agreement or a purchase contact.[26]

Ohio is among a number of states offering a variety of choices concerning the types of relationships between real estate licensees and consumers. Under Ohio law, licensees may be agents of the seller, the buyer, or dual agents acting on behalf of both the buyer and the seller.[27]

The dual agency relationship is a matter of some concern, and therefore a special requirement of disclosure has been adopted for this particular relationship. In order to establish a dual agency, licensees must specify in the agency disclosure form that they are acting as a dual agent.[28] Additionally, the disclosure must include

> (1) An explanation of the nature of a dual agency relationship, including a statement that in serving as a dual agent, licensees in the brokerage represent two clients whose interests are, or at times could be, different or adverse;
>
> (2) That as a result of the dual agency relationship, the dual agent may not be able to advocate on behalf of the client to the same extent the agent may have if the agent represented only one client;
>
> (3) A description of the duties the brokerage and its affiliated licensees and employees owe to each client, including the duty of confidentiality;
>
> (4) That neither the brokerage nor its affiliated licensees have any material relationship with either client other than incidental to the transaction, or if the brokerage or its affiliated licensees have a material relationship[29], a disclosure of the nature of the relationship…;
>
> (5) That as a dual agent, the brokerage cannot engage in conduct that is contrary to the interests or instructions of one party or act in a biased manner on behalf of one party;
>
> (6) A section specifying the source of compensation to the real estate broker;
>
> (7) That the client does not have to consent to the dual agency relationship, and the options available to the client for representation in the transaction if the client does not consent, including the right of the client to terminate the agency relationship and seek representation from another source;

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[26] *See id.*
[27] *Id*. at § 4735.53(A). Licensees may also be subagents to the client of another licensee. *Id.*
[28] *Id*. § 4735.57(B) (2007).
[29] For purposes of this division, "material relationship" means any actually known personal, familial, or business relationship between the brokerage or an affiliated licensee and a client that could impair the ability of the brokerage or affiliated licensee to exercise lawful and independent judgment relative to another client. *Id.* at § 4735.57(B)(4).

(8) That the consent to the dual agency relationship by the client has been given voluntarily, that the signature indicates informed consent, and that the duties of a licensee acting as a dual agent disclosed to the client…have been read and understood.[30]

It is important that all parties understand the role of the real estate licensees. Licensees must understand the roles and responsibilities of each type of relationship along with the duties owed by a licensee to the parties in the transaction.[31] In order to reach this level of understanding, it is important the firms have a schedule of continuing education concerning the proper role of the licensee in the various relationships.

D. Property Disclosure Forms

The residential property disclosure form has become an important device to decrease agent liability.[32] The property disclosure form is a statement of the condition of the property and of information concerning the property actually known by the owner.[33]The form puts the onus on the seller to disclose material defects within the owner's knowledge. To the extent that a full disclosure takes place, the risk of liability shifts from the agent to the seller.

In order for a firm to use the property disclosure form as a liability limitation tool, it is important for licensees to remember that the Ohio statute places the obligation for completing the property disclosure form on the seller. Seller disclosure laws do not require that the licensee

[30] *Id.* at § 4735.57.
[31] *See* Chapter 2, *supra*.
[32] As we presented in Chapter 3, fraud and misrepresentations are among the most common claims against real estate licensees. These claims are brought by surprised purchasers who discover after the closing, rather than before, the existence of significant defects in the physical condition of the property. One study indicates that most brokers thought that the seller disclosure form was effective in informing buyers of the condition of the property and providing some protection for liability. The study found that approximately 70 percent of the agents felt that the disclosure form provided protection for the sales agent. Additionally, the study documents a statistically significant decrease in the number of post-closing surprises before and after the introduction of mandatory property condition disclosure. *See* Moore, *supra* note 16.
[33] *See* OHIO REV. CODE ANN. § 5302.30 (2007).

assist the seller in completing the form. In most cases, the agent should refrain from becoming directly involved with the seller disclosures. [34] The agent needs to make sure that the disclosure form is solely the work of the seller. It is difficult not to try to be helpful, but potential liability is created when a licensee incorrectly advises a seller that a particular disclosure is unnecessary or recommends that a seller explains something in a certain manner. In general, licensees should leave sellers to fill out the disclosure alone. Additionally, licensees should refer any questions a seller may have concerning proper disclosure to the seller's attorney.[35]

Honesty is a very good liability control policy, but only if licensees are honest about the extent of their knowledge or lack of knowledge. If licensees do not know something for sure, they should not guess or volunteer opinions. For example, if a buyer asks whether a structure is sound a licensee should tell the buyer that he is not an engineer and that such questions are best answered by experts.[36] Licensees should not discuss matters about which they have no actual knowledge. Doing so exposes a licensee to potential liability.

On the other hand, licensees need to be concerned about whether false information is being conveyed to the buyer. Licensees who believe a seller is misrepresenting or concealing the true condition of a property should discuss their concerns with the seller and recommend that the seller consult with an attorney. Additionally, licensees should record the date of any such recommendation in a file. In some cases, if the licensee believes that the seller is engaging in concealment or misrepresentation, it may be best for a licensee to decline the listing.

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[34] *See* Newton Marshall, *The Right Road*, REALTORS MAGAZINE ONLINE, Aug. 1, 2007, http://www.realtor.org/rmomag.NSF/pages/forbrokersmainaug07?OpenDocument (last visited Dec. 20, 2007).

[35] *Id*. (suggesting that licensees explain to their clients that deciding what to disclose is a legal matter and that they do not practice law). The actual scope of the disclosure obligation is a little unclear. For example, the disclosure statute does not include any time limit on how far back sellers should go in their disclosures. *See* OHIO REV. CODE ANN. § 5302.30 (2007). However, the disclosure form approved by the Ohio Department of Commerce does, in many places (such as any structural alterations or repairs), mention a five-year limit on the required disclosures. OHIO ADMIN. CODE 1301:1-4-10 (2007).

[36] *See* Marshall, *supra* note 30.

In general, it is useful to disclose the need for a seller's property condition disclosure. The statute provides that "every person who intends to transfer any residential real property … shall deliver … a signed and dated copy of the completed form to each prospective transferee or prospective transferee's agent as soon as is practicable."[37] Although such a duty is not explicitly imposed upon licensees by the statute, a licensee's fiduciary duties to a seller may create a duty to tell the seller about the seller's obligations to provide the buyer with a disclosure form. Licensees representing sellers should inform their clients about the law and provide them with a disclosure form to complete.[38] Licensees representing buyers have a similar duty to tell their clients about their right to receive a property disclosure form from the seller. Although the disclosure law does not require this, such a duty is probably imposed upon licensees because of their fiduciary relationships with their clients.[39]

E. Disclosure of Latent Defects

Although licensees are not required to and should not fill out the disclosure form, they must remember that they still have a duty to disclose any latent defects of which they have knowledge.[40] In general, a real estate agent has an obligation to disclose any latent defect to a buyer. An agent must also disclose any other non-confidential fact of which they have knowledge that could be material to the buyer's decision to purchase the property. Consequently, the warning in this chapter that an agent not help the seller fill out the property disclosure form should not be seen as advocating that any material fact be withheld from the buyer.

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[37] *See* OHIO REV. CODE ANN. § 5302.30(C) (2007).
[38] *See* Marshall, *supra* note 30.
[39] *See* Parahoo v. Mancini, 1998 Ohio App. LEXIS 1630, *34 (Ohio Ct. App. 1998) (holding that a fiduciary relationship between buyer's agent and his client created a duty to disclose all known facts material to the transaction). *See also*, Ohio Ass'n of Realtors, *Disclosure: Seller Disclosure Law*, http://www.ohiorealtors.org/absolutenm/templates/article.aspx?articleid=139&zoneid=22 (last visited Dec. 20, 2007) [*hereinafter* Seller Disclosure].
[40] *See* Chapter 2, *supra*.

In general, licensees should not hesitate to disclose material facts that are not confidential to their clients. For example if a licensee is aware of the presence of asbestos in a home, the licensee should disclose its presence to the buyer.[41] Similarly, negative inspection reports are material facts that should be disclosed to subsequent purchasers. This is true even if later reports contradict those findings or the seller challenges their validity and accuracy.[42]

Licensees should also disclose the presence of environmental hazards. For example, licensees who are aware of high radon gas levels in a building and fail to disclose the condition to buyers risk potential liability to buyers for nondisclosure. Lead paint is also an environmental hazard that deserves special attention. The Federal government requires sellers and their agents to give lead-based paint disclosure forms to renters and buyers of any house built before 1978.[43]

There are some gray areas when it comes to disclosure of material defects. One issue is whether licensees are required to disclose a non-recurring mold problem. Some jurisdictions find that licensees are not obligated to disclose non-recurring mold.[44] However, this is not the rule in all jurisdictions. Accordingly, it is a good idea for licensees to check the rule in their jurisdiction.

Another issue is whether licensees have a duty to disclose stigmatized properties.[45] Stigmatized properties are those where there is no physical defect, but the property has a reputation as a location of misfortune. For example, a murder or suicide occurring in an upscale neighborhood would probably not affect the physical condition of the property; however, some

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[41] Seller Disclosure, *supra* note 39.
[42] *Id*.
[43] 42 U.S.C. § 4852d (2007).
[44] Seth G. Weissman, *A Question of Mold: The Distinction between Recurring and Non-Recurring Mold*, 6 RISK MGMT. REPORTER No. 1 (2003), *available at* www.schinnerer.com/risk_mgmt/real_estate/risk_report/pdfs/riskrpt7.pdf.
See also Dr. Nathan Yost, *Building Sciences Corporation*, REALTOR MAGAZINE ONLINE, Nov. 1, 2002, http://www.realtor.org/rmomag.nsf/pages/moldfaqsnov02; Dr. Jose Herrera, *Moldy Home?*, MICROFUNGI RESEARCH, TRUMAN ST. U., http://microfungi.truman.edu/mold_home.php (last visited Dec. 20, 2007).
[45]Ohio Ass'n of Realtors, *Stigmatized Properties*, http://www.ohiorealtors.org/absolutenm/templates/article.aspx?articleid=140&zoneid=22 (last visited Dec. 20, 2007).

buyers may consider the occurrence of a murder or suicide a material fact. This places a licensee in the position where, on one hand, non-disclosure potentially could lead to litigation, and on the other hand, disclosure could be a breach of the duty of loyalty a licensee owes to his client. The licensee should discuss this issue with the seller and obtain the seller's consent before making a disclosure.[46]

The best overall advice with regard to disclosures is to have a standard checklist of disclosures a licensee makes to the seller and the buyer. Additionally, licensees should disclose all material conditions to the parties. A condition is material if it affects the sales price that the buyer would be willing to pay. If a licensee is not clear whether a condition is material, the licensee should discuss any disclosure of the condition with the licensee's client. Finally, licensees should document any disclosures they make.

F. Inspections

An inspector is a trained professional who attempts to report any major damage that may create a great deal of expense. Consequently, licensees should always encourage the use of good home inspectors. From a risk management standpoint, inspections represent the opportunity for a licensee to shift liability risk to someone else.[47] Transferring the risk to someone who is better able to bear it is a crucial theme of risk management. In most cases, inspections are conducted by people who have substantial knowledge concerning specific areas. Licensees should explain the need for inspections to their clients and document that they explained the types of inspections that are usually done in a real estate transaction.[48] Licensees may want to create checklists of the

[46] *Id.*
[47] Alan J. Heavens, *Home-Sales Professional Trying to Avoid Greater Legal Risk*, PHILA. INQUIRER, Apr. 2, 2004.
[48] Marshall, *supra* note30.

type of inspections available to buyers and ask buyers to explain why they chose not to have certain types of inspections performed. A licensee should document any information obtained.

Licensees should not order, pay for, or interpret any inspection or pest reports.[49] Rather, they should arrange for the report to go directly to the clients. If the inspection reports are sent to a licensee, the licensee should not discuss the conclusions with the licensee's client. Instead, the licensee should give a copy of the report to the client and ask that the client discuss any questions regarding the report with the inspector.

G. Avoiding Conflicts of Interest

Chapter 3 illustrated one common theme regarding severity of risk: in most of the cases resulting in large judgments, the licensees had conflicts of interest in the real estate transactions. The best advice is to avoid any conflict of interest. However, because completely eliminating conflicts of interest is economically costly, licensees need to at least fully disclose any potential conflicts of interest to all involved parties involved in the real estate transaction.[50]

The policies and procedure manual for the real estate firm should specifically contain the firms policy's with regard to conflicts of interest. These should also be disclosed and discussed by top management. In many cases, disclosures may need to be incorporated into the agency disclosure pamphlet. As noted, the content of the company's conflict of interest policies will

[49] Heavens, *supra* note 43.

[50] One of the most frequent conflicts of interest is dual agency. Several commentators have suggested that outright elimination of dual agency in real estate transactions would be a very good idea. *See, e.g.*, Douglas C. Kaplan, *The Phoenix*, 69 FLA. BAR J. 77, 79 (1995) (stating that dual agency "is a moral impossibility."); J. Clark Pendergrass, *The Real Estate Consumer's Agency and Disclosure Act: The Case Against Dual Agency*, 48 ALA. L. REV. 277, 299 (1996) (noting that the benefits of dual agency are substantially outweighed by the negative aspects).

often affect the underwriting of the E&O policy, and in many cases the situation creating the conflict of interest will not be covered by the agent's real estate E&O coverage.

H. Conflict Resolution

Customer satisfaction is the firm's greatest defense against potential suits because a satisfied customer will rarely litigate against a firm.[51] Consequently, an important step in any firm's risk control procedure is to create a procedure for complaint handling and complaint resolution. A firm should establish an internal complaint policy that provides for prompt responses to and investigations of any complaints.[52] Complaints should be time stamped when received and a formal complaint document should be created.[53] A written acknowledgement of the complaint should be given to the person filing the complaint.[54] At this point the firm should resolve the complaint in a prompt manner. This means that a firm should immediately start an investigation to ascertain the true facts surrounding the issue. The firm should keep the complainant informed about any progress on the issue.

It is important that complainants walk away from the complaint process feeling that they were treated fairly. Accordingly, responsibility for the complaint system should be clearly assigned to a person with the proper temperament. That person should be able to give special attention, courtesy, and empathy to the complainant.

Outside assistance can often be useful is resolving conflicts. In some cases, it may be useful to ask a mediator to become involved in the process. Depending upon the circumstance

[51] *See* Gary Moore, *Are You Really Satisfying Your Customer?*, 13 REAL ESTATE BUS. 58, 58-62 (1994).
[52] *See* Essentials, *supra* note 2.
[53] *Id*.
[54] *Id*.

mediation can be either formal or informal. In some cases, the mediation can be structured as an alternative to litigation.

Ultimately, good conflict resolution systems more than pay for themselves. E&O carriers use the quality of the conflict resolution system as criteria in underwriting a policy. Additionally, satisfied customers bring in repeat business.

I. Proper E&O Policy

As noted in previous chapters, there are four different types of E&O policies available in Ohio. To properly transfer the risk, it is essential that someone in the firm understand the type of insurance policy that the firm purchased. In most cases, a firm should discuss an insurance policy with its attorney before purchasing it.

An insurance policy is composed of four parts: (1) the declaration, (2) the insuring agreement, (3) conditions and (4) exclusions.[55] The declaration states the name and address of the insured and information regarding the duration of the premiums. The insuring agreement outlines the duties of the insurer.[56] The conditions section specifies the duties and rights of the insured parties.[57] The exclusions section states what the insurance company does not cover.[58] It is important to review all four parts of a policy and compare the policy with other possible policies.[59] In reviewing a policy, the exclusions section is probably the most important consideration because some policies have different exceptions to what they do not cover. Additionally, it is important to note whether a policy combines the duty to defend and the duty to indemnify into a single coverage limit.

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[55] *See* Vaughan, *supra* note 1, at 172.
[56] *Id.*
[57] *Id.*
[58] *Id.*
[59] For an excellent treatment of the issue see Essentials, *supra* note 2, at 327-48.

J. Loss Segregation – Form of Ownership – Series LLC

One part of risk control is loss segregation. Loss segregation attempts to isolate the effects of a risk to a smaller economic entity. Most commonly, this is done through limited liability business forms. Various forms of organization are available to the owner of a real estate firm to limit liability. These forms include the C Corporation, the S corporation, the LLC, and the Series LLC. In addition, some protection is usually available through such entities as a master limited partnership. Each of these legal entities has particular advantages and disadvantages. Table 5.2[60] outlines the characteristics of limited liability entities.

Each of these entities allows for the separation of high-risk business assets away from other assets. For example, an entity that owns a chemical plant (a high-risk liability) should create a separate entity for its rental home business (a low-risk liability). Likewise, an entity should not keep its investment assets in the same entity as a business subject to tort liability. If a company wants to do this through traditional entities such as a corporation or LLC, it is forced to form multiple entities. However, one new idea limits the administrative costs associated with separate entities by using a Series LLC.[61]

[60] *See* Chris Riser, *When One Is Better Than Many: The Series LLC*, in THE ASSET PROTECTION BOOK, http://www.assetprotectionbook.com/Dev_Apr2005.htm#series (last visited Dec. 20, 2007); *Legal Entity Comparison*, FORM-A-CORP, http://www.form-a-corp.com/entity_comparison.php (last visited Dec. 20, 2007); *Entity Comparison Chart*, LAUGHLIN ASSOCIATES, http://www.laughlinusa.com/LLC_chart.asp (last visited Dec. 20, 2007).

[61] These are often called Delaware LLCs, because Delaware was the first state to promulgate them. So far, nine states have enacted legislation concerning this form of entity. *See* DEL. CODE. ANN. tit. 6 § 18-215 (2006); IOWA CODE § 490A.305 (2006); 805 ILL. COMP. STAT. 180/37-40 (2005); NEV. REV. STAT. § 86.1255 (2007); OKLA. STAT. tit. 18, § 2054.4 (2006); OR. REV. STAT. § 60.001 (2005); TENN. CODE ANN. § 48-249-309 (2007); UTAH CODE ANN. § 48-2c-606 (2007); WIS. STAT. § 183.0504 (2007).

Table 5.2: Characteristics of Limited Liability Entities

		C CORPORATION	S CORPORATION	LLC	Series LLC
1	**Limited Liability**	Yes	Yes	Yes	Yes
2	**Eligible Owners**	Stockholders	75 Shareholders limit	Members	Members
3	**External Formalities such as Filing Annual Reports?**	Yes	Yes	Operating Agreement Required	Operating Agreement Required
4	**Pass through Tax Entity?**	No	Yes	Yes	Yes
5	**Restrictions on the number of Owners?**	No	Yes	No	No
6	**Expected existence**	Indefinite	Indefinite	Duration is listed in Operation Agreement	Duration is listed in Operation Agreement
7	**Transfer Ownership?**	Yes	Yes	Restricted under State Law	Restricted under State Law
8	**Citizenship Required?**	No	Yes	No	No
9	**Nationally Recognized?**	Yes	Yes	Yes	Maybe some IRC Problems
10	**Ability to Segregate Assets for Liability Purposes**	Must use multiple Corporations	Must use multiple Corporations	Must use multiple LLC's	Can do in one Entity

The series LLC allows each business activity of the firm to be divided into its own accounting and management entity. For example, in a real estate firm it may be possible to segregate the real estate development and the commercial and residential sales into two series. Even finer divisions are possible giving the firm unlimited asset segregation potential.

Within their enabling statutes, Series LLCs have special provisions that provide for one entity to act like many entities, allowing each business activity to be a separate series that owns separate assets. The Series LLC is theoretically the same thing as a number of separately filed

LLCs in one entity. The protection is often called "ring fencing."[62] The series LLC is a very powerful and cost effective asset protection tool. The greatest advantage is that the Series LLC reduces costs associated with separate entity formation and maintenance.[63]

According to the relevant Delaware statute,

> "[t]he debts, liabilities, obligations and expenses incurred, contracted for or otherwise existing with respect to a particular series shall be enforceable *against the assets of such series only, and not against the assets of the company generally or any other series thereof*…"[64]

Because the Series LLC is a relatively new entity, its benefits are still largely theoretical. In *GxG Management, LLC v. Young Brothers & Co.*, the court questioned whether a series can initiate suit on its own behalf.[65] The court noted that "[t]he Delaware statute does not indicate what capacity an LLC has to pursue litigation on behalf of its series…. [n]or does the statute indicated what capacity a series of an LLC has, if any to pursue litigation on its own behalf or even whether it should be regarded as an entity distinct from the LLC from which it is carved." [66]

Ohio has not officially adopted legislation or allowed the Series LLC. Moreover, very little case law exists concerning Series LLCs.[67] Consequently, it is an approach that has not yet been tested and proven in the courts. In any event, should Ohio adopt this new liability control device, this entity type should be established under the guidance of a

[62] *See Report of Finance and Transactions Committee*, 23 Energy L.J. 541, 562-63 (2002) (noting that this process protects assets of a parent company by creating separation between a parent company and its subsidiary).
[63] *See* Carol R. Goforth, *The Series LLC, and a Series of Difficult Questions*, 60 ARK. L. REV. 385, 392 (2007).
[64] DEL. CODE ANN. tit. 6, § 18-215(b) (2006) (emphasis added).
[65] GxG Management, LLC v. Young Bros. & Co., 2007 U.S. Dist Lexis 12337, *18 (D. Me. 2007).
[66] GxG Management LLC v. Young Brothers and Co., Inc., 2007 U.S. Dist Lexis 12337 (2007),
[67] A search of the lexis/nexus database turned up only two cases nationally.

legal professional familiar with its requirements.[68] In the not too distant future this device may have considerable potential.

K. Conclusion

This chapter examined the response of the firm to liability threats to the organization. Risk management can transfer, limit or control the liability risk, but cannot entirely eliminate the liability risk that the company faces. Consequently, strategies to retain the risk but limit their effects through loss reduction or loss segregation are essential. A vigilant risk management program infuses the firm with a perspective oriented toward preventing problems. A real estate firm should manage liability risk not just in the ways that attempt to avoid situations that create potential liabilities but also in the ways it prepares to defend itself.[69] This entails proper documentation of disclosure of agency relationships, understanding of seller disclosure forms, disclosure of latent defects and material conditions, and potential types of inspections. The client should be encouraged to seek the help of other professionals such as inspectors, engineers, and legal representatives. Each of these professionals has skills outside the scope of licensee training and should be relied on because of their extensive training. Hiring these professionals will transfer some of the risk to others. Further, it will result in loss reduction from future problems because experts can identify and treat problem areas. Alternatively, if the problems cannot be treated, a buyer may incorporate knowledge of the problem into the negotiations, resulting in a lower price or alternative terms. In the event there are unpleasant surprises, the firms should have in place a plan to deal with the dissatisfaction quickly and effectively. This means that, as

[68] *See* Advantages of an LLC, http://www.llc.com/LLC_Benefits.html (last visited Dec. 20, 2007).
[69] *See* McAdams, *supra* note 7.

an integral part of a firm's commitment to outstanding service, every firm should have a system for complaint and conflict resolution.

Chapter 6: Limiting Liability through Private Contracting

This chapter explores the possibility of limiting agent liability through private contracting. The effectiveness of clauses that limit contractual liability varies, but in general they are among the most effective devices to limit litigation.

A. "As Is" Clause or Exculpatory Clause

Under Ohio law, the doctrine of caveat emptor is further extended to limit liability of a seller and a seller's agent through the use of an "as is" clause.[1] An "as is" clause is an exculpatory clause that protects the seller from any defects, whether open and obvious or latent, that may arise after the sale of the property.[2] In Ohio, the protection of an "as is" clause also extends to a seller's agent.[3] Accordingly, the potential protection afforded by an "as is" clause is obvious: as long as an agent of a seller does not make an affirmative fraudulent misrepresentation, a buyer cannot maintain an action against the licensee.

Even though the "as is" clause precludes recovery by a buyer for any defects in the property, the "as is" clause in a contract does not completely protect the licensee. The inclusion of an "as is" clause does not prevent a disappointed buyer from bringing a lawsuit against a licensee; it only prevents recovery on the lawsuit.[4] Buyers may not read the clause in the contract, and Buyers who do read the clause may not understand the implications of an "as is"

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[1] *See* Chapter 2, *supra*.

[2] *See As Is Clause in Sales Contracts*, 10-3A REAL ESTATE BROKERAGE LAW & PRACTICE § 3A.12 (2007). Law reviews have noted the broad enforcement of "As Is" clauses in Ohio. For example, in the article "Disclosure Duties in Real Estate Sales and Attempts to Reallocate the Risk", 34 Conn. L. Rev. 1, by Professor Florrie Young Roberts, it is stated that "Broad enforcement of "as is" clauses is provided by appellate courts in Ohio. For example, in Brewer v. Brothers, the buyers claimed that the sellers had failed to disclose faulty wiring. The contract contained an "as is" clause. The court noted the duty on Ohio of a seller to disclose latent defects, but said that an "as is" clause in the contract negates this duty and "places the risk upon the purchaser as to the existence of defects". It relieves the seller of any duty to disclose". Later in his article he notes that "in most jurisdictions, courts do not enforce "as is" provisions in real estate contracts to protect sellers, even when nondisclosure, as opposed to fraud, is being alleged". It would not be surprising for the Ohio courts to move toward the more mainstream view.

[3] *See* Duman v. Campbell, 2002 Ohio 2253 (8th Dist. 2002).

[4] *Cf. id*; Eiland v. Coldwell Banker Hunter Realty, 702 N.E.2d 116 (Ohio App. Ct. 1997).

clause or see the "as is" clause as a warning to have the property inspected.[5] In such situations, the buyer may institute an action against the licensee, notwithstanding the fact that the action will not succeed. Any legal action brought against a licensee will result in legal costs associated with responding to the complaint and defending against the action.

A downside to the use of an "as is" clause is that it leads to a decrease in the selling price of property. An "as is" clause does not preclude a buyer from having the property inspected prior to the execution of the contract.[6] Rather, an "as is" clause places the duty on the buyer to inquire into conditions about the property or seek advice from someone with sufficient knowledge. If asked, a licensee has a duty to disclose any known material defect regarding the property.[7] Since an "as is" agreement is an agreement to purchase the property despite any defects, it is likely that in situations when a buyer discovers a defect before signing the contract, the buyer will negotiate the selling price to adequately compensate for whatever expenses may arise because of the defect. Even in situations in which a buyer does not get an inspection or inquire about possible defects in the property, the use of an "as is" clause acts as a warning to the buyer that there may be something wrong with the property – regardless of whether or not there actually is a defect. The presence of an "as is" clause likely will lead to negotiations over the price of the property. From a seller's perspective, this may be a better bargain than fixing a defect or risking liability for a future defect. However, from a licensee's perspective, this may simply lower the amount of commission that will be made from the sale of the property.

In order to effectively limit liabilities, the contract should present the "as is" clause as conspicuously and unambiguously as necessary to alert the buyer to it.[8] The clause itself should

[5] As Is Clause, *supra* note 2.
[6] *See* Eiland, 702 N.E.2d at 123.
[7] *Id.*
[8] *See* Steve Lesser, *The Great Escape: How to Draft Exculpatory Clauses that Limit or Extinguish Liability*, 75 FLOR. BAR J. 10, 12 (2001).

stand out from the rest of the contract so that the buyer's attention is directed toward it when the buyer reads the contract.[9] Additionally, the language of the clause should be specific. For example, if a party is seeking to be released from its negligence, the clause should specifically use the word "negligence."[10] Finally, a licensee should alert the buyer to the clause and inform the buyer that if the buyer has any questions regarding the clause the buyer should contact an attorney. Good real estate sales contracts will require that the buyer separately sign the "as is" clause. If buyers are fully aware of the "as is" clause, they are less likely to be dissatisfied if they later encounter defects in the property. Also, if buyers have knowledge that the "as is" clause precludes recovery for non-disclosure of a defect, they are less likely to file a lawsuit in the case that a defect arises after closing. Accordingly, legal costs associated with defending a law suit would be avoided.

B. Non-Reliance Clause

Many standard real estate contracts in Ohio include a non-reliance clause. A non-reliance clause limits liability to the seller and possibly the seller's agent by stating that the buyer will not rely on any statements except those contained within the contract. For example:

> Buyer is relying solely upon Buyer's examination of the Real Estate and investigation of offsite conditions, the Seller's certification herein, and inspections herein requested by the Buyer or otherwise required, if any, for its physical condition and overall character, and not upon any representation by the REALTORS(R) involved.[11]

The benefit of a non-reliance clause is that it generally precludes recovery on claims of fraudulent and negligent misrepresentation. As discussed in Chapter 2, in order to prove fraudulent misrepresentation a buyer must show the buyer relied on a statement

[9] *Id.*
[10] *Id.*
[11] *Ohio Residential Real Estate Form*, 1.2 ANDERSON'S OHIO REAL ESTATE PRACTICE MANUAL 2.1 (Matthew Bender & Co., 2007).

made by the seller or the agent.[12] If a buyer has signed a buyer-seller real estate sales contract that contains a non-reliance clause, the buyer may not claim that the buyer justifiably relied on statements not contained in the writing. This limitation applies to statements made by anyone, including agents.[13]

As with "as is" clauses, the non-reliance clause should be conspicuous and unambiguous. A good real estate sales contract will require that the buyer separately sign the non-reliance clause.

Non-reliance clauses are often used in conjunction with "as is" clauses. Accordingly, many of the issues that may arise with an "as is" clause are often present with a non-reliance clause. Disappointed buyers are not prevented from instigating a lawsuit because of a non-reliance clause; they are just not likely to recover on such a lawsuit. Because of this, it is important that licensees explain the presence and, to some extent, the legal significance of such a clause.

C. Contractual Clauses Limited by Privity

As discussed above, the "as-is" and non-reliance clauses may protect the broker from a disappointed buyer even when the broker is not a party to the real estate sales contract. There are other clauses in a real estate sales contract that may protect the parties to the contract, but may not protect a non-party. In a real estate sales contract, the buyer and seller are parties to the contract and are in privity of contract with each other. A real estate broker is not a party to the contract and is not in privity of contract with the buyer and seller. The issue of privity is important in contemplating the possible use of limitation or exculpation clauses because courts in

[12] Moreland v. Ksaizek, 2004 Ohio 2974, *39 (8th Dist. 2004).
[13] Note, however, that not all states have held a non-reliance clause to preclude recovery. *See* Slack v. James, 614 S.E.2d 636, 638 (S.C. 2005) (holding that a clause bearing similar language to a non-reliance clause was actually just an extension of a merger clause and therefore did not protect the seller from liability for fraud).

general and Ohio courts in particular, have distinguished situations in which the parties are in privity with each other and situations in which they are not.

For example, in *Kenney v. Henry Fischer Builder,*[14] a property was purchased by the buyer. The buyer applied for a mortgage loan and the lender required that the buyer pay for the services of a title company. The title company performed the services for the lender and the buyer sued the title company. The trial court granted a dismissal because it found no cause of action could lie between the buyer and the title company because there was no privity of contract between buyer and the title company. The appellate court affirmed the trial court decision even though the court recognized it was foreseeable that the buyer might have relied on the title company.[15]

The Ohio Supreme Court has emphasized the importance of privity in its discussion of the Economic Loss Rule.[16] The Economic Loss Rule provides that in the absence of privity of contract between two disputing parties the general rule is there is no duty to exercise reasonable care to avoid intangible economic loss or losses to others that do not arise from tangible physical harm to persons and tangible things. Consequently, in the case of *Floor Craft Floor Covering v. Parma Community General Hospital,* the Ohio Supreme Court held that the architect and hospital could not be liable for a $5,000 floor defect incurred as a result of the work of the

[14] 716 N.E.2d 1189 (Ohio 1998).

[15] The court found that the Ohio Supreme Court had previously established a requirement of privity. In the absence of privity, the courts had long held that a home buyer has no claim against a title abstracter for negligence in the performance of the title services performed for the mortgage lender, even though the buyer is required to pay for the services. Thomas v. Guarantee Title & Trust 91 N.E. 183 (Ohio 1910). The court invited the Supreme Court to abandon the rule of privity of contract in this area and to adopt, instead, Restatement of Torts, 2d § 552, which provides in pertinent part: 1) one who supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information. 2) The liability stated in Subsection (1) is limited to loss suffered; a) by persons or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and b) through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction. RESTATEMENT (SECOND) OF TORTS, § 552 (1977).

[16] Floor Craft Floor Covering, Inc., v. Parma Community General Hospital Association, 560 N.E.2d 206 (Ohio 1990).

contractor because there was no privity of contract between the contractor and the architect.[17] The court said that "in absence of privity of contract between two disputing parties the general rule is 'there is no duty to exercise reasonable care to avoid intangible economic loss or losses to others that do not arise from tangible physical harm to persons and tangible things'.[18] The Court pointed out that "recovery for economic loss is strictly a subject for contract negotiation and assignment. Consequently, in the absence of privity of contract no cause of action exists in tort to recover economic damages against design professionals involved in drafting plans and specifications".[19]

Many real estate licensees have would like to limit the scope of their liability by inserting clauses in the buyer-seller real estate sales contract. However, many provisions that limit liability must be specifically bargain for and consequently the real estate licensee would have to be in privity with the buyer. The problem with this, of course, is the licensee will lose the protection of the Economic Loss Rule.

D. Contractual Limitations of Action

In the real estate transaction, other professions have contractual limitations on the amount of damages that can be awarded for liability. For example, home inspectors often limit their liability to the cost of the report.[20] Unlike the real estate licensee, however, home inspectors are in privity of contract with the buyer.[21]

Privity of contract occurs when two parties have a contractual relationship with each other. Privity of contract has been defined as a "connection or relationship which exists between two or more contracting parties. It is essential to the maintenance of an action on any contract

[17] *Id.* at 212.
[18] *Id.* (citing PROSSER & KEETON, LAW OF TORTS § 92 (5th ed., 1984).
[19] *Id.*
[20] *See* O'Donoghue v. Smythe, Cramer Co., 2002 Ohio 3447, *5 (App. Ct. 2002).
[21] *See O'Donoghue*, 2002 Ohio 3447 at *2.

that there should subsist a privity between the plaintiff and defendant in respect of the matter sued."[22] In the standard real estate transaction, a real estate licensee will have privity of contract with the licensee's client because the licensee and the client will have entered into a brokerage contract and the liability limitation will be effective if the client sues the broker.

The buyer will have privity of contract with the seller when they enter into a real estate sales contract. However, a real estate agent representing the seller typically will not have privity of contract with the buyer. As previously discussed, in order to enforce a clause in a contract, a licensee must be in privity with the contract.[23] Accordingly, a clause limiting liability to a certain amount in a contract will likely have little benefit to a real estate licensee without the licensee becoming a party to the contract. If the licensee wants to become a party to the real estate sales contract, then the licensee will give up the protection afforded to a non-party licensee by the privity doctrine. Most likely, the licensee will not be willing to become a party to the buyer-seller contract in exchange for the protection afforded by privity and the Economic Loss Rule.

Another contractual limitation present in other professional contracts, such as home inspection contracts, is a limitation on the time in which a claim may be filed. For example, a home inspection clause may state that "any claims must be presented to the home inspector within one year of the date of inspection."[24] Ohio courts have enforced clauses limiting the time in which a claim may be filed in both home inspection and insurance contracts, as long as the time limitation is reasonable.[25]

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[22] ARTHUR CORBIN, 9-41 CORBIN ON CONTRACTS § 41.2 (2007).
[23] *See id.*
[24] *See O'Donoghue*, 2002 Ohio 3477, at *2.
[25] *See id. See also,* Colvin v. Globe American Casualty Co., 432 N.E.2d 167 (Ohio 1982).

Again, privity of contract is generally necessary in order for the clause to be enforceable by the agent. Also, not all states have looked favorably upon such limitations. For example, Florida has a statute invalidating contract provisions that attempt to shorten the statutory time limit.[26] Given that Ohio courts have upheld contractual limitations on time in insurance and home inspection contracts, however, it is possible that the courts would uphold a clause in a real estate contract limiting the time frame in which an action may be brought to a reasonable time. Nevertheless, this clause probably would not limit the time in which a disappointed buyer would be able to sue a broker who is not in privity with the contract.

E. Mediation and Arbitration Clause

One contractual agreement that can limit the cost of defense for a real estate licensee or broker is a clause in a brokerage contract requiring that any disagreements be resolved through alternative dispute resolution (ADR). A major part of modern dispute resolution, ADR employs many diverse mechanisms, two of which, mediation and arbitration, will be addressed.[27]

"Mediation is a structured process in which the mediator assists the disputants to reach a negotiated settlement of their differences."[28] Generally, the mediator is licensed or has received training in mediation. In Ohio, mediators need not be licensed mediators or licensed attorneys -- individuals who have backgrounds in counseling such as psychology and social work make very good mediators.[29] Like other kinds of ADR, parties may select the person who mediates the dispute. Often, if the parties cannot reach an agreement as to the selection of a mediator, their attorneys may make the selection. The court will select the mediator in court-ordered mediation.

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[26] FLA. STAT. § 95.03 (2007).
[27] For a general review of these issues see Anne Bradford,*"Arbitration Clauses in Consumer Contracts of Adhesions*, 21 J. CORP. L. 333 (1996)
[28] KATHERINE STONE, PRIVATE JUSTICE: THE LAW OF ALTERNATIVE DISPUTE RESOLUTION, 7 (Foundation Press 2000).
[29] See 5A OHIO JUR. 3d *Alt. Dispute Res.* § 129-132 (2006). In Ohio, the Rules of Superintendence for Courts of Common Pleas outline the qualifications for individuals who mediate child custody and visitation issues in domestic relations and juvenile courts.

Before mediation, the parties submit all relevant evidence to the neutral mediator. At the mediation session, the parties may, but need not, be represented by an attorney. During mediation, the parties discuss their individual complaints, grievances, and desired outcomes. In Ohio, in order to encourage the use of mediation and to encourage full disclosure by the parties, all communications during the mediation process are confidential and generally cannot be introduced in a civil proceeding.[30]

The mediator, using specialized skills and techniques, assists the parties to settlement, which culminates in a settlement agreement signed by all parties. Mediators strive to assist the parties to reach a settlement on their own, but ordinarily are not authorized to issue a binding decision.[31]

The mediation process is simple and inexpensive, and allows a settlement in which there need not be a winning and losing party. Because parties can decide on partial division of the disputed amount, mediation is much more flexible than a court decision in which the winner takes all. A sample mediation clause may read as follows:

> Any dispute or claim arising out of or relating to this contract, the breach of this contract, or the services provided in relation to this contract shall be submitted to mediation in accordance with the Rules of Procedures of the _____ Dispute Resolution System. Disputes shall include representations made by the Buyer(s), Seller(s), or any real estate broker or other person or entity in connection with the sale, purchase, financing condition, or other aspect of the property to which this contract pertains, including without limitation allegations of concealment, misrepresentation, negligence, and/or fraud. Any agreement signed by the parties pursuant to the mediation conference shall be binding.[32]

[30] The Ohio Uniform Mediation Act, OHIO REV. CODE ANN. §§ 2710.01-10 (Lexis 2007).
[31] *See* 5A OHIO JUR. 3D *Alt. Dispute Res.* § 166 (the mediator's decision may be enforced through contract principles, however, if the "basic elements of contract formation" are present).
[32] NATIONAL ASSOCIATION OF REALTORS, REAL ESTATE BROKERAGE ESSENTIALS, MANAGING LEGAL AND BUSINESS ISSUES 355 (3d ed., 2006).

Arbitration "involves the submission of the dispute to a third party who renders a decision."[33] Typically, the decision of the arbitrator is binding on all parties. Alternatively, in court-annexed arbitration, a court will refer civil suits to an arbitrator who submits a non-binding decision to the court. An arbitration clause may read as follows:

> The undersigned parties hereby agree to settle by binding arbitration any dispute among or between them which may arise out of or in connection with the transaction covered by the purchase agreement dated _____. Such disputes include, but are not limited to, claims of fraud, misrepresentation, warranty, and negligence. The rules of _____ shall govern said arbitration proceedings. This agreement shall survive the closing of the transaction covered by the purchase agreement.[34]

Before the arbitration hearing, the parties submit all relevant evidence to the arbitrator who usually is selected by the parties from a list of available arbitrators. Often, parties submit a list of questions or issues that they want the arbitrator to decide.[35] Arbitration procedures range from very informal to those that closely resemble a structured formal court proceeding. If the parties agree, attorneys or the parties themselves may present evidence and call witnesses to testify before the arbitrator. Like mediators, arbitrators need not be licensed as arbitrators nor are they required to be licensed attorneys.[36] Often arbitrators may be respected members of the trade that is the subject of the dispute. Many arbitrators become experts at deciding particular kinds of disputes, e.g., labor, commercial, real estate, etc.

After the hearing, the arbitrator answers the questions presented and issues an award. If the parties agreed to binding arbitration, the award is final. Because arbitration may closely resemble a trial in court, arbitration may be more expensive and time-consuming than mediation,

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[33] Stone, *supra* at p. 6.
[34] NATIONAL ASSOCIATION OF REALTORS, *supra* note 25, at 366.
[35] *Id*. at p. 305.
[36] 5A OHIO JUR 3D *Alt. Dispute Res.* § 132.

but the fact that arbitration can be binding makes it appealing when the parties cannot agree to a solution even when assisted by a mediator.

In reviewing potential liabilities against real estate brokerages and licensees, it appeared that one of the largest expenses was simply the cost of defending against a lawsuit.[37] Accordingly, mediation and arbitration clauses may be good solutions to limit the costs of defending against a lawsuit brought by a client against a broker. Because mediation and arbitration resolutions are binding, the expenses associated with the lawsuit and any subsequent appeals are avoided. On the other hand, since many potential lawsuits are dismissed early in the litigation process, an ADR clause may result in settlements on claims that have no legal basis. Additionally, for an arbitration and mediation clause to be effective, the real estate licensee or firm may need privity of contract. A real estate firm should weigh the potential cost of defending a lawsuit against the potential cost of a resolved conflict before placing an ADR clause in its contract.

Again, if an ADR clause is included in a buyer-seller real estate sales agreement, that clause probably will not be enforceable by a broker if the broker is sued by a non-client. Because of the lack of privity, the broker most likely will not be successful in attempting to have the lawsuit stayed pending the result of an ADR procedure.

F. Conclusion

This chapter explored a number of private contracting solutions. Some clauses, such as the non-reliance clause, are standard in many real estate contracts. Real estate licensees may wish to include an "as-is" clause in the contract; however, the licensee should weigh the benefits of doing so with the costs that may arise because of such clause.

[37] *See* Chapters 2 and 3, *supra*.

Certain other clauses may require privity of contract in order to be enforceable. Clauses limiting the amount of liability or time frame in which an action can be brought generally require privity of contract in order to be enforceable. A real estate licensee may not want to become a party to a contract in order to limit the amount or time of liability.

Mediation and arbitration clauses may also require privity of contract in order to be enforceable. Though there are some benefits to these clauses, they also pose some potential negative aspects. A real estate licensee should weigh the costs and benefits before determining whether including either of these clauses in a real estate contract.

Chapter 7: The Liability Problem and Institutional Changes

This chapter examines changes in the environment outside the real estate firm that have or may contribute to reducing potential real estate licensee liability. Among the issues explored in this chapter are the effect of seller property disclosure, growth of the use of professional home inspections, growth of the use of home warranty programs, limitations of actions, changes in brokerage laws defining the behavioral roles of agents, and systemic changes to real estate E&O coverage. All of these issues arise outside the control of the individual real estate firm. Consequently, they need to be discussed in a system wide context.

A. Seller Property Disclosure Form

In May 1991, a report by Moore, Smolen, and Conway examined the potential effectiveness of mandatory property disclosure forms.[1] The conclusion of the report was that the situation was a "Win-Win-Win" – buyers, sellers and real estate agents all potentially benefited from seller disclosure.[2] In June 1991, the National Association of Realtors submitted press releases stating that seller disclosure helped everyone.[3] Today, almost two thirds of states require sellers to disclose property condition on a mandated form.[4]

The relative usefulness and effectiveness of disclosure legislation is a matter of contention. One argument is that mandatory disclosure does not necessarily achieve the

[1] Gary Moore, Gerald Smolen & Lawrence Conway, AN EVALUATION OF THE DESIRABILITY OF SELLER AND REAL ESTATE AGENT DISCLOSURES, RESEARCH REPORT NO. 46 (May 1991). The manuscript was review by Dr. Bud "Almon" Smith, Executive Vice President of National Association of Realtors. Dr. Smith probably should be credited as the driving force in the NAR movement in favor of Seller Property Disclosure.
[2] Interview by the Toledo Blade with Dr. Gary Moore (used by the NAR in news release).
[3] News Release, Nat'l Ass'n of Realtors, *Property Disclosure Helps Everyone NAR Says* (June 24, 1991). *See also* George Lefcoe, *Property Condition Disclosure Forms: How The Real Estate Industry Eased the Transition from Caveat Emptor to Seller Tell ALL*, 39 REAL PROP. PROB. & TR. J. 193 (2004).
[4] Lefcoe, *supra* note 3. *See also* Anupam Nanda, *Property Condition Disclosure Law: Why Did State Mandate 'Seller Tell All"*, (U. Conn. Dep't of Econ. Working Paper Series, Working Paper No. 2006-16, 2006).

economically efficient outcome that could be achieved by a signaling equilibrium.[5] The rationale of this argument is that sellers of high-quality houses possess an incentive to disclose information to capture the highest possible price, whereas owners of lower quality houses remain silent, hoping to receive a high price. Consequently, buyers adjust to the quality of seller-volunteered information and assume that less information suggests a lower quality house. When a buyer adjusts his price downward, this creates additional incentive for a "silent" low quality owner to disclose more information.

Another argument suggests that disclosure laws may actually distort the information in the market because less sophisticated buyers interpret the disclosure document as a substitute for a professional inspection.[6] This argument relies on evidence that even after the passage of mandatory disclosure legislation, the incidence of adverse buyer discovery in the post closing period in lower price houses was over 50 percent.[7] The continued incidence of defects in houses even after disclosure suggests the legislation has not been effective.[8]

A third argument is that disclosure legislation has a positive impact on economic efficiency. One study found statistically significant decreases in deviations from expectations concerning the quality of construction (unpleasant post-transaction surprises) and in complaints by real estate purchasers.[9] This study also found that seller disclosure affects the sales negotiation in about 20 percent of real estate transactions.[10] Another study found that sellers may fetch a 3 to 4 percent higher price for a home when a state-mandated property disclosure

[5] Kathy Pancak, T.J. Miceli & C.F. Sirmans, *Residential Disclosure Laws the Further Demise of Caveat Emptor*, 24 REAL ESTATE L.J. 291 (1996).
[6] K.E. Lahey & D.A. Redle, *The Ohio Experience: The Effectiveness of Mandatory Disclosure Forms*, 25 Real Estate L.J. 319 (1997)
[7] *Id.*
[8] *Id.*
[9] Gary Moore & Gerald Smolen, *Real Estate Disclosure Forms and Information Transfer*, 28 Real Estate L.J. 319 (2000).
[10] *Id.*

statement is furnished to the purchaser.[11] One reason why disclosure legislation may be positive is that buyers who receive disclosures are less likely to be disappointed with their home purchases afterward and are therefore less likely to file insurance claims and lawsuits against sellers and brokers for undisclosed defects.[12]

B. Improving Ohio's Disclosure Form

Ohio's Disclosure form is fairly comprehensive. Ohio's required seller disclosure form is divided into subsections that cover the water supply source, the nature of the sewer system, conditions of the foot, foundation, walls and floors, mechanical systems, wood boring insects, hazardous materials, location on a flood plain, drainage erosion, zoning, code violations, assessments, boundary problems, underground tanks and any other know material defects.

Although it is fairly comprehensive, I compared and contrasted the items covered in Ohio with those in Rhode Island. I chose Rhode Island because of the extremely low incidence of E&O claims filed in the state, indicating a population that may be more satisfied with the sales process.[13] Among the items included on the Rhode Island form that appear to be more extensive than the Ohio form are:

- Length of seller occupancy
- Year built
- Sump pump (operational, location, and defects)
- Roofs (layers, age and defects, Ohio requires only disclosure of leaks)
- Fireplace and chimney (including maintenance history)
- Wood burning stove (installation date, permit received, defects)
- Insulation (Wall, Ceiling, Floor, UFFI)
- Termites (treatment company is disclosed)

[11] Anupam Nanda, *Property Condition Disclosure Laws : Does 'Seller Tell All' Matter in Property Values?'* (U. Conn. Dep't of Econ. Working Paper Series, Working Paper No. 2005-47, 2005).
[12] Lefcoe, *supra* note 3.
[13] The 2004 mandatory E&O Premium in Rhode Island was $74, the 2005 Mandatory E&O Premium for Rhode Island was $80. This compares to an average of $145 and $147 for all states having mandated coverage. Rhode Island clearly had the lowest incidence of allegations per licensee and claims per licensee over the 2001 to 2006 period, according to RISC LLC claims data.

- Radon (contains a radon warning)
- Electrical systems (improvements and repairs, amps, defects)
- Sewage system (assessment, annual fees, cesspool/septic location, maintenance history)
- Property tax
- Survey (previous survey in sellers possession must be provided)
- Zoning (Rhode Island form contains a warning)
- Building permits
- Wetland (development problems)
- Pools
- Fire
- Hazardous waste

Several of these provisions may be beneficial on Ohio's disclosure form. In particular, the additional information regarding the roof that is found in the Rhode Island form would benefit many Ohio buyers. Rhode Islands' form requires much more specific information about the roof such as the materials, age, and number of layers. Additionally, Rhode Islands' form requires information regarding issues such as ice damming. This degree of information about the roof would give potential buyers a much better idea of the amount of money that they will eventually have to spend on the roof. This benefits real estate licensees because buyers will then be more aware of circumstances surrounding their purchase and therefore less surprised, and less likely to file a lawsuit, when post-sale expenditures occur.

Licensees may also benefit from the addition of several other items to the Ohio disclosure form. One in particular is a section covering mold problems. One problem with disclosing mold problems is that almost every home has some mold contamination. However, liability coverage for mold damage is explicitly excluded from the real estate licensees E&O policy, so the failure to address the issue leaves the real estate licensee in a vulnerable position. Undisclosed mold was one of the top frequency items in suits against real estate licensee in our examination of E&O frequency data.

Another important concern involves soil stabilization and pollution issues. Some of the very large lawsuits discussed earlier involved pollution and soil stabilization issues, such as landfills or construction landfills, and known soil stabilization issues, such as sinkholes or landslides. Further, liability coverage for pollution damage is excluded from the real estate licensee E&O policy. Consequently, it may be a good idea to give the seller the opportunity to comment on potential pollution issues.

Finally, a record of any insurance claims on the property that have been filed on the property during the tenure of the current seller may be of great benefit. The name of the contractor who did the repair work should also be disclosed.

C. Seller Disclosure Opt-Out

In some states, a debate rages as to whether it is possible to opt out of the required seller disclosure by paying a nominal opt out fee. Three states – New York, Connecticut and Rhode Island – have a monetary penalty when the seller fails to deliver a seller disclosure form. These three states require the payment of $500, $300, and $100 respectively to a buyer in the event a seller fails to complete and deliver a seller disclosure form.[14] In New York and Connecticut the amount is credited at closing, while in Rhode Island the amount is seen as a civil penalty.

Real estate attorneys disagree whether the payment of an opt-out penalty actually relieves the seller from having to disclose to the buyer known problems.[15] Although many attorneys have suggested that these provisions are a true buy-out of the seller disclosure obligations under the statutes, others suggest that these statutes are simply a penalty for violating the statute. For example, in upstate New York sellers are typically advised by their attorneys to fill out the

[14] *See* Mark Borten, Property Disclosure Law's "Opt Out" Provision, 7/25/2002 N.Y.L.J. 2, col. 6 (2002).
[15] Emily Pickrell, *Should You Sign A Property Condition Disclosure?*, NEWSDAY, http://www.newsday.com/business/ny-bzremain075360628sep07,0,99962.story?coll=ny_business_promo (last visited Sept. 18, 2007).

form.[16] However, in rest of the state sellers are advised to pay the $500 penalty rather than fill out the form and risk litigation.[17] Although the statute specifically declares buyers liable only for "knowingly false or incomplete statements ... on [the] form," there is always the risk of litigation, which, at a minimum, results in costs to defend. [18] Accordingly, the de minimus nature of the penalty provisions probably has the effect of defeating any compliance the disclosure law may otherwise have achieved.[19]

D. Inspections

Today, professional home inspections represent an integral part of the home buying process. A joint survey by the National Association of Realtors and the American Society of Home Inspectors found that 77 percent of all buyers got home inspections. [20] Another survey conducted by the General Accounting Office (GAO) indicated that 86 percent of homeowners using FHA Insured Finance in 2002 utilized home inspections.[21] Most home inspection cost less than $400.[22] When the inspections isolated either major or minor problems, about 30 percent of the time the buyers were able to renegotiate one or more terms and most often they convinced the sellers to fix the problems. Nearly half of the buyers surveyed by the GAO indicated that they liked their inspections because the sellers made needed repairs before the buyers moved in.[23]

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[16] *Id.*
[17] *Id. But see* Malach v. Chuang, 754 N.Y.S.2d 835, 838 (N.Y.C. 2002) (noting that the statute maintained all statutory and common law causes of action.).
[18] Karl Holtzschue, *Property Condition Disclosure Act: Implications of the $500 Credit*, 30 Real Prop. L.J. 100, 102 (2002).
[19] Pickrell, *supra* note 15.
[20] Nat'l Ass'n of Realtors & Amer. Soc'y of Home Inspectors, Home Inspection Survey, 2001.
[21] U.S. Gov't Accountability Office, *Home Inspections: Many Buyers Benefit from Inspections, But Mandating Their Use Is Questionable*. GAO 04-462 (2004) [*hereinafter* GAO].
[22] *Id.*
[23] *Id.*

Home loans secured through the FHA require an advisory that says: "FOR YOUR PROTECTION: GET A HOME INSPECTION.[24] Real estate agents should give a similar advisory to all buyers in the state of Ohio. By giving such an advisory, the FHA encourages buyers to protect themselves by getting a home inspection but does not require them to do so. The future Ohio form should explain that all home buyers can expect home maintenance expenses in the first year of ownership, and that inspections can help the buyer estimate the magnitude of these expenses.[25] The form should also point out that Ohio law places the burden on the buyer to conduct an extensive investigation and inspection before the buyer purchases the house and that the best way to do this is with a professional home inspection.

One of the primary reasons for a mandatory warning concerning home inspections is that most buyers have unrealistic expectations concerning the amount of money involved in home ownership and maintenance. Most home buyers will have some substantial home expenses in the first year of ownership. Since dissatisfaction and subsequent lawsuits are a function of deviations from the buyer's expectations, it becomes incumbent upon the real estate profession to educate buyers concerning the realistic expenses that they will incur. Too many buyers fail to realize that all houses have some natural expenses. For example, a house with a fifteen year old roof will probably need a new roof within the next five years. Some people may see this as a defect, while others will realize it's a natural expense in the course of owning a house.

E. Home Warranties

In theory, home warranties are an excellent device to reduce seller and broker liability. A home warranty removes any uncertainty concerning the quality of the house simply by

[24] Form HUD-92564-CN (8/99). This form outlines the importance of home inspections, distinguishes inspections from appraisals, and advises that the FHA does not provide additional funding for repairs after closing.

[25] For example, 46 percent have plumbing problems, 31 percent have problems with appliances, 25 percent have problems with the cooling or air condition, 25 percent have problems with the electrical system, 18 percent have problems with the roof, 17 percent have problems with the heating, and 15 percent have some sort of problem with the structure. GAO, *supra* note 21.

transferring the risk. This is consistent with the general risk management practice of transferring risk where there is a relatively low frequency of occurrence and potentially severe adverse outcome. Unfortunately, the economics of the situation do not work out so that a pure insurance solution is optimal. As mentioned in the previous section, homeowners who purchase existing homes usually have substantial maintenance expenses in the first year of ownership of their home. A general warranty of the home is sometimes provided by builders of new construction and is sometime transferable to subsequent purchasers.[26] However, in an existing house, the most common warranty is a one year mechanical warranty.[27]

Home warranties are not insurance policies or safety nets for potential mechanical breakdowns. Home warranty programs are contractual guarantees that will repair or replace certain property systems if these systems fail due to normal wear and tear during the term of the contract.[28] Currently, there is a growing home warranty market covering mechanical items and appliances. The typical mechanical home warranty covers such items as central air conditioning and heating systems, appliances, doorbells, water heaters, ductwork, garbage disposals, plumbing systems, ceiling fans, electrical systems, and telephone wiring. [29] Other home warranties are more extensive. For example, some home warranties cover the structural integrity of the exterior and interior walls, the structural integrity of the foundation and basement, and the septic tank and wells.[30]

To the extent these warranties increase buyer satisfaction, they should be considered a positive development. However, many home warranties appear to come up short as a solution to

[26] *See* Terry v. Bishop Homes, Inc. 2003 Ohio 1468 (9th Dist. 2003).
[27] *See* Majoy v. Horde, 2004 Ohio 2049 (6th Dist. 2004).
[28] *See* NAT'L ASS'N OF REALTORS, Real ESTATE BROKERAGE ESSENTIALS, MANAGING LEGAL AND BUSINESS ISSUES 319 (3d Ed., 2006) [*hereinafter* Essentials].
[29] *See id. See also* Elizabeth Weintraub, *Home Warranty – What Is a Home Warranty Plan,* http://homebuying.about.com/od/buyingahome/qt/HomeWarranty.htm (last visited July 27, 2007).
[30] *See* Essentials, *supra* note 28, at 319.

the general problem of dissatisfaction over an economically severe defect. One positive byproduct of implementation of a home warranty program within a real estate agency is the opportunity for someone to discuss what is NOT covered by a general home warranty and consequently increase the awareness as to the items that do require extensive investigation. To the extent that buyers are encouraged to obtain more thorough inspections and additional information concerning the property, a home warranty program should decrease claims against real estate licensees.

F. Limitations on Actions

On December 27, 2007, the Ohio Supreme Court decided *Arbino v. Johnson & Johnson*.[31] The case recast the judicial landscape with reference to the ability of the legislature to set limits on action such as caps on non-economic damages and caps on punitive damages.[32] In a sharp departure from previous case law, the court upheld Ohio Revised Code Section 2315.18, a cap on noneconomic damages and Section 2315.21, a cap on punitive damages. The opinion said:

> A fundamental principle of the constitutional separation of powers among the three branches of government is that the legislative branch is "the ultimate arbiter of public policy. It necessary follows that the legislature has the power to continually create and refine the laws to meet the needs of the citizens of Ohio…. The fact that the General Assembly has repeatedly sought to reform some aspects of the civil tort system for over 30 years demonstrates the continuing prominence of this issue.[33]

Given this change in the judicial attitude toward tort reform, it certainly seems possible to enact rational legislation limiting liability of real estate licensees and other parties. A number of

[31] No. 2006-1212, slip op. 6948 (2007).
[32] *Id.*
[33] *Id.* at *P7

states have created specific statutes of limitations associated with disclosures arising in the context of a seller disclosure statement. For example, in Tennessee the law provides that an action must be commenced by a purchaser within one year of receiving the property disclosure statement or within one year of closing on the property, whichever comes first.[34] Hawaii provides a similar statute of limitations with a time frame of two years.[35] California provides that an action for a breach of a duty by a real estate agent shall not commence after two years from the date of closing, recordation, or occupancy, whichever comes first.[36]

The existence of these statutes of limitation in other states suggests that there is no particular public policy against limiting actions for liability against real estate brokers. To the extent a potential liability may arise under a statutory duty in Ohio, it would be useful to set a limit for such a suit to two years. A general limitation could limit all actions for fraud, negligent misrepresentation or any other legal theory associated with a real estate transaction to a statute of limitation of two years.

G. Brokerage Law Changes

Ohio enacted substantial changes in its real estate licensee and brokerage laws in the 1990s.[37] Public understanding and awareness of these laws would greatly benefit licensees. One suggestion is that the Consumer Guide to Agency Relationships describing licensee and brokerage relationships be expanded to explain the implications of the laws, such as Ohio Revised Code §§ 4735.67 and 4735.68, on the parties in a real estate transaction. These statutes are an important part of the buyers' and sellers' understandings of the agency relationship. These

[34] TENN. CODE ANN. § 66-5-208 (2007).
[35] HAW. REV. STAT. ANN. § 508D-17 (2007).
[36] CAL. CIV. CODE § 2079.4 (2007).
[37] *See* OHIO REV. CODE ANN. §§ 4735.51 *et seq.* (2007).

changes in the brokerage laws should decrease the frequency of lawsuits against licensees as much as the seller disclosure laws.

It also would be useful to have the bar association better understand the implications of these sections. A review of some of the recently filed lawsuits revealed that lawyers sometimes filed suit even though these statutes clearly relieved brokers of any responsibility.[38] Statutes such as Ohio Revised Code §§ 4735.67 and 4735.68 establish a consistent standard of conduct.

H. Elimination of Dual Agency

Eliminating dual agency would help the state limit real estate licensee liability. However, dual agency represents a potential lucrative situation for real estate firms since a firm is potentially able to collect a "double" commission. Consequently, real estate firms would probably resist any call for elimination of dual agency. It should be noted that disclosed conflicts of interests are allowed in other legal situations such as insurance companies attorneys representing both the insured and the insurance company's interests.

I. Standardized Mandatory E&O Policies and Underwriting Practices

There has been some discussion about moving Ohio to a mandatory E&O coverage similar to that in other states. One advantage of mandatory coverage is that the marketing and underwriting costs are reduced. Since marketing costs equal 15 to 20 percent of the total cost of E&O premiums, there could be some substantial cost reductions.[39] Additionally, a mandatory E&O policy creates uniformity. This reduces the chances of a split between the amount of

[38] *See* Gordon v. Skopos, 2005 Ohio 4900 (11th Dist. 2005) (holding that knowledge of a defect is a prerequisite for liability under the statutory duties of an agent).

[39] According to filings with the state insurance commission, X, L Insurance estimates its commission and brokerage fees at 21 percent. Transmittal Header SERT-6E8PCJ130/00-00/00-00/00 (filed with Ohio Dep't of Ins., July 12, 2005). CNA insurance companies estimate their commission at 18 percent. Casualty Filing Transmittal Form, (filed with Ohio Dep't of Ins., Feb. 19, 2003).

money available to defend and the amount of money available to indemnify in any particular claim.[40]

The downside of mandatory E&O coverage is that the underwriting process by some insurers actually does change behavior. Some Ohio insurers include risk management practices into their underwriting procedures. For example, Continental Casualty Company allows a risk management credit in its underwriting. The company provides a 10% rate credit for firms that place special emphasis on continuing education and risk management activities as long as they have incurred loss ratios of 60% or less.[41] Continental Casualty Company applies a debit of up to 50% for poor claims history and a credit up to 15 % for a superior claims history.[42] The importance of prior claims history in the underwriting can be seen in the Tables 7.1 and 7.2.

Table 7.1: St. Paul Travelers Litigation History Adjustment

St. Paul Travelers Litigation History Adjustment applies an underwriting adjustment based on litigation history. A rate modifications factor is applied on a per employee basis according to involvement in claim experience and determined based on the frequency, severity, and type of claims as follows:	
Prior Claim / Litigation History	**Factor**
Significant - There is a likelihood of payout exceeding the deductible by $5,000 or more	1.61 – 2.00
Material - While there are established reserves for this account and payout may exceed the deductible, it is not expected to exceed the deductible by more than $5,000	1.26 – 1.60
Minimal - While claims have been reported upon which precautionary reserves have been established, there is a low likelihood of ultimate payout.	1.01 – 1.25
None - There have been no claims reported or if they have been in the past, they have resulted in no payments that have exceeded the deductible of the policy.	1.00 – 1.00
Source: ST. PAUL TRAVELERS 1ST CHOICESM FOR REAL ESTATE PROFESSIONALS, "Claims-Made, Guide (a) Rates", , Filing with Ohio Department of Insurance, Property & Casualty Division, received August 1, 2005, Filing Number: 2005-07-0014, 55786 OH Rev. 07-2005	

[40] Currently, there is the possibility that some Ohio policies combine the total amount that can be spent for defense and indemnification.

[41] CONTINENTAL CASUALTY CO., REAL ESTATE PROFESSIONALS E&O PRODUCT MANUAL, *Premium Modification, Risk Management Credit,* (REA-6, Ed. 04/06) (Filing No. 06-2120 FR with Ohio Dep't of Ins., Prop. & Casualty Div., July 13, 2006).

[42] *Id*.

Going to a mandatory E&O coverage would undermine some of the salutary effects of these underwriting practices. Consequently, the issue then becomes whether the decrease in claims attributable to the underwriting incentives is offset by the increase in costs of premiums caused by the underwriting and marketing costs.

A number of Insurance Companies use prior litigation history as a factor in setting the E&O premium. This has the effect of rewarding good risk management practices and punishing bad risk management practices. Mandatory E&O Coverage usually does not adjust individual premiums based on litigation history. Consequently, mandatory insurance typically does not provide incentives to adopt superior risk management practices. One solution is to allow a prior litigation history adjustment to be incorporated into a mandatory program. E&O insurance programs should be structured so as to encourage superior risk management practices and to discourage the type of behavior that results in E&O claims.

Table 7.2: Continental Casualty Company Experience Rating

NOTE: The experience period shall be limited to a maximum of six years. Debits and credits shown are stated as maximum		
Experience Period Loss Ratio	**Debit**	**Credit**
30% or less	0 %	15%
31-40%	0 %	10%
41-60%	0 %	0 %
61-70%	20%	0 %
71-80%	30%	0 %
81-90%	40%	0 %
91-100%	50%	0 %
101 and over	Refer to Company	0 %
* Debits for loss ratios will only apply to accounts which would otherwise generate at least $2,500 in firm's basic annual limits premium before the application of any modifications.		
Source: CONTINENTAL CASUALTY COMPANY, CAN Plaza, Chicago, IL, 60685, "Real Estate Professionals E&O Product Manual, XV, Premium Modification, Loss Experience Modification REA-5, Ed. 04/06,", Filing with Ohio Department of Insurance, Property & Casualty Division, received July 13, 2006, Filing Number: 06-2120 FR		

J. Increased Quality of Education

Advances in technology, changes in real estate laws and regulations, and the increasing complexities of the real estate transaction require real estate licensees to perform at ever increasing levels of sophistication. This high level of sophistication threatens to potentially increase the number of lawsuits against real estate licensees because the standard of conduct is theoretically increasing. State regulators and associations have responded by adding increased rigor to the educational requirements of real estate licensees.[43] Academic studies indicate that adding rigor to the educational requirements for licensing has a beneficial effect on licensee liability.[44] Throughout the 1990s, the requirements and standards of real estate education increased at the entry level, the brokerage level, and the continuing education level. Agents today have much more training in real estate concepts such as agency law than professionals a generation ago.

On the other hand, the quality of the education that some real estate agents receive may be a matter of concern to some. The Ohio Real Estate Commission approves propriety schools as well as accredited non-profit colleges and universities to provide pre, post and continuing education in Ohio. All of these are subject to approval and audit by the Real Estate Commission. However, some authors have questioned the advisability of allowing so many licensees to acquire their mandated education hours from approved proprietary schools.[45]

State regulators and associations set minimum requirements to become a licensee, to become a broker, and to maintain the status of a licensee or broker. In order to become a real

[43] *See* OHIO REV. CODE ANN. § 4735.07 *et seq.* (2007).
[44] *See* Shilling & Sirmans, *The Effects of Occupational Licensing on Complaints Against Real Estate Agents*, 3 J. of Real Estate Research 2 (1988) (finding a 10 percent increase in the pass rate on the licensure exams resulted in a reduction in the number of claimants against the licensees).
[45] LEONARD V. ZUMPANO & KEN H. JOHNSON, REAL ESTATE BROKER LIABILITY: AN INTERSTATE COMPARISON 27-28 (Ala. Real Estate & Research Ctr., Culverhouse College of Commerce & Bus. Admin. 1999) (questioning the advisability of allowing a majority of Tennessee brokers to obtain their educational requirements from proprietary schools).

estate licensee, Ohio designed laws to establish a minimum performance standard to protect the public against fraud or incompetence. A real estate licensee has a basic set of educational requirements which consists of a high school education or its equivalent and 120 hours of pre-licensee education at an institution of higher education in topics relevant to the real estate profession.[46] These topics include instruction in real estate practice, real estate law (including municipal, state, and federal civil rights law, new case law on housing discrimination, desegregation issues, and methods of eliminating the effects of prior discrimination), real estate appraisal, and real estate finance.[47] Upon the completion of these courses the applicant must pass a written examination prescribed by the Division of Real Estate. Within one year of the date a license is issued, a licensee must take a 10-hour post-licensure course either at an institution of higher education or any institution approved by the Ohio Real Estate Commission.

Brokers in Ohio are subject to both an experience requirement and a set of educational requirements. A candidate broker must be licensed as a salesperson and hold an active salesperson license for two of the previous five years. Additionally, a candidate broker must complete all of the requirements to become a licensee as well as instruction in financial management, human resources and personnel management, business economics, and business law.[48] A minimum of two years of post-secondary education, or the equivalent of 60 semester hours or 90 quarter hours, currently is required.[49]

In order to retain or renew their licenses, Ohio real estate agents must complete 30 hours of approved continuing education every three years. These classes are required so that licensee's knowledge of current real estate practice and law is maintained. Of the 30 hours required for

[46] OHIO REV. CODE ANN. § 4735.09(F) (2007).
[47] *Id.*
[48] OHIO REV. CODE ANN. §4735.07(5) (2007).
[49] *Id.*

renewal, a licensee must obtain nine hours credit in the following subjects: a course in municipal, state and federal civil rights laws, a course in state and federal legislation affecting the real estate industry, and a course on the canons of ethics for the real estate industry.[50]

Ohio has a relatively rigorous state mandated requirement for professional real estate education. However, the quality of education could be higher. Much of the real estate licensee education within the state is being provided by proprietary schools and approved non-academic instructors. The exact quality of the instruction remains a relative unknown. Though state universities may offer a higher level of instruction, the university system has not been very flexible in meeting the educational needs of real estate agents. Further, for some continuing education courses attendance is the only requirement for satisfactory course completion. This provides no basis for analyzing the information retained by licensees in the course.

K. Conclusion

This chapter reviewed a number of institutional factors which have or may have a salutary effect on real estate liability. In accordance with the analysis of these factors, a number of suggestions for the improvement of the situation were proposed.

First, I suggest a more extensive disclosure form similar to that of Rhode Island. Additionally, though I do not endorse disclosure "opt out" provisions utilized in other states, I do believe they desire serious additional study.

[50] *See* OHIO REV. CODE ANN. § 4735.141 (2007).

Also, Ohio should consider mandatory inspections for houses above a certain dollar threshold. Even if this is not adopted, a mandatory warning explaining the need to get a home inspection similar to those in the FHA would be very useful.

Laws describing the duties of licensees have been extremely beneficial and additional education should be available in the agency disclosure pamphlet concerning the content of these laws. A standardized E&O policy would be useful, but mandatory E&O coverage may have the effect of reducing the incentives for proper risk management. Finally, the level of education required for licensees and brokers seems reasonable. However, the outcomes assessment process for these courses could be improved.

Chapter 8: Conclusion

This study was done to gain greater understanding of the nature and scope of the legal liability facing residential real estate licensees in Ohio. The overall assessment is that the current legal climate is relatively favorable to sellers and real estate licensees; however, there are opportunities to decrease the liability risk even more. In spite of the favorable climate, a considerable number of (non-commission) claims and lawsuits are filed each year against Ohio real estate professionals.

The legal liability environment in which real estate professionals conduct their business was explored. Case law, as well as statutory law, was reviewed. Ohio is one of the few states that still enforces the doctrine of caveat emptor. The doctrine of caveat emptor precludes recovery in an action by the purchaser against the seller for a defect in real estate where three factors are present. One factor is that the condition or defect must be open to observation or discoverable upon reasonable inspection. Next, the purchaser must have a full and unimpeded opportunity to examine the premises. Also, the seller must not have acted fraudulently.

As discussed in Chapter 2, Ohio does not allow the defense of caveat emptor if the seller or seller's agent acts fraudulently in regard to a latent defect. But, in order for the buyer to claim fraudulent misrepresentation, the buyer must show that the buyer relied on the misrepresentation. Under current Ohio case law an "as is" clause in a contract further extends the protection of caveat emptor for sellers or sellers' agents. Numerous Ohio cases hold that if an "as is" clause is included in a real property sale agreement, the buyer is foreclosed from claiming fraudulent non-disclosure of a latent defect. It has also been held that a seller or seller's agent can be liable if the seller or seller’s agent makes an affirmative fraudulent misrepresentation about a latent defect.

We noted in Chapter 2 that Ohio Real estate licensees do have substantial obligations in a real estate transaction. As pointed out in Chapter 2, an Ohio broker has a fiduciary duty to the broker's client. Because there is a fiduciary relationship between the broker and the client, Ohio law provides that the client cannot waive any of the duties of the broker listed under ORC 4735.62 through contractual agreement. Of particular note is the duty to (1) exercise reasonable skill and care in representing the client and carrying out the responsibilities of the agency relationship, (2) disclose to the client any material facts of the transaction of which the licensee is aware or should be aware in the exercise of reasonable skill and care and that are not confidential information pursuant to a current or prior agency or dual agency relationship, and (3) advise the client to obtain expert advice related to material matters when necessary or appropriate.

Other substantial broker obligations were noted. A broker must disclose known material facts regarding the transaction to the broker's client. A broker representing the seller cannot extend an offer of sub agency to another broker or offer compensation to a buyer's broker without permission of the seller. In a dual agency, where a broker or brokerage represents both the buyer and the seller, the broker is required to obtain written consent from both parties.

In order to determine the nature and scope of claims against Ohio licensees, three sources of complaint data were investigated: appellate cases from Ohio, E&O claims data, and data from a number of complaints filed in selected Ohio trial courts. The data revealed that nationally, real estate professionals have approximately a 1 in 100 chance of facing a real estate insurance claim in any given year, with about half of those being serious enough that the insurance companies establish a claim reserve. The trends gleaned from the three sources were very similar. This study indicated that the source of claims and lawsuits was similar, but not the same as previous

studies in other states. Like previous research, this study documented that misunderstandings and misrepresentations regarding the condition of property listed for sale by brokers are the major reasons for real estate licensees being sued. The specific types of defective conditions differed from the previous Alabama study because of climate differences. There is an interesting trend in the Ohio cases. The number of appeals cases rose until the mid 1990s, and then fell. This pattern was documented in a number of categories and seems statistically very strong. It is consistent with the passage of seller disclosure laws implemented in 1993, increasing educational standards, legislation clarifying the buyer's role and obligations in real estate transaction and more extensive agency disclosure legislation passed in the mid 1990s.

In terms of the types of lawsuits filed, there were some disturbing trends. A significant number of Ohio real estate suits alleged causes of action that related to "intentional" action, such as fraud or concealment. This is not surprising, given the requirements to allege the fraud or intentional action to prevail under Ohio's version of caveat emptor. However, it is disturbing to find given the extremely high frequency of the fraud allegations that most E&O coverage specifically excludes fraud and willful acts from coverage. Moreover, about 40 percent of the cases filed against real estate licensees also request punitive damages, which are also excluded from coverage. Practically, the effect is not as severe as the contractual language may indicate. Ohio law requires that when one cause of action is alleged which is covered and another is alleged that is not covered, there is a duty to defend both causes of action. It seems clear that Ohio insurance carriers should explore a "cleaner" error and omissions policy, which would better reflect the realities of the litigation situation. A dialogue between the Ohio Association of Realtors, the major E&O carriers, and the insurance commissioner's office should explore policy language that recognizes that allegation of willful acts will be part of most lawsuits filed against

Ohio licensees. A reasonable compromise should provide that at least the defense for such actions is clearly covered by these E&O policies.

There also is the possibility of limiting liability through private contracting. Among the types of contractual exculpatory clauses that limit liability are "as is" clauses, non-reliance clauses, limitations of amount of damages, limitations of time for suit, and mediation and arbitration clauses. Lack of privity may hamper a licensee's ability to claim some of these as a defense.

It also is possible to change the environment outside the real estate firm that have or may contribute to reducing potential real estate licensee liability. Among the issues explored were the effect of seller property disclosure, growth of the use of professional home inspections, growth of the use of home warranty programs, possibility of introducing additional statutory limitation of actions, changes in brokerage laws defining the behavioral roles of agents, and possible systemic changes to real estate E&O coverage.

The study documented the usefulness of seller disclosure and made suggestion for further improvement. In particular, the additional information on the roof that is found in the Rhode Island form would be more helpful to many Ohio buyers. A number of other omitted items on the Ohio disclosure form warrant discussion. The first is the omission of any discussion of mold problems. Mold is explicitly excluded from the real estate licensees E&O coverage, so the failure to address the issue leaves the real estate licensee and potentially the seller in a vulnerable position. Undisclosed mold was one of the top frequency items in suits against real estate licensee in our examination of E&O frequency data. Another important concern involves disclosure of soil stabilization and pollution issues. Some of the very large lawsuits discussed

earlier involved pollution and soil stabilization issues, such as landfill or construction landfill, and known soil stabilization issues such as sinkhole or landslides.

Today, professional home inspections represent an integral part of the residential purchase process. As mentioned earlier, real state licensees are under an obligation to advise the client to obtain expert advice related to material matters when necessary or appropriate. There is clearly a duty on the part of the buyer to properly inspect a property that they are trying to purchase. Perhaps the buyers need a clear explanation of that duty. One of the ways in which this could be accomplished is to develop a mandatory warning regarding the need for inspections to be included in all residential real estate transactions. One of the primary reasons for a mandatory warning concerning home inspections is that most buyers have unrealistic expectations concerning the amount of money involved in home ownership and maintenance.

The possibility of statutory limitations of actions associated with real estate transactions is important. A number of states have created specific statutes of limitations associated with any duty to disclose that arise in the context of a seller disclosure statement. This implies that there are few strong public policy arguments against this type of statutory limitation of action statutes. Because Ohio has yet to expand liability with regard to seller disclosure statements, the need for this type of legislation has not emerged. On the other hand, some limitation of actions legislation (tort reform) has been passed by the Ohio legislature.

Ohio enacted substantial changes in its brokerage laws in the 1990s. This legislation dealt with the responsibilities of real estate brokers, real estate buyers, and real estate sellers. In general, the legislation defined the agency responsibilities of real estate licensees, and in general more clearly defined acceptable and unacceptable behavior for licensees, sellers and buyers. As mentioned before, these efforts seemed to have been extremely successful. The only major

change that would improve these statutes is having the public understand them better. The Consumer Guide to Agency Relationships should be expanded to explain the implications of the sections, such as Ohio Revised Code §§ 4735.67 and 4735.68, of the law with respect of each of the parties in a real estate transaction. These sections make very clear that the buyer has a significant obligation to aggressively investigate the condition of the property. Buyers should know that their failure to do so will seriously compromise any future claims. In conversations, claims representatives suggested the elimination of dual agency would be one of the more helpful things that the state could do to limit real estate licensee liability. The topic of dual agency was dealt with by the agency disclosure legislation and is a significant disclosure found in the Agency Disclosure Statement. Although consent of both parties, both parties is required, dual agency will remain a controversial issue because of the inherent conflicts of interest associated with it.

The need for an increased quality in real estate education was explored. Advances in technology such as the internet, constant changes in real estate laws and regulations, and the increasing complexities of the real estate transaction require that real estate licensees perform at ever increasing levels of sophistication. Theoretically, this required high level of sophistication threatens potentially to increase the number of lawsuits against real estate licensees because the standard of conduct is theoretically increasing. The state and profession has responded by increasing the level of training and education. However, it is clear that the standard of education will need to continue to rise as the challenges of the real estate profession become more extensive.

Precautions that can be taken by real estate firms to reduce real estate licensee and real estate firm liability were examined. These activities are within the control of the owner of the

local real estate firm and should be implemented regardless of changes in the institutional environment. To be effective litigation prevention tools these activities need to be documented. Clear firm policy and procedures manuals, paper trails of disclosures, and documented proper agent training are important risk management strategies. The National Association of Realtors has an excellent publication, Real Estate Brokerage Essentials that discusses the proper way this should be done.

A variety of relationships can exist under the current legal system between licensees and consumers. Unfortunately, the nature of those relationships is not always clearly understood by the firm's clients. Ohio has attempted to improve this situation on numerous occasions. In 2005, new rules regarding the timing and content of agency disclosure were instituted. A document called the "Consumers Guide to Agency Relationships," which explains a brokerage's agency policy, is now delivered to buyers and sellers at first contact. An Agency Disclosure statement is always signed before any transactions. The firm's policies and procedures manual should specifically delineate how the statutory disclosure and any helpful explanation of Ohio agency law is done in the firm. Specific training needs to be done so that the agency disclosure is properly done and properly documented. Simply having the buyers and sellers signature on the "Consumer Guide to Agency Relationships" document and the required Agency Disclosure Statement is not enough. The firm's manager needs to make sure that the customers understand Ohio agency law.

Another important issue is the handling of the seller property disclosure form**.** This study disclosed that fraud and misrepresentation are among the most common claims against real estate licensees. These claims are brought by surprised purchasers who discover after the closing, rather than before, the existence of significant defects in the physical condition of the property. A

previous survey by Dr. Moore indicated that 70 percent of agents felt that the disclosure form provided protection for the sales agent. In order not to mitigate the effectiveness of the property condition disclosure as a liability limitation tool, it is important for the licensee to remember that the statute places the burden for completing the property condition disclosure form on the seller. The seller disclosure law does not require that the licensee assist the seller in completing the form. In most cases, the agent should refrain from becoming directly involved with the seller disclosures.

A home inspector is a trained professional who posses expertise on the structural wear and tear that could create a great deal of expense. Consequently, the agent should always encourage the use of a good home inspector. Agents are not trained in structural engineering. Never should the agent attempt activity outside the scope of the agent's competence. Since agents are not structural engineers and they should not act as such. Opinions concerning the structural integrity or other property condition issues are best left to the experts. From a risk management standpoint, many experts see inspections as an opportunity for the agent to shift the liability risk to someone else. Transferring the risk to one who should be better able to bear it is a crucial theme of risk management. When agents give their opinions concerning properties, they are undoing the positive effects of this potential risk transfer.

In reviewing the largest judgments against real estate licensees the common element was that the agents had a conflict of interest. Although I suggested, "Don't have any", this is not always possible. We do need to remember that all fiduciaries and people in positions of trust have a duty of loyalty. One of the cardinal rules of the duty of loyalty is to avoid self dealing and other conflicts of interest. Because completely eliminating conflicts of interest is economically costly, many in the real estate profession suggest that the agent at least fully disclose any

potential conflict of interest completely to all involved parties. At least a few commentators have suggested that the elimination of dual agency would be a very good idea.

As noted in some of the previous chapters, there are different types of E&O coverages currently available in the state of Ohio. An insurance policy is composed of four parts: a declaration, an insuring agreement, conditions, and exclusions. The most important part of the policy from a risk management standpoint is the exclusions. Most E&O policies exclude willful acts such as fraud, and they do not cover punitive damages. Some exclusions, such as civil rights violations or agent disciplinary cases, can be added by rider. It is important for the owner of the firm to clearly understand what is and is not covered so that the owner can develop a risk management strategy with the knowledge of these gaps in mind.

One part of risk control is loss segregation. Loss segregation attempts to isolate the effects of a risk to a smaller economic entity. Most commonly, this is done through limited liability business forms. Various forms of organization are available to the owner of a real estate firm to limit liability. Among the various forms that are available are the C Corporation, the S corporation, the LLC and the Series LLC. The traditional forms, such as the LLC, remain the superior choice for law segregation. The series LLC may have potential impact in the future.

This paper examined the response of the firm to liability threats. Risk management can transfer, limit or control the liability risk, but cannot entirely eliminate the liability risk that the firm faces. Consequently, strategies to retain risk but limit its effects through loss reduction or loss segregation are essential. A vigilant risk management program infuses the organization with a perspective oriented toward preventing problems.

Although this project has been a tremendous amount of work, I have tremendously enjoyed the opportunity. I would like to thank those that gave me this opportunity. As a long

time researcher in the area of real estate licensee liability, I have had the pleasure of seeing some my earlier work have some impact upon the thinking in the area. This is a scholar's highest reward. In this paper I have suggested several additional potential solutions to the liability problems facing Ohio licensees. Some of my suggestions will ultimately be more useful than others. I am certain there are areas in this report where others will have significantly different opinions from mine. Moreover, in changing environment what seems like sage policy in one environment may have less than the desired effect in another. There are no final answers here. Debate is welcome, for in the exchanges of ideas, avenues for additional research and thought will arise. Hopefully, real estate professionals will be able to take advantage of the considerable amount of expertise on liability risk management already exists at the national level. Sage brokers will continue to work with their state and national associations.

Appendix for Chapter 2

Appendix Table 2.1: Statutory Duties of Real Estate Licensees: Other States

Alabama	*Real Estate Consumer's Agency and Disclosure Act*; Ala. Code 34-27-80 *et seq*.	Written disclosure of nature of relationship; duty of good faith and reasonable skill; disclose all known material information to client; not liable for false information provided by client; disclosure duty does not extend to transaction broker
Alaska	Alaska Stat. 08.88.60 *et seq*.	Written disclosure of nature of relationship; disclosure to all parties known physical conditions material to the contract; no duty to investigate; duty to inform buyer of murder or suicide occurring within one year of first showing
Arizona	Ariz. Admin. Code R4-29-1101	Written disclosure of nature of relationship; disclosure of any information the broker possesses material or adverse to the transaction, including any information that the seller or buyer is unable to perform, any material defect existing in the property, or the existence of a lien or encumbrance on the property
Arkansas	Ark. Code Ann. 17-42-108	Duty to disclose which party broker is representing
California	Cal. Civ. Code 2079 *et seq*.	Duty to conduct reasonable visual inspection of property and disclose conditions material to contract; two-year statute of limitations on actions; duty to provide information regarding sex offenders, water conservation and energy rating, environmental and geological hazards; written disclosure of nature of relationship
Colorado	Col. Rev. Stat. 12-61-801 *et seq.*	Written disclosure of nature of relationship; disclosure to client conditions that materially affect the contract; no duty to inspect;
Connecticut	Conn. Gen. Stat. 20-311 *et seq.*	Duty to disclose nature of relationship; if a buyer asks, duty to disclose whether a homicide or suicide occurred on premises; duty to disclose material facts; three year limitation on civil actions
Delaware	24 Del. Code Ann. 2901 *et seq.*	Written disclosure of nature of relationship to all parties; duty to disclose material information;
District of Columbia	D.C. Code 42-1703; D.C. Code 47-2853.01 *et seq.*	Written disclosure of nature of relationship; duty to disclose material facts regarding the physical condition of property actually known to broker;
Florida	Fla. Stat. 475.278	Written disclosure of nature of relationship (either single or transactional agent); duty to disclose material facts; statutory form provided for disclosure requirements
Georgia	*Brokerage Relationships in Real Estate Transactions*; Ga. Code Ann. 10-6A-1 *et seq.*;	Written disclosure of nature of relationship; duty to disclose material facts regarding physical condition of property and physical condition of area within one mile of property known by broker; no liability created absent a finding of fraud on the part of the broker;

Hawaii	Haw. Rev. Stat. 508D-7, 508D-17	Duty to deliver residential property disclosure to buyer and duty to notify buyer of rights regarding disclosure; duty to disclose facts inconsistent with the disclosure of which the broker knows or becomes aware; two-year statute of limitations from either time of disclosure or time of completion of sale if there is no disclosure form
Idaho	*The Idaho Real Estate Brokerage Representation Act*; Idaho Code 54-2082 *et seq.*	Written disclosure of nature of relationship (statutory short form); duty to disclose material facts; duty to show upon request reasonable proof of buyer's financial ability
Illinois	225 ILCS 454/15-5 *et seq.*	Written disclosure of nature of relationship; duty to disclose material facts;
Indiana	Ind. Code Ann. 25-34.1-10-0.5 *et seq.*	Written disclosure of nature of relationship; duty to disclose material facts; duties prescribed for buyer, seller, and limited agencies.
Iowa	Iowa Code 543B.55 - 543B.64	Written disclosure of nature of relationship; duty to disclose material facts unless facts are known by other party or revealed upon reasonable inspection or discovered by inspector of other party; common law still applies to fraudulent or negligent misrepresentation;
Kansas	*Brokerage Relationships in Real Estate Transactions Act;* Kans. Stat. Ann. 58-30, 101 *et seq.*	Written disclosure of nature of relationship; duty to disclose material facts; punitive damages limited to cases showing willful, wanton, fraudulent, or malicious conduct
Kentucky	Ky. Rev. Stat. Ann. 324.160 *et seq.*	Written disclosure of nature of relationship; duty to deliver residential property disclosure form; duty to disclose known defects which substantially affect the value of the property
Louisiana	*Louisiana Real Estate License Law*; La. Rev. Stat 37:1430 *et seq.*	Provide pamphlet describing nature of relationship or written disclosure of dual agency relationship; duty to disclose known material defects
Maine	Me. Rev. Stat. Ann tit. 32 s. 13271-13283	Written disclosure of nature of relationship; duty to disclose known material physical defects;
Maryland	Md. Code Ann., Bus. Occ. & Prof. 17-528 *et seq.*	Written disclosure of nature of relationship; duty to disclose material defects to client; duty to act fairly and honestly with all parties
Massachusetts	254 CMR 3.00	Written disclosure of nature of relationship;
Michigan	Mich. Comp. Laws 339.2517	Written disclosure of nature of relationship; duty to disclose known information that affects the client
Minnesota	Minn. Stat. 82.22	Provide client(s) with agency disclosure forms; fiduciary duty to client; duty to disclose known material facts about the property
Mississippi	Code of Miss. Rules 50-025-001	Written disclosure of nature of relationship
Missouri	Mo. Rev. Stat. 339.710 *et seq.*	Written disclosure of nature of relationship; duty to disclose known material defects; general duties to client are disclosed in written disclosure of nature of relationship

Montana	Mont. Code Ann. 37-51-101 *et seq.*	Written disclosure of nature of relationship; duty to disclose known adverse materially defects; no duty to inspect
Nebraska	Neb. Rev. Stat. 76-2401 *et seq.*	Written disclosure of nature of relationship; duty to disclose known adverse materially defects, including anything affecting seller's ability to perform
Nevada	Nev. Rev. Stat. Ann. 645.630	Duty not to make any false misrepresentations
New Hampshire	N.H. Code Admin R., Rea 701.01; N.H. Rev. Stat. Ann 331-A:25(a)-(d); 477:4(a)	Written disclosure of nature of relationship; written disclosure of dual agency relationship; duty to provide notification regarding possibility of radon gas or lead-based paint
New Jersey	N.J. Stat. Ann. 45:15-17	Commission may investigate and suspend license if broker does not disclose a dual agency relationship, makes false promises or substantial misrepresentations; no statutory duties listed
New Mexico	N.M Stat. Ann. 61-29-1 *et seq.*; N.M Admin. Code 16.61.19	Written disclosure of nature of relationship; duty to disclose adverse known material facts
New York	N.Y. Real Prop. Law 443, 443-a	Written disclosure of nature of relationship, statutory form provided; no duty to disclose psychological conditions unless asked about by the buyer and known by broker
North Carolina	21 N.C. Admin. Code 58A.0104	Written disclosure of nature of relationship;
North Dakota	N.D. Cent. Code 43-23-01 *et seq.*	Duty to disclose relationship if broker is anything but a seller's agent, buyer's agent, or subagent; duty to act in best interests of client
Ohio	Ohio Rev. Code Ann. 4735.51 *et seq.*	Written disclosure of nature of relationship; duty to disclose all material facts broker has actual knowledge of that are not discoverable upon reasonable inspection
Oklahoma	*The Oklahoma Real Estate License Code*; 59 Okla. St. 858-101 *et seq.*	Written disclosure of nature of relationship; duty to disclose information pertaining to the property as required by the Residential Property Condition Disclosure Act
Oregon	Or. Rev. Stat. 696.800 *et seq.*	Duty to provide pamphlet regarding broker relationship to prospective clients; duty to inform parties of known material facts; duty to inform seller of seller's duty to provide residential property disclosure form; duty to inform buyer of right to residential property disclosure form
Pennsylvania	63 Pa. Stat. 455.606 *et seq.*	Written disclosure of nature of relationship; probable duty to disclose known material defects
Rhode Island	R.I. Gen. Laws 5-20.6-1 *et seq.*	Written disclosure of nature of relationship; cannot submit an offer from a buyer until buyer has received disclosure from the seller regarding known material defects
South Carolina	S.C. Code Ann. 40-57-5 *et seq.*	Written disclosure of nature of relationship; duty to disclose known material defects
South Dakota	S.D. Codified Law 36-21A-130 *et seq.*	Written disclosure of nature of relationship; duty to disclose adverse material facts

Tennessee	Tenn. Code Ann. 62-13-401 *et seq.*	Verbal disclosure of nature of relationship; written agreement to act as broker or to assist with closing; duty to disclose adverse material facts; duty to disclose known market conditions
Texas	Tex. Occ. Code 1101.551 *et seq.*	Written disclosure of nature of relationship, statutory requirements for form provided; duty to advise buyer to have title examined and to get title insurance
Utah	Utah Admin. Code 162-6-2	Written disclosure of nature of relationship; no listed duty to disclose material defects
Vermont	26 Vt. Stat. Ann. 2296	Duty to inform buyer of agency relationship with seller; duty to disclose all known material facts to buyer
Virginia	Va. Code Ann. 54.1-2130 *et seq.*	Written disclosure of nature of relationship; duty to disclose to buyer all known adverse material facts
Washington	Rev. Code Wash. 18.86.010 *et seq.*	Duty to provide pamphlet regarding broker relationship (prescribed in statute); duty to disclose all known existing material facts
West Virginia	W. Va. Code 30-40-26	Written disclosure of nature of relationship
Wisconsin	Wis. Stat. 452.01 *et seq.*	A broker may not negotiate on behalf of a party without providing a form explaining the nature of the relationship (provided by statute); duty to disclose certain material adverse facts
Wyoming	Wyo. Stat. Ann. 33-28-301 *et seq.*	Written disclosure of nature of relationship; duty to disclose all adverse material facts actually known by broker

Appendix for Chapter 3

Appendix Table 3.1: OLS Analysis of Number of Real Estate Professionals Cases

	1950 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	-4.757	0.188	58.500	<0.001
Year	1.263	<0.001	-2.808	<0.001
R Square	0.677	-	0.785	-
Adjusted R Square	0.669	-	0.763	-
F – statistic	92.048	<0.001	36.486	<0.001

Appendix Table 3.2: Number of Real Estate Licensee Appeal Cases

Year	Real Estate Agent	Real Estate Broker	Real Estate Professionals (Real Estate Agent OR Real Estate Broker) Cases
1955	2	13	14
1956	3	9	10
1957	2	17	17
1958	5	16	19
1959	1	6	6
1960	1	4	4
1961	2	8	9
1962	1	7	7
1963	1	2	3
1964	2	8	9
1965	4	7	8
1966	1	3	4
1967	0	0	0
1968	1	3	3
1969	2	2	4
1970	2	3	3
1971	3	2	4
1972	0	1	1
1973	4	4	8
1974	2	14	15
1975	9	18	24
1976	2	19	21
1977	10	22	29
1978	10	21	29
1979	15	37	44
1980	16	45	56
1981	18	47	58
1982	23	36	49
1983	17	29	42
1984	29	36	60
1985	28	24	46
1986	23	35	52
1987	17	31	46

1988	24	32	50
1989	23	30	45
1990	27	31	53
1991	26	23	43
1992	25	24	41
1993	26	25	46
1994	34	28	54
1995	36	35	62
1996	31	30	57
1997	25	26	46
1998	36	22	51
1999	27	17	38
2000	30	8	38
2001	18	21	32
2002	29	13	38
2003	18	13	29
2004	25	13	33
2005	18	11	25
2006	21	16	34
TOTAL CASES	**771**	**990**	**1568**

Appendix Table 3.3: Regression Analysis of Number of Fraud or Misrepresentation Cases Involving Real Estate Agent or Broker over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	7.876	0.001	25.303	<0.001
Year	0.899	<0.001	-1.213	0.004
R Square	0.630	-	0.590	-
Adjusted R Square	0.610	-	0.549	-
F – statistic	32.293	<0.001	14.378	0.004

Appendix Table 3.4: Regression Analysis of Concealment Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	1.133	0.296	11.000	<0.001
Year	0.395	<0.001	-0.577	0.007
R Square	0.538	-	0.539	-
Adjusted R Square	0.513	-	0.493	-
F – statistic	22.093	<0.001	11.708	0.007

Appendix Table 3.5: Regression Analysis of Negligence Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	3.143	0.022	9.106	0.001
Year	0.234	0.030	-0.003	0.989
R Square	0.223	-	<0.001	-
Adjusted R Square	0.183	-	-0.100	-
F – statistic	5.468	0.030	<0.001	0.989

Appendix Table 3.6: Regression Analysis of Basements or Foundation or Structural or Floor or Wall Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	0.786	0.613	21.470	<0.001
Year	0.734	<0.001	-1.367	0.002
R Square	0.657	-	0.638	-
Adjusted R Square	0.639	-	0.602	-
F – statistic	36.469	<0.001	17.625	0.002

Appendix Table 3.7: Regression Analysis of Basements or Foundation Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	-0.581	0.629	10.561	<0.001
Year	0.486	<0.001	-0.612	0.005
R Square	0.583	-	0.564	-
Adjusted R Square	0.561	-	0.520	-
F – statistic	26.519	<0.001	12.940	0.005

Appendix Table 3.8: Regression Analysis of Roof over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	0	1	2.318	0.002
Year	0.182	<0.001	0.066	0.384
R Square	0.530	-	0.076	-
Adjusted R Square	0.506	-	-0.016	-
F – statistic	21.452	<0.001	0.828	0.384

Appendix Table 3.9: Regression Analysis of Sewer System over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	0.205	0.669	2.652	<0.001
Year	0.064	.107	-.203	0.0015
R Square	0.131	-	.464	-
Adjusted R Square	0.085	-	.411	-
F – statistic	2.86	.107	8.667	0.0015

Appendix Table 3.10: Regression Analysis of Water and Well Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	1.900	0.083	6.394	0.001
Year	0.191	0.032	-0.266	0.163
R Square	0.219	-	0.185	-
Adjusted R Square	0.178	-	0.103	-
F – statistic	5.335	0.032	2.266	0.163

Appendix Table 3.11: Regression Analysis of Termites or Rodents or Pests Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	0.738	0.224	3.333	0.003
Year	0.097	0.051	-0.154	0.215
R Square	0.186	-	0.149	-
Adjusted R Square	0.143	-	0.064	-
F – statistic	4.347	0.051	1.755	0.215

Appendix Table 3.12: Number of Drainage or Flooding Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	-0.700	0.277	3.273	0.001
Year	0.194	0.001	-0.119	0.241
R Square	0.443	-	0.135	-
Adjusted R Square	0.413	-	0.048	-
F – statistic	15.087	0.001	1.557	0.241

Appendix Table 3.13: Regression Analysis of Boundaries or Encroachment Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	1.690	0.011	2.621	<0.001
Year	0.045	0.355	-0.185	0.017
R Square	0.045	-	0.450	-
Adjusted R Square	-0.005	-	0.395	-
F – statistic	0.898	0.355	8.177	0.017

Appendix Table 3.14: Regression Analysis of Zoning or Code Violations or Tax Assessments or Home Owner's Association Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	2.171	0.042	8.455	0.001
Year	0.179	0.036	-0.493	0.063
R Square	0.212	-	0.304	-
Adjusted R Square	0.171	-	0.235	-
F – statistic	5.117	0.036	4.372	0.063

Appendix Table 3.15: Regression Analysis of Environmental Liability Cases over Time

	1975 – 1995		1995 – 2006	
Variables	**Coefficient**	**P Value**	**Coefficient**	**P Value**
Intercept	-0.119	0.729	2.788	<0.001
Year	0.058	0.043	-0.147	0.056
R Square	0.199	-	0.319	-
Adjusted R Square	0.156	-	0.251	-
F – statistic	4.710	0.043	4.685	0.056

Appendix Table 3.16: Frequency of Issues Alleged in Superior Court Complaints

Non-Commission Cases (2002-2006)	Percentage of Cases Containing Issues
Fraud	46.5%
Misrepresentation	47.5%
Breach of Contract	40.4%
Failure to Disclose/Conceal	25.3%
Breach of Fiduciary Duty	23.2%
Civil Conspiracy	4.0%
Foundation	12.1%
Basement	23.2%
Size/Boundary	4.0%
Flooding	6.1%
Sewer	8.1%
Septic Tank	4.0%
Termites	2.0%
Plumbing	5.1%
Electricity	6.1%
Heat	5.1%
Roof	10.1%
Hazardous Materials/Lead Paint	2.0%
Porch	2.0%
Zone	2.0%
conveyance/ marketable title	8.1%
Miscellaneous	45.5%
Punitive Damages	43.4%
Ohio Consumer Protection Act	1.0%
Escrow repayment	7.1%
Commission	0%

Appendix Table 3.17: Complaint Allegation Descriptions for Three Large Ohio Counties

Complaint Descriptions: Lucas County

0201543 – Lawson vs. West: Leakage in the basement, leakage on the porch, misrepresentation, failure to disclose, breach of contract, breach of fiduciary duty

0203083 – Chow vs. Mulopulos: Defective furnace, leaking roof, fire damage, breach of contract, concealed defects, misrepresentation, and punitive damages

0203597 – Rober vs. Nicholson: Negligent representation, leaking roof

0206187 – Polykandriotis vs. Green: Misrepresentation, heating leak, roof leak, concealed damage to floors & carpet, breach of contract

0206344 – Ramlow vs. Flex Realty: No public sewer

0301232 – Garland vs. Close: Misrepresentation, termite infestation, breach of fiduciary duty, failure to disclose, punitive damages

0302150 – Welles Bower vs. Wozniakowski: Slander/Libel (based on allegations of fraudulent concealment, flood damage)

0303881 – Glass vs. Keeler: Termite infestation, failure to disclose, concealed defect, breach of contract, fraudulent conveyance, negligent inspection, punitive damages

0305197 – Walters vs. Rose: Failure to close on sale, misrepresentation of mortgage

0403091 – Abbott vs. Loss Realty: Fraudulent representation of total square footage, breach of fiduciary duty

0502561 – Nicholson vs. Ulmer: Lead paint in house

0506854 – Winkler vs. Westhaven Group: Fraudulent mortgages

0506939 – Gabriel vs. Seagate Inspection: Negligent inspection, breach of contract, cracks in foundation (1st inspection showed no cracks, one year later revealed substantial damage)

0601607 – Beckett vs. Hartle: Misrepresentation, plumbing leaks, improper amps in electrical, defective roof, concealed mold, concealed evidence of leaks, defects in flooring, breach of contract, fraudulent concealment, punitive damages

0603050 – Gildemeister vs. Goldin: Breach of contract, failure to deliver marketable title

0603169 – Danberry Co. vs. Spring Forest: Breach of contract, failure to pay commission, interference with sale

0605553 – Michael Realty vs. Moore Inc.: Failure to pay broker's fee

0606852 – Juscot Realty vs. McCauley: Breach of fiduciary duty, violation of trade secrets, conversion & misappropriation of trade secrets, unfair competition, interference, slander, punitive damages

CL0301160 – Szigeti vs. Loss Realty: (appeal from arbitration) Failure to pay broker's fees

Complaint Descriptions: Cuyahoga County

462098 - Kresic vs. Shpeb: Breach of contract, escrow repayment

462549 - George vs. Realty One, Inc.: Failure to disclose, breach of fiduciary duty, misrepresentation, basement leakage, civil conspiracy, fraud, punitive damages

462714 - Raifsnider vs. Realty One, Inc.: Misrepresentation, fraud, failure to disclose, septic could not be installed on property, punitive damages

462849 - Ardary vs. Stepien: Breach of contract, misrepresentation, fraud, septic backups, punitive damages

474143 - Angelotta vs. Century 21 Timeshare: Misrepresentation of offer price, fraud, punitive damages

474668 - Randall vs. Coldwell Bank-Hunter Realty: Breach of contract (D contracted to watch house after P moved and keep it in good repair until sale, didn't turn on heat, pipes froze and exploded, house lost a lot of value due to damages), punitive damages

476290 - Invesco Management Co. vs. Frisco: Breach of fiduciary duty, tortious interference, fraud, failure to return escrow

477230 - Poole vs. Marshall-Robertson: Misrepresentation, fraud, failure to disclose, sewer problems, basement leakage, flooding, roof problems, porch collapsed, electric damage

477454 - Norris vs. Miller: Failure to convey, escrow repayment

477938 - Milano vs. Graham: Breach of contract, failure to provide able and willing buyer, misrepresentation of buyer's credit

478354 - Marinescu vs. Crete Properties: Misrepresentation of value of property, civil conspiracy, fraud, punitive damages

480104 - Klima vs. Elite Realty Co.: Failure to disclose, lead paint, punitive damages

483602 - Grabovez vs. Venedetti: Breach of contract, escrow repayment

484439 - Grubb & Ellis vs. Ashley Associates: Brokerage fees

486010 - Bauer vs. Graham: Breach of fiduciary duty, malpractice, reliance upon agency in determination of credit-worthiness of buyer

490314 - Li vs. Stanek: Breach of fiduciary duty, fraud, misrepresentation of value of house, misrepresentation of builder of house, misrepresentation of square footage, breach of contract

491196 - Ellis vs. Eldridge Mortgage Co.: Breach of contract, misrepresentation (agent represented buyer as able and willing)

492489 - Ramos vs. Rogers: Failure to disclose, failure to convey quiet enjoyment (tenant still lived on property at closing), failure to provide warranty

493401 - Placko vs. Anderson: Failure to close, failure to pay escrow to P upon breach of contract

495211 - French vs. Kuzlik: Failure to disclose, fraud, misrepresentation, basement leakage, damage to floor, mold, punitive damages

498112 - Nguyen vs. Riganti-Fulginei: Failure to deliver property, misrepresentation of real estate taxes

498413 - Salters vs. Stewart Title Guarantee Co.: Failure to convey marketable title

500632 - Ghose vs. Morales: Failure to disclose, fraud, foundation problems, basement leakage, ineffective furnace, plumbing leakage, misrepresentation, punitive damages

501028 - Realty One, Inc. vs. Ciofani: (interpleader) Failure to close, doesn't know which party breached to return escrow

502385 - Hart vs. Huntley: Misrepresentation, fraud, failure of improvements to comply with building code, failure to disclose, electrical problems, heating problems, drywall problems, roof leakage, foundation problems, basement leakage, improper drainage, punitive damages

503130 - Highlands Business Park LLC vs. Grubb & Ellis: Brokerage fees

503182 - Knarr vs. Streicher: Failure to disclose, basement leakage, cracks in foundation, fraud, breach of contract, breach of warranty, punitive damages

503345 - Boyd vs. Realty One, Inc.: Failure to close, failure to provide quiet enjoyment (owner wouldn't leave), concealment of alteration of premises after contract signing, breach of fiduciary duty, failure to disclose (didn't say that owner was unstable)

505621 - Diamond vs. Household Realty Corp.: Misrepresentation, fraud, concealment of scope of damage in structure and foundation

505712 - Taylor vs. Crum: Breach of contract, escrow repayment

507237 - Salerno vs. Leprovost: Breach of contract, fraud, misrepresentation, civil conspiracy (there was not a fence or a wood-burning stove as advertised)

509744 - Patton vs. Leo Baur Realty: Fraud, withholding of able and willing buyer until after closing date, punitive damages

510375 - Boyne vs. Simonetta: Fraud, concealment of black mold, water damages, basement leakage, misrepresentation

513672 - Gallagher vs. Thomas: Failure to disclose, fraud, flooding, basement leakage, foundation problems, duress to chimney, punitive damages

514627 - Jasper vs. Smokler: Breach of contract, failure to close, failure to inform, breach of fiduciary duty, punitive damages

518773 - Craig-Cochran vs. Homestar Mortgage: Breach of contract, failure to close (by seller), unconscionable lending, punitive damages

529213 - Ford vs. Kings Path Condominium Association: Failure to rebuild properly after fire

529301 - Molnar vs. Realty One, Inc.: Misrepresentation (flooring listed as hardwood but area under dining room rug was plywood), punitive damages

531571 - Drlik vs. Trombetta: Failure to disclose, basement leakage, punitive damages

534625 - Gibson vs. Jennie Chiccola Realty: Breach of fiduciary duty, contract misrepresentation, breach of contract

536511 - Berry vs. Booher: Fraud, failure to disclose, slippage in foundation, punitive damages

537183 - Oke vs. Realty One, Inc.: Misrepresentation of square footage, punitive damages

538922 - Staso vs. Davis: Failure to close, misrepresentation, breach of fiduciary duty, punitive damages

540118 - Johnson vs. Rotar: Fraud, misrepresentation, basement leakage, water damage

542451 - Schuchart vs. Hovan: Failure to screen buyer's credit worthiness

544084 - Shulman vs. Shoni: Breach of contract, fraud, breach of fiduciary duty, misrepresentation of drainage on property

569060 - McPherson vs. McCartney: Failure to disclose, foundation damage, basement leakage, flooding, fraud, breach of contract, misrepresentation, breach of fiduciary duty, civil conspiracy, punitive damages

570191 - Century 21 Trammell-O'Donnell vs. Antoinett Dottore: Brokerage fees

574345 - Russell Realtors vs. Anthony Gaffney: Brokerage fees

574575 - West vs. Lowe: Basement damage, predatory lending, punitive damages

576695 - Peters vs. Bristol: Misrepresentation, fraud, foundation problems, basement leakage, water damage, holes in chimney wall, concealment of mold, punitive damages

579207 - Bencivenni vs. Dietz: Misrepresentation of value of property, leaking roof, heating problems, concealment of water damage in basement, fraud, failure to disclose, punitive damages

579390 - Gibson vs. Jennie Chiccola Realty: Fraudulent inducement to purchase (thought he was signing a credit application, not a purchase contract), basement leakage, water damage

579845 - Karim vs. Dibiase: Breach of contract, basement leakage, mold, failure to disclose, fraud

584097 - Becker vs. Edmiston: Failure to disclose, basement leakage, plumbing leakage, shifting foundation, ice damming, sewer overflow, flooding, misrepresentation, fraud, breach of contract, punitive damages

584809 - Realty One, Inc. vs. Bennis: Brokerage fees

584837 - Staso vs. Huperts: Breach of fiduciary duty, breach of contract (realty told P to vacate in order to close when they had knowledge that there was no closing), punitive damages

585512 - Hadley Investments, Inc. vs. Chung: Failure to use best efforts to sell property, failure to monitor buyer's actions, punitive damages

588032 - Specialty Painting, Inc. vs. Keller Williams Realty: Breach of contract (failure to pay contract price for work done prior to closing)

588520 - Cleveland vs. Ibrahim: Breach of fiduciary duty, failure to indemnify in lawsuit

600045 - Ibrahim vs. Ristas: Breach of fiduciary duty (P was willing to sell, but D made

representation to buyers of P's unwillingness to sell), punitive damages

600288 - Ohio 2034 LLC vs. Redden: Breach of contract, failure to close, attempted price gouging, punitive damages

601486 - Cozzens vs. Pittman: Misrepresentation, no public sewer, punitive damages

603197 - Ultimate Wash, Inc. vs. Chicago Title Co.: Clouded title

610750 - Erie Insurance Group vs. Wolke: Failure to convey

610857 - Lloyd vs. Misch: Fraudulent concealment of defects, misrepresentation, breach of fiduciary duty

611415 - West vs. Lowe: Basement flooding, misrepresentation, civil conspiracy, violation of Ohio Consumer Sales Practice Act, breach of contract, fraud, unjust enrichment

613573 - Zyla vs. Oroz: Fraud, misrepresentation, breach of contract, misrepresentation of zoning ordinance, sewer problems, basement leakage, punitive damages

616474 - All Star Development, Inc. vs. Krueger: Breach of contract (wrongful termination)

623471 - Amato vs. Chandler's, Inc.: Breach of contract (failure to close on transaction in a seasonable time), fraud, misrepresentation, violation of Ohio Consumer Sales Practice Act, punitive damages

Complaint Descriptions: Franklin County

02-CV-009498 – Donmoyer vs. Fancil: Tortious interference (HER Realty), punitive damages

03-CV-05716 – Grier vs. Sergio: Fraud, misrepresentation, electrical problems, roof problems, plumbing problems, punitive damages

03-CV-09912 – Wanke vs. Pearson: Breach of contract (seller's agent sent letter to buyer's agent informing him that he was ready to sell without approval by seller; buyer sued seller, this is an indemnity complaint)

04-CV-05437 – Adkins vs. Walker: Fraud, misrepresentation, breach of fiduciary duty, foundation, soil conditions, punitive damages

05-CV-05155 – Hyder vs. Ward: Breach of contract, misrepresentation, sewer

05-CV-05750 – Ohio Civil Rights Commsn. Vs. Continental Real Estate: Violation of R.C. Chapter 4112 (discriminatory practice towards individual because of disability)

05-CV-09008 – Kleski vs. German Village Holdings, Ltd.: Misrepresentation, breach of fiduciary duties, roof problems

05-CV-09344 – Jacques vs. Peters: Fraud, breach of contract, breach of fiduciary duty, failure to disclose, foundation problems and grading

05-CV-10680 – Puhr vs. Edwards: Indemnification, fraud, misrepresentation, misrepresentation of square footage, punitive damages

05-CV-12458 – Grassley vs. Lamb: Fraud, misrepresentation, failure to disclose, breach of contract, sewer problems, punitive damages

05-CV-14209 – Vitullo vs. Faiello: Fraud, odor in crawlspace, leak in crawlspace, punitive damages

06-CV-05379 – Dietz vs. Paras: Fraud, misrepresentation, zoning issue (commercial), punitive damages

06-CV-06103 – Butler vs. Johnson: Fraud, misrepresentation, septic problems, electrical problems, punitive damages

06-CV-09122 – Kramp vs. Michael: Fraud, misrepresentation, basement flooding, punitive damages

06-CV-10207 – Remias vs. Doddridge: Fraud, misrepresentation, sewer, septic, punitive damages

06-CV-14886 – Brewer vs. Leeman: Fraud, misrepresentation, breach of contract, breach of fiduciary duty, unjust enrichment, roof problems, basement leakage, electrical, punitive damages

07-CV-04755 – Borstein vs. Kanas: Breach of contract, breach of fiduciary duty (instructed seller to sign an offer directly with buyer in violation of the relocation company's requirements)

07-CV-05673 – Dye vs. Hulse: Negligence, personal injury while viewing a house