

REAL ESTATE ERRORS AND OMISSIONS CLAIMS STUDIES

Rice Insurance Services Company, LLC (RISC) specializes in real estate errors and omissions (E&O) insurance. RISC manages group programs for the vast majority of states that require real estate licensees to maintain E&O insurance. RISC's in-house claims adjusters handle all claims under our programs.

Even experienced real estate licensees may face a claim (a written demand, institution of arbitration or mediation proceedings, or service of a lawsuit seeking damages and alleging a negligent act, error, or omission in the licensee's professional services). Often, the licensee did nothing wrong but is the victim of a frivolous claim from a disappointed buyer or seller. When there is a lawsuit, certain steps must be taken to comply with court rules and protect a party's position. Even for frivolous claims, defense costs sometimes reach tens of thousands of dollars.

For the following examples, assume each involves a claim covered under the terms of the insurance policy. Because every claim is unique, coverage cannot be determined until a claim is actually made and reported to the carrier in writing.

I. CLAIM STUDY – DRAINAGE ISSUE: After the seller's husband passed away, she decided to sell the house they'd lived in for decades and move closer to her daughter. The seller contacted a friend with more than 20 years' experience as a real estate licensee to list the property.

After meeting the seller at the home, the listing agent emailed the seller a disclosure form and explained in the email the importance of thoroughly and accurately completing the form. The seller marked "Yes" to the following questions on the disclosure form: "Has the basement leaked at any time while you lived in or owned the property?" and "Have any repairs been done to the basement?" The seller also wrote on the disclosure form that a basement leak had been repaired by Basement Systems and there was a transferrable warranty. The listing agent emailed a copy of the disclosure form to the buyer's agent, who returned a copy signed by the buyer.

After a few weeks on the market, the buyer made an offer. The buyer obtained a home inspection, which revealed an issue with the downspout that did not drain away from the home. The inspection also indicated there was moisture in the basement. The buyer also obtained a structural inspection, which found the home was in good structural condition but did note several cracks from normal settlement.

More than four years after the closing, the property flooded during a major storm, leaving more than two feet of water in the basement. The buyer sued the seller and listing agent for allegedly failing to adequately disclose prior drainage issues and water intrusion. The buyer sought more than \$90,000 to regrade the property so it sloped away from the home and to repair damage to the home. The listing agent immediately reported the claim in writing to her E&O insurance carrier.

Result: The listing agent's E&O carrier retained an attorney to represent her and incurred more than \$8,500 in defense costs. After more than a year of litigation, the case settled for \$2,500 from the insurance carrier on the insured's behalf and \$2,500 from the seller. Several facts strengthened the insured's position:

1. She had an email showing she informed the seller of the importance of completing the disclosure form completely, thoroughly, and honestly.
2. She maintained a copy of the disclosure form signed by the buyer, which shows the plaintiff was on notice of the prior water in the basement before closing and chose to proceed anyway.
3. The buyer's home inspection revealed moisture in the basement, further evidence that the plaintiff was on notice of the potential of water in the basement and chose to close anyway.

Takeaways: Documented evidence is a valuable defense tool. Without documented evidence, it is often difficult to establish proof to validate either party's version of events.

II. CLAIM STUDY – DEAL FELL THROUGH: Abe Agent met Steve Seller at the property, a large, rural lot. Steve represented he owned the property with his brother. Steve said he thought he had power of attorney to handle the transaction for his brother who lived out of the country. Abe asked Steve to get him a copy of the power of attorney, and Steve said he would. Steve signed the listing agreement on his and his brother's behalf, and Abe went ahead and listed the property.

Becky Buyer contacted Abe to view the property. Becky and Steve signed a dual agency disclosure and entered into a contract signed by Becky as the buyer and by Steve on his and his brother's behalf as sellers. Becky hired a well-known architect to draw plans for a custom home and barn on the property.

When the closing was scheduled, the closing company asked Abe for a copy of the power of attorney. Abe realized he never received it and asked Steve for a copy. Steve searched his records but could not find one. The closing company drafted another for Steve's brother to sign. However, Steve's brother was unhappy with the contract price and refused to sign the power of attorney.

Becky demanded the sellers sell the property in accordance with the contract; however, that was impossible without Steve's brother's agreement. Becky sued Abe and Steve. She argued Abe should have verified the property could be sold, since she represented her (in addition to Steve) in the transaction. She claimed to have spent nearly \$20,000 for due diligence and architectural plans. Abe immediately reported the claim in writing to his insurance carrier.

Result: Abe's insurance carrier retained an attorney to defend him and spent more than \$10,000 in defense costs. The claim ultimately settled at mediation, with Abe's insurance carrier paying \$7,000 on his behalf. Steve also contributed to the settlement.

Takeaways: When there are multiple sellers, one often takes the lead in communications. In this case, Abe knew there were two sellers, but only communicated with one. While Abe had no reason to think Steve had not discussed selling the property with his brother, he did not attempt to verify that before listing the property. He also did not follow up on his request for a copy of the power of attorney, even though Steve said he "thought" there was one.

Powers of attorney, trusts, and estates have specific legal issues that may be outside of most licensees' expertise. Even if Steve had a power of attorney, it would have been wise for Abe to advise him and his brother to consult with an attorney to confirm it was sufficient for their goals.

III. CLAIM STUDY – FAILURE TO SUBMIT OFFER: Blair Broker represented the seller of a home in a desirable neighborhood. On June 1, a couple looked at the property and made a \$325,000 offer the same day. The following day at 3:00 p.m., without calling first, another real estate agent emailed Blair a \$350,000 offer with several contingencies on behalf of another potential buyer.

Unfortunately, Blair did not see that email before meeting with the seller, who signed a counteroffer of \$340,000 to the first couple. Blair emailed the counteroffer to their real estate agent on June 2 at 6:00 p.m. The couple accepted it and their agent emailed Blair the fully executed contract on June 2 at 8:00 p.m. The couple was to pay cash and there were no contingencies.

The next morning, Blair's heart sank when she saw the email with the \$350,000 offer. She immediately called the seller and explained what happened. Blair contacted the second potential buyer's real estate agent and asked if they wanted to enter into a backup contract in case the first contract did not close, but they did not.

The first couple purchased the property for \$340,000. The seller sent Blair a demand letter alleging she was negligent in not seeing the other offer or sending it to the seller before he made the counteroffer to the first couple. The seller sought \$10,000, the difference between the first contract and the second offer. Blair immediately reported the claim in writing to her insurance carrier.

Result: Blair's insurance company paid \$5,000 on her behalf to settle the claim. The second offer had several contingencies, so even if the property was not already under contract, the second offer might not have resulted in a closing.

Takeaways: In today's world, many professionals are inundated with emails and other communications throughout the day. It's important to keep up with professional emails even though it sometimes feels impossible.

IV. CLAIM STUDY – SERVICE ANIMAL: Olivia Owner retained Mike Manager to help her locate a tenant for a house she owned. A man called Mike and asked to look at the property. Mike showed him the home, and the man wanted to lease it.

On the rental application, the man indicated he had two children, one with a service dog trained to detect upcoming seizures. Mike told him a pet deposit and monthly pet fee would be required for the dog. The man rented the home. After living there several months, he filed a complaint with the local Housing and Urban Development (HUD) office. He alleged Mike violated fair housing laws and sought return of the pet deposit and all pet fees paid. Mike immediately reported the claim in writing to his insurance carrier.

Result: In this case, Mike's insurance coverage included limited discrimination coverage of \$10,000.00 for damages and claim expenses, combined, per discrimination claim and in the aggregate. Mike's insurance carrier paid an attorney \$5,000 to represent him in connection with the HUD complaint. After consulting with the attorney, Mike advised the property owner it would be wise to discontinue charging fees for service animals on any rental properties. The carrier ultimately paid the tenant \$2,500 on Mike's behalf to settle the claim.

Takeaways: Discrimination claims were traditionally not covered under real estate E&O policies, because it would be against public policy to encourage discrimination. However, as this example demonstrates, discrimination claims sometimes arise due to a licensee's lack of familiarity or misunderstanding of fair housing laws. Frivolous discrimination claims also sometimes arise. Accordingly, most of the policies we administer now include limited coverage for discrimination claims. It's important to check your policy to determine if it includes discrimination coverage. If so, you should review your policy to determine the amount of coverage and whether it applies to damages, claim expenses, or both.

These examples help illustrate the type of claims that might be made against a real estate licensee. While you don't have to do anything wrong to be involved in a claim, sound risk management techniques and good documentation can help avoid claims and reduce payments.

Note, these are examples of types of claims encountered by Rice Insurance Services Company, LLC in the handling of real estate errors and omissions claims in numerous states. Specific facts and circumstances may have been altered. Information current as of March 7, 2019. This information is for illustrative purposes only and is not a contract. Nothing herein should be construed as legal advice or advice regarding any applicable standard of care. Rather, this information is intended to provide a general overview of certain products, services, and situations encountered in the course of our business. This information does not amend any E&O policy in any way. Only the policy can provide actual terms, coverages, amounts, conditions, and exclusions. The program referenced herein is underwritten by Continental Casualty Company, a CNA insurance company. The E&O program described herein is only available in certain states. CNA is a registered trademark of CNA Financial Corporation. Copyright © 2019 CNA. All rights reserved. Prepared by Rice Insurance Services Company, LLC © 2019