Real Estate Agents' Liability for Negligent Misstatement

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Abstract

During the process of selling or leasing a property, a real estate agent may make statements about the property which later turn out to be false (incorrect). This article examines the liability of real estate agents in the tort of negligence for the making of false statements. Cases discussed are *Shaddock & Associates Pty Ltd* v *Parramatta City Council* (1980-1981) 150 CLR 225, *Norris* v *Sibberas* (1989) Aust. Torts Reports 80-288, *Richard Ellis (W.A.) Pty Ltd* v *Mullins Investments Pty Ltd (in liq)* (1995) Aust Torts Reports 81-309 and *Rawlinson & Brown Pty Ltd* v *Witham* (1995) Aust Torts Reports 81-341.

Introduction

In the course of selling or leasing a property, a real estate agent makes statements to the intending purchaser about the property. Property in this context includes not only real property, but also those sales of property that incorporate a business component, for example the sale or lease of a going concern such as a shop or farm. After the sale, it may emerge that statements made by the real estate agent were false (incorrect). If the purchaser considers that, as a result of the false statement, the property is worth less than the amount actually paid for it, the purchaser may seek compensation from the real estate agent.

Should there be a contract between the real estate agent and the purchaser, the purchaser may sue in contract. It is more likely, however, that there is no contract between the real estate agent and the purchaser, and in that case the purchaser must turn instead to the tort of negligence. A tort is a civil wrong in those situations where the law determines the rights and obligations of the parties.[1]

Even where there is a contract, suing in tort may be preferable for a plaintiff purchaser. In contract, the limitation period[2] commences when the contract is breached, and the resultant damage may not be immediately obvious. In tort, the limitation period starts when the damage is discovered. In addition the assessment of damages may be more advantageous to the plaintiff purchaser in a tort action.

This article examines the liability of real estate agents in the tort of negligence, negligent misstatement simply being a form of negligence. The tort of negligence concerns those situations where the negligent act of one party causes damage to another and the law, in certain circumstances, deems that the loss be shifted from one to the other. The first part examines negligent misstatement generally and the second part looks at some cases involving real estate agents.

[1] This is in comparison to the law of contract, which may also be categorised as a civil wrong, but here the parties themselves have decided upon their mutual rights and obligations.

[2] This is the period within which a plaintiff must commence an action. In Western Australia the limitation period for tort and contract is six years: *Limitation Act* 1935 (W.A.), s38.

Part One - The legal requirement in a negligent misstatement action

The plaintiff, the purchaser, in a negligent misstatement action must prove the following:

- that the defendant, here the real estate agent, owes the plaintiff a duty of care (the duty of care);
- that the defendant has failed to conform to the required standard of care (the standard of care); and
- that there has been material damage to the plaintiff (damage), caused by the defendant and which is not too remote.

Duty of care (the legal duty to be careful)

Fleming defines the duty of care as '… an obligation, recognised by law, to avoid conduct fraught with unreasonable risk of danger to others.'[3] The history of the duty concept shows that the courts have always envisaged that there must be a closeness between the parties, a relationship neatly crystallised in Lord Atkin's 'neighbour' speech in *Donoghue* v *Stevenson.*[4] Lord Atkin said: 'You must take reasonable care to avoid acts or omissions which you can reasonably foresee would be likely to injure your neighbour'.[5]

Where the 'damage' suffered by the plaintiff is personal injury, or damage to property, the courts generally have no difficulty in finding that a duty of care exists. In these cases the nature of the damage demonstrates that there must have been at least a physical closeness between the parties at some point. Traditionally, however, the courts have been reluctant to compensate for pure economic loss, i.e., where the negligent act causes no personal injury or damage to property and the loss is a financial one only. Pure economic loss is often caused by negligently given advice or information (a negligent misstatement or a negligent misrepresentation). This is the situation that arises when a real estate agent makes a false statement (the negligent act) to a purchaser.

The plaintiff in pure economic loss cases may lose the case on the basis that there is no duty of care owed by the defendant to that plaintiff because the court decides that their relationship is not sufficiently close. The reason for this judicial reluctance to impose a duty of care is the fear of 'opening the floodgates' to all manner of claims for financial loss.[6] This reluctance does not necessarily extend to the relationship between real estate agents and purchasers. Some decisions, which will be examined further below, have found that, in the circumstances, a duty existed between the parties.[7] A number of judgments in negligence cases against real estate agents refer to *Shaddock & Associates Pty Ltd* v *Parramatta City Council*,[8] which did not involve a real estate agent as a party, but did involve the sale of real property. Reference is made in particular to the following passage on negligent misstatement in the judgment:

> It would appear to accord with general principle that a person should be under no duty to take reasonable care that advice or information which he gives to another is correct, unless he knows, or ought to know, that the other relies on him to take such reasonable care and may act in reliance on the advice or information which he is given, and unless it would be

[3] J. Fleming, *The Law of Torts* (1998) Sydney, 149.
[4] *Donoghue* v *Stevenson* [1932] AC 562.
[5] *Donoghue* v *Stevenson* [1932] AC 562, 580.
[6] This is best expressed by Cardozo CJ in respect of the liability of accountants and auditors to third parties in *Ultramares Corp.* v *Touche* 174 NE 441, 444 (N.Y. 1931). Cardozo CJ refers to '… a liability in an indeterminate amount for an indeterminate time to an indeterminate class'.
[7] See, for example, *Richard Ellis (W.A.) Pty Ltd* v *Mullins Investments Pty Ltd (in liq)* (1995) Aust Torts Reports 81-319, 62,083; *Rawlinson & Brown Pty Ltd* v *Witham* (1995) Aust Torts Reports 81-341, 62,405-62,406.
[8] *Shaddock & Associates Pty Ltd* v *Parramatta City Council* (1980-1981) 150 CLR 225.

> reasonable for that other person so to rely and act.[9]

In *Shaddock's* case the High Court found the Parramatta City Council liable to the plaintiff developer for failing to advise of road widening plans in existence at the time of the purchase by the plaintiff of a development property. The facts of the case were that the plaintiff's solicitor had submitted a form to the Council in application for a certificate under s342AS of the *Local Government Act* 1919 (N.S.W.). The form asked whether there were any road widening proposals affecting the property, to which the Council made no response. As it was the usual practice of the Council to make a notation on the certificate if such proposals did apply, the solicitor assumed that the property was clear and the purchase went ahead. The developer sued the Council, losing at first instance and on appeal to New South Wales Court of Appeal Division, but won in the High Court. A total of $173,938 damages were awarded. This was made up of $133,000 for the difference in price between the actual value of the property and the price paid by the developer, an amount of $18,745 for consequential damage, including, for example, such items as Council rates, land tax, insurance, stamp duty, and an interest component of $22,193.

Standard of care (how careful is careful enough?)

This is the negligence part of a negligence action. The required standard of care expected of a defendant is reasonable care. Reasonable care is determined by objective standards:

> … in other words, the appropriate standard is not that which the defendant *could* have reached, but rather the standard which the law says *should* have been reached.[10]

As Fleming points out, 'This means that individuals are often held guilty of legal fault for failing to live up to a standard which as a matter of fact they cannot meet.'[11]

In certain instances the law does allow the particular circumstances of the defendant to be taken into account. This is relevant in the context because 'skill' is one such circumstance and a real estate agent holds him/herself up as having a special skill. The skill may relate to property transactions in general, or to specialised property transactions such as the sale or lease of commercial properties or the sale or lease of farming properties. The defendant real estate agent's work will be judged in comparison with the standard of competence expected of a reasonable real estate agent, or specialist real estate agent, not how the reasonable person in the street would have acted, nor what the particular defendant regards as a reasonable standard.

Expert evidence is called by both sides to illustrate what is a reasonable standard of competence in that particular profession or calling. Where there are regulations governing a profession, whether the regulations are imposed by the profession itself or by statute, the courts usually regard these as a minimum standard. Failure to conform will almost certainly mean the defendant has not reached the required standard of care. Conformance, however, does not necessarily mean the defendant has been careful enough. The same principles apply to compliance with custom and accepted commercial standards. The High Court made it clear quite a long time ago that compliance with accepted standards would not necessarily exonerate the defendant from liability.[12]

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[9] *Shaddock & Associates Pty Ltd* v *Parramatta City Council* (1980-1981) 150 CLR 225, per Gibbs CJ 231. This passage is quoted in *Rawlinson & Brown Pty Ltd* v *Witham* (1995) Aust Torts Reports 81-341, per Kirby P 62,405 and in *Norris* v *Sibberas* (1989) Aust. Torts Reports 80-288, per Marks J 69,059.

[10] F. Trindade and P. Cane, *The Law of Torts in Australia* (1999) Melbourne, 436.

[11] Fleming, supra n., 119.

[12] *Mercer* v *Commissioner for Road Transport* (1937) 56 CLR 580, 589. For a more recent decision, see also *Rogers* v *Whitaker* (1992) 175 CLR 479, per Mason CJ,

Damage

The third element the plaintiff has to prove is that the plaintiff has suffered damage, i.e. the plaintiff has suffered material injury caused by the negligent act of the defendant (causation) and such damage is not too remote (remoteness). The damage, or material injury, claimed in negligent misstatement cases involving real estate agents is most likely to be monetary compensation to make up the difference between what the property is actually worth, compared with the price paid by the plaintiff purchaser.

Causation

Causation requires the plaintiff to show that the defendant's negligence - in the present context the false statement made by the real estate agent - caused, or materially contributed to, the plaintiff's loss. This may be established by using the 'but for' test: the question asked is, 'Would the plaintiff's loss have occurred 'but for' the defendant's negligence?'[13] If the loss would have occurred even if the defendant had not been negligent, the defendant is not liable.

Remoteness

Where the defendant's negligence has caused the plaintiff's injury, the plaintiff is only compensated where the damage caused by the defendant was reasonably foreseeable. Consequences are reasonably foreseeable if they are the result of the occurrence of a risk which the reasonable man would describe as 'real' (even 'if remote') rather than 'far fetched'.[14]

Defences

There are two possible defences to a claim in negligence. The first, voluntary assumption of risk, can be equated to consent. It is based on the proposition that the plaintiff has waived his/her rights to complain of the damage suffered, for example injuries resulting from the normal rough and tumble of contact sports. If the court finds that voluntary assumption of risk applies, the plaintiff loses the case.

The second defence, contributory negligence, allows apportionment of damages. This means that the judge is able to reduce the damages by however much the plaintiff is deemed to have contributed to his/her own injury. Contributory negligence occurs where there is a failure by the plaintiff to meet the standard of care for his/her own protection and that failure is a legally contributing cause together with the defendant's negligent act in bringing about the injury. An example is where injuries in a car accident are worsened by not wearing a seat belt.

Part Two

This part examines three Australian cases where a purchaser has sued a real estate agent for negligent misstatement.

Norris v Sibberas[15]

The plaintiffs, Mr and Mrs Sibberas, purchased a motel and milk bar in Bonnie Doon near Mansfield in Victoria. They had no previous experience in running any kind of business. The defendants were a real estate agent, Mrs Norris (Norris), and the company for whom she worked, John S Bell & Co. At the time of the purchase the motel and milk bar were nearly new, having only been in existence for eleven weeks, and were operating unprofitably. The plaintiffs were aware of this. The amount of the purchase price apportioned to goodwill was very low, $16,000 of the total $110,000.

Before the plaintiffs signed the contract documents, Norris (who said that she had sold many motels and had owned several herself) made certain representations about

Brennan, Dawson, Toohey and McHugh JJ 483 and 487-488.

[13] *EH March* v *Stramare* (1990-1991) 171 CLR 506, per McHugh J 533-534.

[14] *Overseas Tankships (UK)* v *Miller SS Co* [1967] 1 AC 617, 643.

[15] *Norris* v *Sibberas* (1989) Aust. Torts Reports 80-288.

the business, describing it as a 'once in a lifetime opportunity' and saying 'once you get going it will be a gold mine'.[16] The plaintiffs also sought the advice of an accountant on the viability of the business, but signed the contract before receiving any formal statement from the accountant. The plaintiffs' solicitor rang the accountant just prior to the signing and received some positive comments that influenced the plaintiffs to go ahead with the purchase. The plaintiffs ran the businesses unprofitably for three months, then put them on the market.

The plaintiffs sued the real estate agent and the accountant for negligent misstatement. The trial judge found the real estate agent liable and the accountant not liable. All parties appealed, but the plaintiffs later dropped their cross-appeal against the accountant.

The Full Court of the Supreme Court of Victoria allowed the appeal by the real estate agent. The leading judgment said that the required degree of proximity is established by 'reliance', and the evidence pointed to the plaintiffs relying on the advice of the accountant for matters relating to the financial viability of the businesses.[17] In addition, the comments Norris made about the business being a 'gold mine' were predictive and, for fulfilment, required effort on the part of the plaintiffs. The plaintiffs were aware of this, and three months was not time enough to test the potential of the business. As a result the court found that 'the plaintiffs failed to establish that Norris made to them a misstatement or that, if she owed a relevant duty of care, she breached it'.[18] Leave to appeal to the High Court was refused.

[16] *Norris* v *Sibberas* (1989) Aust. Torts Reports 80-288, 69,054.
[17] *Norris* v *Sibberas* (1989) Aust. Torts Reports 80-288, per Marks J 69, 061.
[18] *Norris* v *Sibberas* (1989) Aust. Torts Reports 80-288, per Marks J 69, 062.

Richard Ellis (WA) Pty Ltd v Mullins Investments Pty Ltd (in liq)[19]

The plaintiff company, Mullins Investments Pty Ltd (in liq) (Mullins) was the lessee of two offices (the original offices) on the 6th and 7th floors in Australia Place in William St, Perth. The defendant company, Richard Ellis (WA) Pty Ltd (Richard Ellis), a real estate agent and valuer, was the property manager for Australia Place. Mullins wished to consolidate the office and was offered some alternative space on the 6th floor of Australia Place, occupied at the time by Citibank (the Citibank space).

During the inspection of the Citibank space, which took place in September 1987, Mullins made it clear to the defendant's representative, Mr Swale (Swale), that there would be no commitment unless the original offices were re-let. Mullins sought the advice of Swale on the prospects of re-letting the original offices and this advice was provided in a letter dated 21 September 1987. The critical part of the letter states:

> … we would suggest that you proceed with the commitment on the Citibank space. As you would appreciate, it will probably take about 2 months before you are actually in the Citibank premises, thus allowing you this period to secure a tenant

[19] *Richard Ellis (W.A.) Pty Ltd* v *Mullins Investments Pty Ltd (in liq)* (1995) Aust Torts Reports 81-319

> for the abovementioned areas. This, we believe, would give you ample time to lease the 6th floor although it may take somewhat longer for the 7th.[20]

The 'somewhat longer for the 7th' was taken to be an additional month. There was no suggestion that this advice was negligent in the circumstances. On 24 September 1987 Mullins notified Swale that Mullins would commence negotiations on sub-leasing the Citibank space. The stock market crashed on October 19th 1987, resulting in a reduction in demand for commercial office space. The formal offer to sub-lease the Citibank space was made by Mullins on 4 November 1987. Mullins proceeded with the move to the Citibank space in January 1988.

The events of the following two or so years are complicated, but in essence no tenants were found for the original offices. Mullins later sued Richard Ellis, claiming that there was a continuing duty of care with respect to the advice given by Richard Ellis. Mullins alleged that as a result Richard Ellis had been negligent in failing to amend its advice with respect to the leasability of the original offices after the stock market crash.

At the trial Richard Ellis conceded that it owed Mullins a duty to take reasonable care with respect to the advice given, but the trial judge accepted that the advice was reasonable at the time.[21] The trial judge found for Mullins, on the basis that the advice had 'a continuing effect and operation'.[22] The Full Court of the Supreme Court of WA disagreed, saying there was no reliance by Mullins on the advice at the time that the formal offer was made on 4 November. This was because the formal offer was made when Mullins 'either knew that neither floor had been let or did not know whether or not either of them had been let … in neither case was there any reliance on the representation'.[23]

Rawlinson & Brown Pty Ltd v Witham[24]

The defendant in this case, Rawlinson & Brown Pty Ltd (Rawlinson), was a stock and station agent in the Riverina in NSW, and a Mr Owers (Owers) was one of their representatives. In 1982 Rawlinson was engaged to sell a farm on which there was a bore that the vendors told Owers had a capacity of 21 megalitres per day (mpd). The bore broke down in 1983 and, following repairs, was given a life expectancy of five years and a reduced capacity of 13 mpd.

In 1985 the plaintiffs, Mr and Mrs Witham, inspected the property. They informed Owers that they wished to purchase a well irrigated property, but said they knew nothing about bores. Owers told them the bore had a 21 mpd. He said, further, that while the bore itself could not be inspected because it was too deep, the Withams could expect many years of trouble free pumping. He also mentioned that he was aware of two bores in the area, which were still working after nearly twenty years of operation. With Owers assistance in drawing up a farm budget, the Withams worked out that they could afford the property, providing the bore operated as Owers had advised it would. The Withams purchased the property. Later in 1985 the reduced capacity of the bore became obvious and the repair work carried out on the bore in 1983 became known to the Withams. The bore finally broke down permanently in 1988.

The Withams sued the defendant, Rawlinson, alleging negligent misstatement on the part of the defendant's representative, Owers. The defendant argued that even if the advice was incorrect there had been no negligence as,

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[20] *Richard Ellis (W.A.) Pty Ltd* v *Mullins Investments Pty Ltd (in liq)* (1995) Aust Torts Reports 81-309, 62,078.
[21] *Richard Ellis (W.A.) Pty Ltd* v *Mullins Investments Pty Ltd (in liq)* (1995) Aust Torts Reports 81-309, 62,083.
[22] *Richard Ellis (W.A.) Pty Ltd* v *Mullins Investments Pty Ltd (in liq)* (1995) Aust Torts Reports 81-309, 62,084.
[23] *Richard Ellis (W.A.) Pty Ltd* v *Mullins Investments Pty Ltd (in liq)* (1995) Aust Torts Reports 81-309, 62,090.

with respect to the information about the bore's capacity, it had simply passed on information provided by the vendor. With respect to the life expectancy of the bore, the defendant argued that this had simply been an expression of opinion by Owers.

In this case the defendant was found liable both at first instance and on appeal to the New South Wales Court of Appeal. In addition to the damages payable (the amount is not recorded) costs were awarded against the defendant. The court found that the Withams had relied on the statements made by Owers about the bore, and the defendant, through Owers, owed the Withams a duty of care. Reliance was the critical factor in establishing that a duty of care existed:

Silence was one thing. But once Mr Owers made representations to the Withams, it was self evident that it would be crucial to their decision to proceed or not to proceed with the purchase.[25] Owers had then failed to exercise the required standard of care by not checking that the information was correct, or referring the enquiries to some other person competent to give the correct answers.[26]

The difference between this case and the previous two cases is that the Withams made it clear that their knowledge of bores was limited, and that they were relying on the advice given by Owers. In *Norris* v *Sibberas* the advice given by the real estate agent, and on which the real estate agent had expertise, was predictive, and the plaintiffs were aware of this. In addition they also made it clear that for financial advice they were relying on their accountant. In *Richard Ellis* v *Mullins Investments* the advice was accurate at the time given, but when the formal offer was made at a later date, the plaintiff was not acting in reliance on the advice.

Conclusion

Real estate agents should take little comfort from cases where the agent eventually won. Defending a legal action is onerous financially even if, in the end, costs are awarded in favour of the real estate agent. Legal actions are also long-winded and time consuming. In *Norris v Sibberas* the statements complained of took place in 1983 and the appeal judgment was handed down in 1989. In *Richard Ellis* v *Mullins* the advice was given in 1987, and the appeal judgment was handed down in 1995. In *Rawlinson & Brown* v *Witham*, where the real estate agent lost, the negligent misstatement was made in 1985 and the appeal judgment was handed down in 1995.

The situation for real estate agents is best summed up by Kirby P. in *Rawlinson & Brown* v *Witham*:

> If the agent is silent, protests its lack of personal expertise or knowledge or expressly acts as no more than a conduit of the vendor's claims, risk of liability in the agent for negligent misstatement will be minimised. If, however, the agent offers personal advice and opinions - particularly to purchasers who are known to be ignorant and vulnerable - it cannot be surprised if the courts hold it to the accuracy and reasonableness of its statements. Courts will do so where such statements help to induce a contract later found to be based upon false expectations which were, in part, induced by the agent's advice carelessly given.[27]

[24] *Rawlinson & Brown Pty Ltd* v *Witham* (1995) Aust Torts Reports 81-341.
[25] *Rawlinson & Brown Pty Ltd* v *Witham* (1995) Aust Torts Reports 81-341, per Kirby P 62,407-62,408.
[26] *Rawlinson & Brown Pty Ltd* v *Witham* (1995) Aust Torts Reports 81-341, per Kirby P 62,406.
[27] *Rawlinson & Brown Pty Ltd* v *Witham* (1995) Aust Torts Reports 81-341, per Kirby P 62,407-62,412.