

April 19, 2016

Via Email Only (jessica.vogele@liebatlaw.com)

Lieb School

Attn: Jessica Vogele

Re: Broker's Duty to Disclose

Dear Ms. Vogele:

Your letter of March 4th has been sent to me for reply. You have requested guidance regarding a broker's duty to disclose "facts which materially affect the value of the property in landlord-tenant transactions." In your letter, you referenced the recent Appellate Division, Second Department, decision in Ader v. Guzman, 22 N.Y.S.3d 576 [2d Dept 2016] and asked how that decision influences an agent's conduct. Specifically, you have asked the following questions:

1. Whether it is the Department of State's current position that a landlord's agent has an affirmative duty to investigate/discover the legal status of a rental property; or, if an unknown status obviates License Law exposure pursuant to Ader v. Guzman?
2. Whether it is the Department of State's current position that, when it is known that no rental permit exists, a landlord's agent has an affirmative duty, without the prospective tenant's inquiry or a misleading advertisement, to disclose such fact that the rental property lacks a rental permit to a tenant because failing to do so would not be active concealment pursuant to Ader v. Guzman?
3. Whether it is the Department of State's current position, as consistent with Ader v. Guzman, that a landlord's agent only has a duty to disclose when both:
 - a. Such salesperson has actual knowledge that no permit exists; and
 - b. Such salesperson receives an inquiry from the prospective tenant or the landlord misrepresents the legal status in advertisements?

To begin, the Department does not read Guzman as permitting an agent to be ignorant of the legal status of a property which is being marketed. The Guzman court's holding was limited to plaintiffs' fourth cause of action, which was, whether "defendants negligently listed ... [a] residential rental when the premises lacked a valid rental permit." Guzman, at 577. According to the court, plaintiffs alleged that the agent "had violated the duty under Real Property Law § 443 (4) (b) to deal with . . . honestly, fairly, and in good faith, and to disclose all facts known to them that materially affected the value and desirability of the premises." Guzman, at 577-78. While true that the Guzman



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court opined that Section 443 of the New York Real Property Law ("NY RPL") "did not impose a duty upon the ... landlord's agent, to investigate whether the premises had a valid rental permit... [and] does not 'alter the application of the common law of agency with respect to residential real estate transactions'",¹ the court reasoned that

[u]nder the common law, New York adheres to the doctrine of caveat emptor and imposes no liability on the seller or the seller's agent to disclose any information concerning the premises when the parties deal at arm's length, unless there is some conduct on the part of the seller or the seller's agent which constitutes active concealment. Here, the complaint is bereft of any allegation that the Corcoran defendants engaged in any conduct constituting active concealment. Accordingly, the fourth cause of action does not set forth a viable basis upon which to impose liability against the Corcoran defendants.

Guzman, at 578-79 (internal citations omitted).

The Guzman opinion is otherwise silent as to the agent's other responsibilities under the NY RPL (i.e., requirements imposed apart from Section 443). The Department is aware of at least one other court which has distinguished common law of agency/"doctrine of caveat emptor" with a broker's other obligations when dealing with the public.

In McDermott v. Related Assets, LLC, an action was commenced seeking damages for an agent's failure to exercise proper due diligence as a licensee. 45 Misc.3d 1205(A), 998 N.Y.S.2d 306, 2014 WL 4977412 [Civ Ct, Richmond County 2014]. The allegations against the agent concerned an incorrect listing which marketed the property as being connected to a public sewer line. Id. In that case, the court specifically rejected the position that an agent was not liable for ostensibly failing to have a working knowledge of the property being marketed. In finding against the broker, the court held, inter alia,

... real estate brokers insist that they are professionals, and as professionals they are to be held to a higher standard than an unsophisticated, untrained buyer and seller. This court has previously held that along with receiving a license, brokers and salespersons are charged with knowledge and responsibility to check the public records to confirm any information the broker is conveying to the potential purchasers. [Acquino v. Ballester, 37 Misc.3d 705 (2012); Olukotun v. Reiff, NYLJ 8/1/8/04, p. 19, col.1]. Counsel for defendant has cited several cases holding that New York follows the rule of "caveat emptor" that is "let the buyer beware." Defendant argues that as a result the claimant should be charged with knowledge of any facts which the claimant could have obtained using reasonable means of inquiry and defendant has no liability.

This legal theory does not apply to the facts of this case. Claimant is not suing the seller for making a misrepresentation as to the existence of city sewers. Claimant is suing the listing broker for failing to use due diligence in checking the information being provided by the seller from the easily accessible on-line public record. Had the defendant acted as a "professional" and checked out the public records, the listing

¹ Id. at 578 (internal quotations and citations omitted).

would have been corrected and claimant would not have even looked at the house (according to his testimony). The actions of the defendant set the improper information ball rolling and as such the defendant must bear the bulk of the responsibility. This is so even if the court is skeptical that the claimant did not know the true condition prior to closing.

Id. at 4. The McDermott decision therefore supports the conclusion that an alternative theory underlying a similar cause of action (e.g., negligence in exercising duty diligence) can exist where an agent is responsible for publishing inaccurate information regarding a property being marketed.

It should also be noted that a different Appellate Division (the First Department) has also opined on what an agent should know regarding a property being marketed, and has expressly held that "[a] real estate broker should have a working knowledge of the legal status of the property he is marketing." 23 Realty Associates v. Teigman, 213 A.D.2d 306, 308 [1st Dept 1995]. In Teigman, a broker erroneously "advertised leasehold space in . . . [a] building as rent-stabilized apartments in a converted hotel, when in fact the hotel designation had never been changed." Id. at 307. Relying in part on the New York City Consumer Protection Law, the Appellate Division, giving deference to the New York City Department of Consumer Affairs, held "offering of rental housing is a legitimate area of interest for consumer protection against deceptive advertising and misrepresentation, and we agree." Id. at 308.

The Department is persuaded by both McDermott and Teigman, and does not believe that a licensee can avoid responsibility for placing a misleading advertisement by reason of an unknown status. Accordingly, notwithstanding the decision in Guzman, a broker who fails to demonstrate a working knowledge of the property being marketed, fails to demonstrate the level of competency required to transact business as a licensee in violation of NY RPL §§ 441 and 441-c.

It is also worth noting that there was a parallel proceeding in Guzman, relating to the tenants' action against the landlord to recover rent paid. Ader v. Guzman, 23 N.Y.S.3d 292 [2d Dept 2016]. In the companion litigation, the same Appellate Division upheld the trial court's order granting summary judgment in favor of plaintiffs for rent. Id. In the case against the landlord, "plaintiffs argued that it was illegal for Guzman to lease the premises without a rental permit and that a valid rental permit was a condition precedent to the collection of rent pursuant to section 270-13 of the Town Code." Id. at 294. As a general rule, "[I]n the absence of an agreement to the contrary, a real estate broker will be deemed to have earned his commission when he [or she] produces a buyer who is ready, willing and able to purchase at the terms set by the seller." SPRE Realty, Ltd. v. Dienst, 119 A.D.3d 93, 97 [1st Dept 2014] (internal citations omitted). The Department has previously held that a commission premised upon an unlawful agreement is "unearned", in part, because the agent has not produced a buyer who is willing and able, and therefore a violation of NY RPL § 441-c. See generally DLS v. Jacob et al., 121 DOS 93 (1993). Therefore, notwithstanding the absence of a duty under Section 443, consistent with McDermott, Teigman, SPRE Realty, Ltd., and the Department's own precedent, an agent may not benefit from procuring an unlawful apartment, and the unknown status of a property may not obviate licensing law under NY RPL Article 12-A.

Responding to your second question, the Department finds that where a broker has actual knowledge that a property lacks a permit or is otherwise illegal (i.e., illegal conversion), such information must be affirmatively disclosed. This requirement is found squarely within the Department's powers to discipline a licensee for: "dishonest or misleading advertising, or [where such licensee] has demonstrated untrustworthiness or incompetency." NY RPL § 441-c. It is a well-established rule that the Department is "vested with broad discretion in imposing punishment on real estate licensees who have demonstrated untrustworthiness, and the exercise of that discretion will not be lightly disturbed." Brabazon v. Cuomo, 49 A.D.2d 430, 433 [3d Dept 1975] (internal citations omitted). Though there is

inherent flexibility in the term "untrustworthiness," it has been established that, in determining what should be deemed untrustworthy conduct, there should be such factual presentation concerning acts or conduct by the licensee or his agent as would warrant a conclusion of unreliability and which establishes that any confidence or reasonable expectation of fair dealing to the general public would be misplaced. It is apparent from the wording of the statute that the legislature intended that the Secretary of State, who has the obligation of protecting the public against wrongdoing or incompetency, be vested with wide discretion in determining "untrust-worthiness" [sic].

Bloom v. Lomenzo, 50 A.D.2d 1, 4 [3d Dept 1975] (internal citations omitted).

These broad powers to protect the public, operating in tandem with the express intent behind NY RPL Article 12-A, support the conclusion that when a licensed professional markets a property, and fails to include information which s/he has actual knowledge of which would impair a prospective tenant's/purchaser's right to enjoy the property (i.e., possession itself is unlawful), this action is a breach of the "confidence or reasonable expectation of fair dealing" required to transact business. See generally In re Wilson Sullivan Co., 289 N.Y. 110, 114 [1942] (holding, in part, "[t]he purpose of [NY RPL] article 12-A was to assure by means of licensing competency and the observance of professional conduct on the part of real estate brokers and salesmen"); People v. Sickinger, 79 Misc.2d 572, 574 [Crim Ct, New York County 1974] (holding, in part, "[t]he plain purpose of Article 12-A of the Real Property Law is to protect the public from inept, inexperienced or dishonest persons who might perpetrate or aid in the perpetration of frauds and to establish protective or qualifying standards to that end." (internal citations omitted)). Accordingly, a licensee who fails to include in an advertisement or otherwise disclose that a property is defective also commits an error of omission and fails to deal equitably and competently with the public.

The Department believes that the above explanations also address your third question.

In consideration of the foregoing, the Department recommends that the best practice for all licensees is to make a reasonable effort to verify the legal status of the properties they are offering.

We trust that you will have found the above information helpful.

Very truly yours,

/s/

David A. Mossberg, Esq.
