

Damages and Liability for Misrepresentation of Lot Size by Dale Alberstone, Esq.

Imagine that the seller tells the buyer's broker that the apartment complex sits on one acre of land. The broker then relays that information to the buyer, who, believing that people are honest and knowledgeable, relies on the information when purchasing the property for \$5,000,000. Imagine further that the property was only three-quarters of an acre, but still had a fair market value of \$5,000,000. Finally, imagine that if the property consisted of a full acre, it would be worth an additional \$500,000, that is: \$5,500,000.

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Shortly following the close of escrow, the buyer discovers, through his surveyor, that the property was one-quarter acre less than that represented to him by his broker and by the seller. This month's column will focus on the monetary remedies available to the buyer for the misrepresentations.

As we will see, the broker's exposure is significantly greater than the seller's exposure, even though both may have been acting in good faith.

Out-Of-Pocket Rule

Absent a fiduciary relationship between a buyer and the other party (such as a seller), the measure of damages for a deceived buyer is determined by the "out-of-pocket" rule. The out-of-pocket rule provides that a buyer is entitled to recover the difference between the price he pays and the market value of the property he receives. In the hypothetical stated above, the buyer paid 5 million dollars and received, in exchange, property smaller in size than he anticipated, but nevertheless, still worth 5 million dollars. Since the buyer did not pay more for the property than its market value, he is said not to be "out-of-pocket" any money. In other words, he simply exchanged his personal property (i.e. money) for the seller's real property of equal value.

On the other hand, if the buyer paid 5.1 million dollars for property which was only worth 5 million dollars, he would be entitled to a \$100,000 rebate from the seller because the buyer is "out-of-pocket" \$100,000.

Since a seller is not the fiduciary of a buyer (i.e. the seller owes no duty of loyalty to the buyer), the buyer's damages are measured by the out-of-pocket rule.

The out-of-pocket rule is subject to certain qualifications under Civil Code Section 3343, such that even if the buyer does not pay more for the property than its market value, the buyer can still recover certain other limited consequential amounts, such as money attributable to loss of enjoyment or loss of profits, if any.

Benefit of the Bargain Rule

The benefit of the bargain rule applies if a fiduciary relationship exists between the buyer and some other party. In the above hypothetical, the buyer's broker has a fiduciary duty to the buyer which includes, at a minimum, the obligation to reveal to the buyer that he (the broker) had not verified the information which he learned from the seller concerning the acreage. In the above example, the broker innocently misrepresented the size of the property, but because he is the buyer's fiduciary, his exposure is measured by the "benefit of the bargain" rule rather than the more limited "out-of-pocket" rule.

The benefit of the bargain rule provides that the buyer is entitled to recover from his broker the difference between the amount the buyer paid for the property and what the value of the property would have been had it been as represented. In other words, since the property would have been worth \$5,500,000 if it contained five acres (as the broker represented), the buyer is entitled to receive from the broker \$500,000. That \$500,000 represents what would be the

buyer's benefit of the bargain had he received what he was told he would receive i.e. a full acre of land.

In Salahutdin v. Valley of California, Inc. (1994) 24 Cal.App.4th 555, the buyer's real estate agent employed by the buyer's broker made false representations about the size of the property and concealed his failure to adequately investigate or disclose the true facts. The court found that not only had the agent breached his fiduciary duty of care, he also committed constructive fraud by representing that the property was more than one acre in size and that it could be subdivided where, in fact, the property was less than one acre and could not be subdivided.

The fair market value of the property, had it been as represented by the agent, would have been \$1,100,000. However, because the value in its actual condition was only \$925,000, the court awarded the buyer \$175,000, plus interest at the legal rate of 10% per annum from the date of entry of the judgment until paid.

Punitive damages were not discussed in the case. However, the United States Supreme Court determined just two years ago that punitive damages for fraud may be awarded in single-digit multiples of the compensatory damages. That could be a sizeable amount of moneys.

Lawyers wishing to research the differences between the out-of-pocket rule and the benefit of the bargain rule should review Civil Code Sections 1709,3333 and 3343 and the annotations thereto. Lawyers wishing to research the most recent significant cases discussing punitive damages should review State Farm v. Campbell (2003) 538 U.S. 408 and Simon v. San Paolo (2005) 35 Cal.4th 1159.

Conclusion

There are lots of morals to this story. Among them are the following:

- 1) A seller should be careful not to make any factual representation about his property which the seller has not confirmed to be true.
- 2) A buyer's broker should not pass along to the buyer information he learns from the seller (or from the seller's broker) unless the buyer's broker has independently verified the data.
- 3) If the buyer's broker does not verify the information, the buyer's broker should, at a minimum, tell the buyer that the broker has not verified the data that he was passing along, and that the broker was simply relying upon the information provided by the seller.
- 4) When a buyer receives information from a seller which, if untrue, would materially affect the value or desirability of the property, the buyer should independently verify the data.
- 5) When a buyer receives information from his broker, which, if untrue, would materially affect the value or desirability of the property, the buyer should inquire of his broker as to whether the broker has verified the information.

Real estate brokers are regulated by the California Department of Real Estate and are held to high standards of ethical conduct. Sellers are not. Most misrepresentations by a party's broker are due to innocent mistakes, such as inadvertence in verifying given information, rather than intentional deception. With respect to representations that are material to the buyer's decision to purchase an apartment building, the buyer should verify the information on his own, or at least query his broker as to whether his broker has confirmed the accuracy of the data.

Dale Alberstone is a prominent real estate attorney who has practiced real property and business law for the past 28 years. He is a former judge pro tem of the Los Angeles Superior Court and a former arbitrator for the American Arbitration Association. He also testifies as an expert witness for and against other attorneys who have been accused of legal malpractice.

*Mr. Alberstone has been awarded an **AV** rating from Mardindale-Hubbel. An **AV** rating reflects an attorney who has reached the heights of professional excellence and is recognized for the highest levels of skill in integrity. **AV** is a registered certification of Reed Elsevier Properties Inc.*

The foregoing discussion is intended as a general overview of the law and may not apply to the reader's particular case. Readers are cautioned to consult an advisor of their own selection with respect to any particular situation.

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