FAIR PLAY OR FAIR GAME

by A. C. Schwethelm, CRE

For the real estate counselor, the probability of dealing with conflicting interests and goals in client service is significant, since he often is confronted with having to resolve difficult, gray-area ethical situations. Real estate ethics include the relationships between the practitioner with the client; with other individuals; with other real estate professionals; with other professionals such as attorneys, title company personnel, surveyors, etc.; and with the public. What obligations exist with these relationships, and how are conflicts resolved? How does the present business world impact real estate ethics? The answer is, in short, profoundly. Deciding to *do* the right thing is easy. Deciding on the right thing often is very difficult. Here are several examples to consider.

A Compromising Position

Conflict

I performed real estate counseling services for a client on a ranch property in preparation for foreclosure. After the client completed the foreclosure and resold the property, I was asked by a bank to appraise part of the property for financing. Before proceeding, I first obtained the client's permission. Subsequently, the fee was not paid, and I filed suit against the bank and the owner who had agreed to pay. The owner filed bankruptcy, and I was subpoenaed for a deposition and requested to bring "all records pertaining to any services I may have performed regarding the subject property" without limit. The purpose of the deposition was to gather evidence in an attempt to prevent foreclosure, not in regard to my claim.

Clearly a conflict existed because my first client financed the remaining part of the property and also was probably involved as a creditor. To provide information on the counseling assignment might be detrimental to his position. My available alternatives were to: 1. comply with the request; 2. appear for deposition, but refuse to answer questions regarding the first assignment; 3. contact the first client for permission to reveal the information; 4. seek to quash the subpoena by contacting the attorney representing the lender trying to foreclose; 5. engage my own attorney.

Resolution

Since I felt strongly about my obligation to the first client, I engaged an attorney at my expense to prevent discovery of the counseling information. To involve an attorney representing any part in the lawsuit might have compromised my position.

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A Conflict Of Interest?

Conflict

I was engaged by an attorney representing an insurance company to investigate the effect of a range fire on value and marketability of a ranch property. The client was accused of permitting a controlled burn on his ranch to get out of control and burn hundreds of acres on adjoining ranches. In the course of the investigation, I gained the confidence of an owner who had suffered a similar fire, and he spoke frankly with me. Subsequently, I was contacted by an attorney defending another insurance company in a claim for damages—by the individual who confided in me. It would be a profitable assignment because of my previous experience, and there was no conflict of interest. Since I felt it would be taking unfair advantage of someone who had confided in me, I decided to decline the assignment.

Subsequently, I was contacted by an attorney for the property owner who asked that I work for him against the insurance company. When he learned that the insurance company attorney had previously contacted me, he was delighted because I obviously would be a persuasive witness for him to cite when he informed the jury I had been sought by the insurance company.

Resolution

Certainly, I had no conflict of interest, since a different attorney and insurance company were involved. Again, the assignment would be profitable because of my experience. However, I reluctantly declined the assignment because I felt it unfair to the insurance company.

When Is Fair—Fair?

Conflict

In another case, I was not involved directly, but my counsel was sought by a friend. A client had signed an earnest money contract to sell a property; however, it was subject to clearing up several property line encroachments—my friend's assignment. Although one of the owners agreed to sign the necessary instruments, another responded with, "I won't sign anything of the kind, but I will offer $10,000 more than the current offer. Also the owner will save the commission if he has not signed an exclusive listing." My friend's client badly needed to sell at the best possible price.

Financially, the best results for his client would be for the contract to fail so a sale could be consummated with the neighbor. My friend could advise his client to inform the broker and buyer that it was not possible to clear the encroachment, cancel the contract and return the earnest money. This would leave him free to accept the higher offer. Ethically, however, to recommend this course of action would be questionable. Clearly, it would be disadvantageous to the listing broker who would not be protected in such a sale. It might be unfair to the buyer to simply void the contract and return the earnest money without making him aware of the alternative.

Resolution

My recommendation was to inform the owner of the neighbor's reaction and to caution him that to void the existing contract on the grounds already mentioned here and to accept the new offer might result in a lawsuit. The broker should be advised of the inability to clear up the encroachment. If the prospect was willing to close promptly, subject to the encroachment, the seller should do so. If not, the earnest money should be returned and the seller should pursue other opportunities. There should be no mention of another offer because it could be perceived as an attempt to exert pressure. My suggestion was followed, and the buyer decided to accept the encroachment and close promptly.

Client V. Client

Comal County was a previous client, and we had a good relationship. Subsequently, I was engaged by an attorney representing a client with a claim against Comal County. Ms. Odmark had purchased property, some years ago, consisting of a residence and two lots located between the beautiful Guadalupe River and a county road. She wanted to construct a second residence on the site and applied to the county for a septic tank permit and verification that the property was out of the 100 year flood plain. The county consented, but only after she dedicated a 30-foot wide drainage easement between the two residences to allow for the maintenance of a grass-lined ditch. It was anticipated that the culverts under the county road at that point would be replaced with larger ones. No construction or maintenance took place.

In 1993, a hard rain in the drainage area resulted in one of the houses flooding due to the undersized culverts and severe erosion of the drainage easement area. The erosion extended beyond the easement area, washing a substantial part of the yards into the river. Consequently, the county engaged an engineering firm to design a concrete drainage structure enclosed by a six-foot chain link fence to be constructed with the existing easement. However, an additional seven-foot wide easement on each side would be required for maintenance of the structure, such as cleaning out debris.

The new easement line came within five feet of the larger of the two residences, much to the owner's displeasure. As a concession the county agreed, as a condition of the easement, to utilize the access easement toward the smaller residence

whenever possible and to use the other side only under emergency conditions. My role as a real estate counselor was to determine the proper criteria for estimating the proper compensation to the owner based on a new taking, damages resulting from flooding of the residence and erosion, and any decrease in value resulting from the failure of the county to properly fulfill its responsibilities.

In the course of reviewing all the information available, I discovered a serious problem caused by the design of the proposed structure that would prevent utilization of the easement on the smaller residence side without encroachment on the property or considerable preparation. Clearly, the concession given in the easement could not be honored. The case was scheduled to be heard by a mediator within a very short time. If I cited the design deficiency it would reflect badly upon the county whose integrity was already in question. On the other hand, if I made the county aware of the problem before the hearing, it would probably result in an increased easement area taken or the withdrawal of the concession.

Resolution

After reflecting on the alternatives, I decided to inform my client and her attorney of my findings. In accordance with their wishes, I pointed out the design fault during the hearing. Partly as a result, the client received what she and her attorney considered a fair settlement. I had concluded that my prior relationship with the county should not influence me in any way. I felt no responsibility to inform the county of a circumstance it should have known about since it had the services available of the design and county engineers.

Highest And Best Use

The property was the site of a concrete ready-mix plant and an asphalt paving plant. Part of the front of the property was being taken by the state for highway widening, and the owner had not accepted the state's offer. After a commission hearing and appeal, the case was set for jury trial, and I was employed by the condemnor to appraise the property. In the course of inspecting the property, I observed that the asphalt delivery trucks were routinely cleaned at the edge of a draw on the property. Petroleum residue was washed into the watershed and downstream. My conclusion of highest and best use was for commercial development in the future with the present usage in the interim. However, the threat of pollution resulting from the truck cleaning clearly was a problem.

In preparing my report I could comment on the need for a Phase 1 inspection and provide only minimal comment on the conditions. There was apparently little, if any, effect upon the highest and best use of the property in my opinion, and no effect upon the compensation to the owner. On the other hand, the owner was contending that the present use was the highest and best use, and in that case, the continued pollution would be a serious consideration. Presenting such evidence would be important to refute its contention of H & B Use. I felt an obligation to my client to present evidence to support my H & B Use contention, and I described the existence of the pollution threat in my report.

As a result, the assistant attorney general handling the case felt an obligation to inform the state and federal agencies of the condition. They investigated and issued orders requiring correction, remediation and threatening fines. The owner naturally was furious. During the trial the condemnor presented evidence on the environmental violations, and the condemnee protested the use of other governmental agencies to penalize an owner who did not accept the state's offer. The verdict was favorable to the state, but the court set aside the jury verdict and found for the owner on grounds not connected with the environmental issue. The case is now in the appellate court system.

Resolution

Although admittedly controversial, I stand by my decision. Had the appraisal been prepared for another client and another purpose, I would certainly have felt obligated to reveal my findings, as I did.

One Property, One Client, Three Assignments

Sometimes the practitioner is placed in an awkward position by the client, not specifically on an ethics question, but rather on business judgment. For a number of years I performed an annual inspection of two adjoining lots of very low value for the trust department of a large bank. Although inspection consisted of photographs and visual inspection for current physical conditions, the low fee made the inspection unprofitable. This was clearly an accommodation to my client.

I was then contacted by the client and asked to perform an appraisal of the property, since I was already familiar with it. It was a difficult call because the lots were marginally large enough to accommodate a small residence after a septic tank variance was obtained from the county. Although the view was good, neighboring properties were low cost second homes with only fair maintenance. Obviously, the market was thin. Nevertheless, the appraisal was performed, again as an accommodation.

Some time thereafter I was again contacted by the client. The property was to be placed on the market and other brokers in the area were not interested in handling it. Would my sales department please sell the property as expeditiously as possible? My first impulse was to refuse the listing because of my previous involvement.

Resolution
I saw no conflict of interest because the contract was initiated by the client, and I felt some obligation to assist. Unfortunately, the market for the property turned out to be even poorer than I anticipated. After considerable market exposure, an earnest money contract offer came in for significantly less than the appraisal. It was presented and reluctantly accepted. Although the client was apparently satisfied with the results, I think the experience probably reflected unfavorably upon our firm. Even without any conflicts of interest or questions on ethics, careful consideration must be given to circumstances that involve the rendering of several services for the same property.

An Unfair Position
A ranch property had been sold in the early 1980s when prices were rising almost daily and the sky was the limit. The owner carried the note and now, years later, payments were no longer being made. The purchaser took bankruptcy, and we were employed by the note holder to appraise the property in preparation for foreclosure proceedings. The owner agreed to our inspection, and he volunteered that the property was for sale with a price obviously far in excess of the value. He would welcome our participation in marketing the property. Our reply was that we had no interest in listing the property, but would keep it in mind if we heard of a prospect.

During testimony before the bankruptcy judge, I was asked by the attorney for the bankrupt about the conversation to market the property. He was insinuating that I had low-balled the appraisal because I had not sold it and collected a commission. I was not allowed to explain my answer and, later in the hearing, was chastised by the judge for improper action. I was absolutely furious because there was no improper action of any kind on our part.

Resolution
I told my client's attorney that I intended to write the judge, setting him straight on the facts. The attorney asked me not to do so, or at least to wait until the case was concluded. I reluctantly agreed in the client's best possible interest. Unfortunately, it was an extended time before conclusion of the case, and I never wrote the judge. In retrospect, I probably should have insisted on my right to make him aware of the facts to protect my reputation. As to the outcome of the case—the judge ruled that my valuation was too low and allowed the bankrupt to keep the property, subject to my client's note. Several years later it was finally sold for less than my appraisal in spite of rising prices in the interim. I had the last laugh, but my client suffered the loss.

Make Your Choice
These represent my recent personal experiences as a small town, small office practitioner who specializes in providing litigation-oriented real estate appraisal and counseling services. Although the specifics will obviously vary, all real estate professionals frequently have to confront ethical choices. What is best for the client? What is best for the profession? What is best for me and my practice? The answers, in the context of overall fairness and equity, are not always easy. In the final analysis, if one can say in all candor, "I have considered all facets of the matter and can defend my decision to my own conscience," the resolution probably is right.