AVOIDING MALPRACTICE – ATTORNEY APPROVAL

by Harold I. Levine

A trap for the unwary lawyer is the so-called attorney approval rider which is a rider to many residential contracts. This may come as a surprise to many lawyers and local bar associations who have endorsed and approved the attorney approval rider and consider it a positive step in the attorney's participation in a residential real estate contract.

To the writer, they are just the opposite and should be eliminated. The attorney approval rider varies from area to area in Chicago and the various counties. An example is as follows:

Rider 304, attorneys' approval

"It is further agreed by and between the parties hereto that their respective attorneys shall have five (5) business days from the date of acceptance to approve or disapprove the terms of this contract, except the purchase price, closing date, and possession date. In the event a party's attorney disapproves any of the terms hereof, he shall within the said five (5) business days, serve notice upon the other party, his agent, or attorney, of his disapproval. Said notice shall contain a statement of the specific terms which are not approved and suggested revisions of those terms. If within ten (10) business days from the date of acceptance and any written extensions thereof, all of the terms disapproved by the attorney in the aforementioned notice are not revised in writing to the satisfaction of the parties, then this contract shall be null and void and all monies paid by the buyer shall be refunded to him. IN THE ABSENCE OF WRITTEN NOTICE WITHIN THE TIME SPECIFIED HEREIN, THIS PROVISION SHALL BE DEEMED WAIVED BY ALL PARTIES HERETO AND THIS CONTRACT SHALL CONTINUE IN FULL FORCE AND EFFECT."

Another example is:

Rider 101, attorney's approval

"This rider shall be attached to and become a part of real estate sale contract dated ___,19___ covering the sale of the property commonly known as street _____, city, state.

"It is further agreed by and between the parties hereto as follows: That their respective attorneys may approve and make modifications, other than price and dates, mutually acceptable to the parties. Approval will not be unreasonably withheld but, if within 3 business days after the date of this contract it becomes evident agreement cannot be reached by the parties hereto, and written notice thereof is given to either party within the time specified, then this contract shall become null and void and all monies paid by the Buyer shall be refunded to him. IN THE ABSENCE OF WRITTEN NOTICE WITHIN THE TIME SPECIFIED HEREIN, THIS PROVISION SHALL BE DEEMED WAIVED BY ALL PARTIES HERETO AND THIS CONTRACT SHALL BE IN FULL FORCE AND EFFECT."

Provisions are made on the forms for signatures of the buyers and sellers.

What seems to be the problem with this seemingly helpful form? There are at least six things wrong with the concept:

1. The attorney is asked to review a contract he has not negotiated or dealt with in any way. The contract may be the result of extensive negotiations between buyer, seller and broker, but the legal and negotiating skills of the lawyer are not involved. Of course, if something goes wrong, the broker will loudly proclaim, "But your lawyer approved the contract," and that position is hard to refute. Lawyers ought to be responsible for contracts they have reviewed, negotiated and drafted. They should not be responsible for someone else's negotiations and contract.

2. The time frame is outrageous. Broker, seller and buyer can spend weeks or months negotiating a deal, but the lawyer has 72 hours to review the contract and be charged with the responsibility. Those of us who labor in the valleys of the law will tell you that the lawyer usually gets the contract in the last 24-36 hours.

3. Disapproval involves serious rights. When the lawyer gets a contract with the attorney approval rider, it is executed by all parties, broker's commissions have been earned, the seller may have purchased a second home, the buyer's wife has already mentally redecorated the bathroom. To disapprove the contract is to disturb serious rights and responsibilities.

4. The attorney approval rider allows the broker to operate freely without a lawyer and to exclude the lawyer from the entire contract process, which is where he should be. The broker says, "Why, after we get all done, your lawyer can approve or disapprove the contract, so we don't need him during the negotiations." It sanitizes the broker's actions and passes all risks to the lawyer.

5. The requirements are onerous. The rider requires service on specific parties at specific times, and there are whole areas such as price, closing, possession, which cannot be negotiated.

6. The attorney approval rider greatly increases the threat of attorney malpractice. A contract with an attorney approval rider is delivered to the attorney for buyer or seller two to three days before it expires. The lawyer is faced with the choice of going through the difficult job of choosing whether to disapprove and sever the parties, or by not doing so, impliedly approving the contract. If something goes wrong, the lawyer is at fault on a deal he never negotiated because he had this illusory opportunity to object and didn't do it.

This view is not shared by all lawyers. Many or most real estate lawyers feel differently. They feel the attorney approval rider is a definite benefit. Their reasoning is as follows: No matter what the contract says, buyer and seller are not going to get a lawyer during the negotiations, and the attorney approval rider represents the only chance for an attorney to get residential real estate business. Without it, they say, the brokers will run wild and the lawyer will never be involved.

Another view was expressed by Marshall Moltz, a prominent real estate lawyer, in a recent comment in the *Chicago Sun-Times*. He said:

"Although the attorney approval rider probably saved the young couple hundreds of dollars, most home buyers are not protected by one."

"Seventy percent of home purchasers never bother to hire a real estate lawyer until *after* they sign a sales contract. Ideally, a buyer should hire a lawyer first, then buy the house."

"Here's what typically happens: A buyer sees a home he likes listed at $110,000. He offers $100,000, but the real estate broker says: 'Don't hire a lawyer until the deal is signed. Let's make the contract subject to your attorney's approval.'"

"Although real estate boards print sales contracts that say the transaction is subject to attorney approval, this is the fly in the ointment. Many of these contracts stipulate that if the broker doesn't hear from the attorney in three to five business days the contract is binding."

"I have had many buyers ask for attorney approval when it's too late. Only about 25 percent of the home sales contracts include attorney approval riders."

"If the real estate market is hot and buyers are standing in line to buy homes, they may not have time to get attorney approval before they buy."

The author's opinion remains that the attorney approval rider is the best thing that ever happened to a broker because it sanitizes the transaction and passes the entire risk to the lawyer and this is a trap for the unwary lawyer.

NOTICE REQUIRED TO RECOVER FROM REAL ESTATE RECOVERY FUND

An Illinois Appellate Court has held that the failure of a party to give statutory notice of a claim against the realtor to the Illinois Department of Registration and Education at the commencement of a civil action against a real estate broker precludes that party from recovering from the Real Estate Recovery Fund.

In March 1981, plaintiff filed an action against a real estate broker and others for return of a $10,000 earnest money deposit that the real estate broker was holding as escrow agent. No notice was given to the Department of Registration and Education at the time of the commencement of the action. Judgment was entered in favor of the plaintiff later in 1981, but the real estate broker filed for bankruptcy and a portion of the judgment remained unsatisfied. In December 1983, plaintiff filed a motion for payment from the Fund, but notice was not received by the Department until January 1984. The trial court awarded damages from the Fund to the plaintiff and the Department appealed.

The Department raised the defense that the plaintiff had failed to comply with §8.3 of the Act. (*Ill.Rev.Stat.*, C. 111, ¶5718). Section 8.3 of the Act provides that when any person who has been aggrieved as a result of the conduct of a real estate broker commences an action "for a judgment which may result in collection from the Real Estate Recovery Fund, the aggrieved person *shall* notify the Department in writing to this effect at the time of the commencement of the action." Section 8.3(b) prescribes that when the aggrieved individual recovers a valid judgment against a real estate broker, the holder of the judgment "*may* . . . file a verified claim in the court in which the judgment was entered and, upon thirty days written notice to the Department, . . . may apply to the court for an order directing payment out of the Real Estate Recovery Fund."

The Appellate Court noted that there was not case law in Illinois determining this issue and looked to other jurisdictions which had similar statutes. Other state courts have held that when the principal action is commenced against a real estate broker, the statute requires plaintiff to notify the appropriate governmental agency in writing. The court noted that this seemed consistent with the legislative intent for the Illinois statute since other provisions of the Act authorized the Department, upon receiving notice, to take certain specified actions in the trial court "on behalf of and in the name of the defendant." The court concluded that since the statute permitted the Department to intervene in the civil action against the broker, the notice provision mandated that the claimant give such notice at the commencement of any such action. This interpretation is also consistent with the use of the term "shall" which term mandates that the department receive notice at the initiation of the action.

The court thereby concluded that since notice was not given at the commencement of the action against the broker, no recovery could now be sought by the claimant from the Fund.

Toufexis v. Hughes, 137 Ill.App.3d 882, 92 Ill.Dec. 758, 485 N.E.2d 569 (1985).

DEVELOPER FAILS TO REPORT FLOODING HAZARDS

An Illinois Appellate Court recently held that homeowners could sue the developer on a theory of negligent misrepresentation for failing to record their property's propensity to flood. The court also held that the homeowners could not bring a cause of action against the savings and loan from which they had borrowed funds to purchase their home for its failure to comply with the National Flood Insurance Act.

Plaintiffs were homeowners whose home experienced periodic flooding. Following the third year of flooding, plaintiffs discovered that their house was located in a flood hazard area.

The homeowners argued unsuccessfully that the implied warranty of habitability, which applies to new homes, can be extended to include vacant land. Plaintiffs claimed that the developer breached the implied warranty of habitability by selling land which was located in a flood hazard area.

The court refused to extend the implied warranty of habitability beyond the builder to the seller of vacant land. The court explained that a purchaser does not necessarily rely on any expertise of the seller of the land, and further stated that it would be unfair to impose a duty of warranty of habitability on the seller of unimproved land for a house that has not yet been built.

The homeowners' second count was a claim for negligent misrepresentation against the developer for failure to record the property's propensity to flood. Plaintiffs based this count on an Illinois statute which states that the Department of Transportation must review any map, plat or subdivision of lands situated near a water course serving a large tributary to determine potential flood hazards. A penalty is paid to the county for a violation of the statute. *Ill.Rev.Stat.*, C 115, ¶13.

The developer maintained that the above statute did not create a duty in favor of homeowners because it provided exclusively for a penalty. Defendant also argued that plaintiffs could not recover in tort even if a duty did exist. The court rejected the developer's arguments and allowed for tort recovery under this statute. The court found that the purpose of the statue was to protect homeowners from unknown flood hazards, that plaintiffs fit this category, and that a civil remedy provided an incentive for injured homeowners to correct the public record. Thus, the court held that the developer was liable for negligent misrepresentation for failure to include the flooding hazard in the public record.