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New York State Bar Association
Committee on Professional Ethics

Opinion 993 (11/13/13)

Topic: Misrepresentations as to purchase price in residential real estate contracts; disclosure of "gross-ups"

Digest: The requirement to disclose a "grossed up" real estate purchase price is triggered when the purchase price has in fact been grossed up in connection with a seller's concession.

Rule: 8.4(c)

FACTS

1. A local bar association and a local association of realtors have jointly approved a new form to be used for residential real estate sales. This new "Contract of Sale for Residential Property" includes the following sentence: "The Purchase Price reflects an increase equal to the amount of the Seller's Concession."

2. This sentence (the "Disclosure Clause") was added to the form in an effort to comply with N.Y. State 882 (2011). That opinion followed the reasoning of N.Y. State 817 (2007). According to the inquiry, these two opinions require the Disclosure Clause to be included in all contracts that include a seller's concession.[1]

3. The inquirer reports that since adoption of the new form, attorneys and real estate personnel "have encountered continual problems with various lenders" such as "significant delays, requests for modifications of contracts, including strike out of the gross up text, and outright rejection of mortgage loan applications."

4. The inquiry says that these problems have arisen because, with the addition of the Disclosure Clause, mortgage lenders "consider the Seller's Concession to be an 'inducement to purchase.'" These mortgage lenders therefore "will only lend on the amount of the Purchase Price ***less*** the Seller's Concession, rather than based on the adjusted Purchase Price or the grossed up amount" (emphasis in inquiry).

5. The inquirer requests that the Committee reconsider N.Y. State 882 and modify it "by eliminating the requirement that all Seller's Concessions must be stated as an increase in the

[1] The inquiry states (incorrectly) that N.Y. State 882 and N.Y. State 817 "assume that all Seller's Concessions are phantom gross ups," and it urges that contracts should not need to "characterize every Seller's Concession as an increase or gross up of the Purchase Price *as the Majority in Opinion 882 currently requires*" (emphasis added).

6. Purchase Price." The inquiry, and a memorandum submitted with it, set forth arguments in support of that request.

OPINION

7. The inquiry is based on a misunderstanding of our prior opinions. Those opinions did not require that *all* transactions with a seller's concession be characterized as involving an increase or gross-up of the purchase price. N.Y. State 817 is clearly limited to situations in which there is, in fact, a gross-up of purchase price in connection with a seller's concession.[2] Our opinion in N.Y. State 882 is similarly limited, and its disclosure requirement does not apply to situations in which "the seller actually bears an economic cost equivalent to the concession."[3] In the most recent opinion in this line, we again adhered to the disclosure requirement in the context of a transaction in which "there has been a gross-up of the purchase price" in connection with a seller's concession. N.Y. State 892 ¶8 (2011).

8. Under our opinions, what the lawyer must disclose depends on the facts of the transaction. The relevant obligation is that a lawyer shall not "engage in conduct involving dishonesty, fraud, deceit or misrepresentation." Rule 8.4(c). In some instances, as reflected in previous inquiries to this Committee, the parties may agree on a purchase price and thereafter agree to increase or gross up that price in connection with a seller's concession. The lawyer would be required to disclose such a gross-up. But when there has in fact been no gross-up, because the seller is actually bearing an economic cost reflected in the concession, the lawyer is under no obligation to assert that a gross-up has occurred. Indeed, it would be inappropriate for the lawyer to "disclose" something known to be inaccurate.

9. Thus, because the facts may vary from transaction to transaction, the lawyer's disclosure

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[2] That opinion dealt with this situation: "Following written agreement between buyer and seller of real estate as to terms," the buyer requested that the agreed sales price be increased by 3% to cover closing costs, and that the increase be set off by a seller's concession, allowing the buyer to obtain a larger mortgage loan. N.Y. State 817 ¶1. We concluded that when there is "a 'gross up' of the actual purchase price and concomitant seller's concession," then "the gross-up … must be disclosed," *id*. ¶14.

[3] N.Y. State 882 distinguished the situation it considered – one in which there had been a "'gross-up' in the sales price to offset the seller's supposed concession" – from one in which

> "the seller actually bears an economic cost equivalent to the concession. … This is a distinction with a difference. … The problem here is the matching 'gross-up' of the sales price, which effectively wipes out the seller's concession."

Opinion 882 states that an ethical violation occurs "when a seller, buyer, lender, and their attorneys engage in the device of a seller's concession accompanied by a like increase in the purchase price that create a misrepresentation." The Committee concluded that "an attorney may ethically participate in a real estate transaction where the sales price is grossed-up by an amount equal to a corresponding seller's concession if the amount of the gross-up and the amount of the seller's concession are expressly and meaningfully disclosed."

obligation may vary from transaction to transaction as well.[4] It appears that the Disclosure Clause quoted above is invariably included in the described Contract of Sale for Residential Property. That degree of uniformity is not required by the rules of legal ethics, nor is it appropriate if it results in misstatement of the facts in particular cases. The inquiry also mentions another form, adopted in one county, that takes a less uniform approach. In that county's alternate form, there is a checkbox next to the disclosure that "The Purchase Price has been increased by a sum equal to the Seller's Concession," and above that line is the instruction "Check if Applicable." We do not opine as to the best wording for forms, but we note that this alternate form allows a lawyer to make or not make the disclosure in question, depending on the known facts of the transaction.

10. The inquiry details problems that can result from use of the Disclosure Clause, including resistance by mortgage lenders. This is not the first time the Committee has addressed such problems. A prior inquiry recounted how use of similar disclosure language led a lender to balk at a transaction, advising the seller's attorney: "Contract states price increased due to Seller concession; increase for this reason is not allowed." N.Y. State 892 ¶2 (2011). The Committee answered that a lawyer may not ethically participate in a residential real estate transaction in which a lender's objection precluded the required disclosure. *Id*. ¶8. The current inquiry tells us that the kind of problem addressed in N.Y. State 892 is not aberrational, but rather is faced with some frequency. That circumstance may make N.Y. State 892 and previous opinions more important in practice, but it does not refute their reasoning, which we believe continues to be sound.

11. The inquiry asserts that "the mortgage loan industry is fully familiar with and permits use of Seller's Concessions." As we have noted, however, the issue is not simply whether there is a seller's concession, but whether there is an associated gross-up of the purchase price. The reported industry reaction supports the significance of this distinction. The inquiry suggests that mortgage lenders do not consider sellers' concessions in general to be "inducements to purchase," but do consider them to be inducements to purchase when the purchase price is stated to be correspondingly grossed up. In effect, the very lenders that "permit" the use of sellers' concessions may not permit associated gross-ups, when explicitly recognized as such, to be included in the basis for the loan amount. This industry reaction does not undercut our prior conclusion that stating a grossed up purchase price without disclosing the gross-up is a misrepresentation. Indeed, the industry reaction demonstrates the materiality of that misrepresentation. The required disclosure of gross-ups may preclude uniformity of loan documents and may lead lenders to reject contracts in some cases, but an attorney's

[4] We recognize that the lawyer may not always be aware of the history of negotiations. For example, we understand that it is not unusual for draft contracts already reflecting sellers' concessions to be submitted to lawyers, and we do not suggest that the mere statement of a seller's concession will suffice to put the lawyer on notice of a grossed up purchase price. A lawyer's good-faith omission to disclose unknown facts does not constitute "dishonesty, fraud, deceit or misrepresentation." On the other hand, we do not think that a lawyer may avoid the disclosure requirement by remaining willfully blind to the existence of a gross-up. *Cf*. Restatement (Third) of the Law Governing Lawyers §120, Reporter's Note to Comment c (2000) (citing court decisions that arguably articulate for certain disciplinary purposes "a version of the conscious-avoidance doctrine" applied in criminal law); Rule 1.0(k) ("A person's knowledge may be inferred from circumstances.").

understandable desire to avoid such complications cannot justify misrepresentation.

CONCLUSION

12. We adhere to the conclusions in N.Y. State 882 and N.Y. State 817. The mere existence of a seller's concession does not require a statement that the purchase price has been increased. However, when the purchase price in a sale of residential real estate has in fact been grossed up in connection with a seller's concession, then a lawyer who participates in the transaction is required to ensure that the grossing up of the price is disclosed.

(37-13)