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COMMENTS

DUAL AGENCY IN RESIDENTIAL REAL ESTATE BROKERAGE: CONFLICT OF INTEREST AND INTERESTS IN CONFLICT

*The most critical issue in today's real estate transactions is the inherent conflict of interest created by dual representation by the real estate broker in the usual real estate transaction. The problem is endemic in the common transaction*¹

I. INTRODUCTION

The nature of the agency relationships between residential real estate brokers and their clients has always been somewhat paradoxical, very problematic, and fraught with potential fraud, malfeasance, and serious conflicts of interest.² Unsophisticated vendors and purchasers of residential property rely heavily on the expertise of real estate brokers in matters of price, terms, financing, and the condition and habitability of the real property in question despite the fact that conflicting loyalties and objectives commonly exist between the real estate broker and the broker's clients.

The broker's role is no longer merely that of a salesperson

1. 1 H. MILLER & M. STARR, *CURRENT LAW OF CALIFORNIA REAL ESTATE* § 4:18, at 17 (Supp. 1981).

2. Litchfield, *Unprofessional Conduct by Real Estate Brokers: Conflict of Interest and Conflict in the Law*, 11 *PACIFIC L.J.* 821 (1980). Litchfield quotes Justice Cardozo in *Roman v. Lobe*, 243 N.Y. 51, 54, 152 N.E. 461, 462, (1926): "The real estate broker is brought by his calling into a relation of trust and confidence. Constant are the opportunities by concealment and collusion to extract illicit gains. We know from our judicial records that the opportunities have not been lost." See also Comment, *A Reexamination of the Real Estate Broker-Buyer-Seller Relationship*, 18 *WAYNE L. REV.* 1343 (1972).

or middleman whose legal obligations require only honesty and fairness.³ The real estate broker is held to a professional standard of care as to knowledge of the real property being sold.⁴ The common law considers the broker an agent with fiduciary duties of absolute loyalty to clients, including the duty to disclose to the principals any information which could result in a decision not to buy or not to sell.⁵ The broker may also be required to disclose information adverse to his own interests (i.e., the interest in consummating a sale).⁶ Yet, it appears from a review of the cases that the full scope of the broker's role is unsettled, and, unsettling.⁷ The law on the subject is in flux. Both the California Department of Real Estate and the Federal Trade Commission are engaged in detailed inquiries into these relationships to determine what legislative or administrative remedies may exist for the maladies of the real property business.⁸

The perils of broker representation to home sellers and home buyers, the unsophisticated segment of the real estate

3. Under certain circumstances, the real estate broker may be held to be only a "middleman." See note 26 and accompanying text *infra* for the middleman exception.

4. *Brady v. Carman*, 179 Cal. App. 2d 63, 3 Cal. Rptr. 612 (1960).

5. *Rattray v. Scudder*, 28 Cal. 2d 214, 223, 169 P.2d 371, 376 (1946). See text accompanying notes 72-75 *infra*.

6. Stamber and Stein, *The Real Estate Broker—Schizophrenia or Conflict of Interests*, 28 J.B.A.D.C. 16 (1961), quoted in Comment, *supra* note 2, at 1344. In the typical real estate transaction the broker receives a contingent fee; that is, a commission based on a fixed percentage of the gross sale price. If the sale falls through, the realtor gets nothing. The longer the deal takes to close, the longer the realtor must wait for the commission. Thus, if the realtor discloses to the seller that the buyer's financial position is weak and that the buyer will likely default on a proposed second mortgage to be held by the seller, the seller is likely to reject the offer.

7. When the broker, as negotiator between the contracting parties, works for a contingent fee payable only if the realty is actually sold, he favors any sale to earn his fee with a minimum time investment rather than risking loss of the sale and commission by fully prosecuting the seller's interest to obtain the highest and best price.

Comment, *supra* note 2, at 1344. It is "understandably" difficult for a broker not to urge acceptance of a buyer's offer, regardless of fairness to the seller. *Id.* at n.5.

8. The California Department of Real Estate has commissioned two studies on agency and dual agency relationships. See notes 17 and 20 *infra*. The Federal Trade Commission has undertaken a staff investigation after receiving numerous complaints from real estate agents, consumers and consumer groups about unfair practices in the industry and inadequate representation of parties' interests. Among the issues that have been covered in the inquiry are the role of the broker in residential brokerage transactions, including conflicting duties and interests which make it difficult to adequately represent consumers. 45 Fed. Reg. 77,959 (1980).

market, are particularly acute because of the prevalence of brokers practicing dual agency. Dual agency exists when the adverse parties to a transaction are represented either by one broker acting in a dual capacity,⁹ or by a listing broker and a cooperating (or buyer's) broker who, at common law, is also the seller's agent,¹⁰ or by two agents or salespeople of a single brokerage firm (which is the same as dual capacity).¹¹ Such relationships are permitted by law (and widely used) in California, despite the obvious conflicts of interest, provided both principals consent to the arrangement after disclosure by the agent.¹²

Real estate transactions are becoming increasingly complex in a market in which "creative financing" rather than conventional bank financing is the norm,¹³ and where real estate agents are as much financial advisers and mortgage brokers as they are salespeople. These financial complexities increase the danger that misbegotten loyalties will leave either the buyer, the seller or both hanging by a slender financial thread.¹⁴ Full disclosure by agents of possible future financial dangers is viewed as counter-productive by the agent. As a result, undisclosed or insufficiently disclosed dual agency has become a common prob-

9. 1 B. WITKIN, *SUMMARY OF CALIFORNIA LAW, Agency and Employment* § 97 (8th ed. 1980).

10. The listing broker, also called the seller's broker, has a contractual relationship with the vendor. The cooperating broker brings a prospective buyer to the seller in expectation of sharing the commission if a sale is consummated.

11. The listing broker is the seller's agent. *Rodes v. Shannon*, 222 Cal. App. 2d 721, 725, 35 Cal. Rptr. 339, 342 (1963). The cooperating broker brings the buyer to the deal and in most cases splits the commission with the listing broker. Under most multiple listing agreements, the cooperating broker is deemed a sub-agent of the listing broker, hence an agent to the seller. CAL. CIV. CODE §§ 2349, 2351 (West 1954).

12. *Wilson v. Lewis*, 106 Cal. App. 3d 802, 806, 165 Cal. Rptr. 396, 398 (1980); *Bonaccorso v. Kaplan*, 218 Cal. App. 2d 63, 68, 32 Cal. Rptr. 69, 72 (1963); RESTATEMENT (SECOND) OF AGENCY § 392 (1958).

13. The *Wall Street Journal* quotes the National Association of Realtors as predicting that up to 70 percent of home resales will depend on some form of creative financing, that is, where the seller carries or assists in some part of the financing. Chase, *Creative Loans: How to Sell a House? Lend Buyer the Funds, Homeowners Discover*, *Wall St. J.*, May 1, 1980, at 1, col. 6. A recent survey of creative financing in California shows 56 percent of home transactions sampled involve some form of seller-assisted, non-conventional or creative financing. CALIFORNIA TECHNICAL ASSISTANCE ASSOCIATES, INC., *THE EXTENT AND NATURE OF CREATIVE FINANCING IN RESIDENTIAL REAL ESTATE TRANSACTIONS IN CALIFORNIA 2* (1981) (commissioned by the California Department of Real Estate).

14. See Samson & Kirby, *Creative Financing Abuses. Creative Litigation Against the Mortgage Loan Broker*, *REAL PROPERTY NEWS*, Fall, 1981, at 10.

lem,¹⁵ although that is a ground for rescission by either party as a matter of agency law, even if no harm is done.¹⁶

Dual agency has become the customary arrangement in residential real estate transactions¹⁷ largely because of the widespread use of multiple-listing agreements. Most multiple listing agreements create sub-agency relations between the cooperating broker and the seller's broker,¹⁸ giving rise to fiduciary duties between the seller and the cooperating broker, who ostensibly represents the buyer. Those duties effectively preclude adequate representation of the buyer.

Broker confusion over and ignorance of the duties and liabilities of a real estate agent is widespread.¹⁹ The inherent danger of litigation from such confusion, and the desire to bring an air of professionalism to real estate brokerage have resulted in establishment of a growing number of "alternative" or buyers' brokers, who use single or general agency (unconflicted) arrangements.²⁰

Some real estate industry observers say there is a growing concern that dual agency is not only unethical per se but may be

15. 1 MILLER & M. STARR, *supra* note 1, § 4:18, at 17-20.

16. *Id.* at 19.

17. CALIFORNIA TECHNICAL ASSISTANCE ASSOCIATES, INC., DUAL AGENCY PROBLEMS IN CALIFORNIA REAL ESTATE TRANSACTIONS 40-41 (1981) (commissioned by the California Department of Real Estate) [Hereinafter cited as CTAA DUAL AGENCY report].

18. *Id.* at 13.

19. See Romero, *Theories of Real Estate Broker Liability: Arizona's Emerging Malpractice Doctrine*, 20 ARIZ. L. REV. 767, 772 (1978). The author, a licensed real estate broker, contends cooperating brokers either ignore or are unaware of their duties to sellers, and many merely assume the sub-agency clauses in listing contracts are intended only to confer the right to earn a commission from the seller. *Id.*

20. Small firms of alternative brokers, offering to work on a flat fee, or hourly fee rather than commission basis, have been established around the state. CALIFORNIA TECHNICAL ASSISTANCE ASSOCIATES, INC., THE EXTENT AND NATURE OF SINGLE AGENCY REAL ESTATE PRACTICES IN CALIFORNIA 3-5 (1981) [hereinafter cited as CTAA SINGLE AGENCY report]. See also *Gina Williams Outrages Brokers By Cutting Fees, Selling Secrets*, Wall St. J., Aug. 13, 1980, at 29, col. 1.

The Menlo Park-Atherton Board of Realtors Multiple Listing Service has adopted a listing agreement that expressly negates the sub-agency relationship common in other California multiple listing contracts. The Menlo Park agreement explicitly makes the cooperating broker the buyer's broker. Menlo Park's is the only MLS agreement in California with explicit single agency understandings. CTAA SINGLE AGENCY report, *supra* at 31.

legally untenable.²¹ Under the current scheme of relationships in the ordinary real estate transaction, there is also a growing consensus that buyers of real estate are often unrepresented, largely due to the dual agency.²²

This Comment will explore the legal status and vulnerability of real estate brokers who engage in dual agency. It will discuss the under-representation of home buyers, and the advantages and disadvantages of some suggested statutory and administrative reforms requiring or encouraging single, unconflicted agency arrangements in residential real estate transactions.²³ It concludes that:

- [1] unlike commercial and industrial real estate buyers who usually are represented separately, in dual agency transactions the relatively naive home buyer is effectively unrepresented;
- [2] dual representation is frequently not adequately or meaningfully disclosed to either the buyer or the seller;
- [3] even when disclosed and mutually consented to, the inherently-conflicted dual agency relationship leads to unfair dealing which can be undone only through the expensive and wasteful process of rescission;
- [4] undisclosed or inadequately disclosed dual agency may become a leading ground upon which disgruntled buyers and sellers will seek to rescind common residential real estate transactions; and,
- [5] dual agency fails to serve the consumer in what is normally the largest single personal transaction: a home purchase or sale.

The only way to avoid these problems is the elimination or discouragement of dual agency in residential real estate transactions.

21. 1 H. MILLER & M. STARR, *supra* note 1, at § 4:18.

22. CTAAs DUAL AGENCY report, *supra* note 17, at 51.

23. *Id.* See also note 9 *supra*.

II. DISCUSSION

A. REAL ESTATE AGENCY: SELLER-BROKER RELATIONSHIP

An agency is created when the principal and agent mutually agree that the agent will act on the principal's behalf and be subject to the principal's control.²⁴ Under the California common law of agency, real estate brokers, and their licensed salespeople, are agents and have a fiduciary relationship to their clients with a duty of absolute loyalty, confidentiality and the utmost good faith.²⁵ The major exception to that rule is in the truly exceptional situation when the broker is acting strictly as a "middleman", that is, when the scope of the broker's employment is limited to bringing parties together, and where the broker has no authority to negotiate, i.e., exercise discretion.²⁶

The courts have long held the real estate agent owes the principal the same duty of undivided service, confidentiality and loyalty that a trustee owes his beneficiary.²⁷ It is basic to the agency relationship that the broker is not permitted to obtain any interest that is adverse to his principal or to secure any financial advantage over his principal either through the use of fraud, deceit, concealment or misrepresentation.²⁸ Any secret profits from the sale of a principal's property reaped by the agent may be recovered by the principal.²⁹ The classic instance of a broker's taking advantage of his principal is when the

24. However, authority to exercise discretion is not *essential* to creation of agency. *Skopp v. Weaver*, 16 Cal. 3d 432, 439, 546 P.2d 307, 311, 128 Cal. Rptr. 19, 23 (1976); RESTATEMENT (SECOND) OF AGENCY § 3, comments a, c (1958).

25. *Batson v. Strehlow*, 68 Cal. 2d 662, 675, 441 P.2d 101, 109-10, 68 Cal. Rptr. 589, 597-98 (1968). In this Comment, the terms broker and agent are used interchangeably. The broker is a real estate agent who has met the state real estate broker's license requirements in addition to the real estate agent's licensure regulations. A real estate sales agent must operate under the auspices of a broker, however. See CAL. BUS. & PROF. CODE §§ 10000-10185 (West 1964).

26. *Batson v. Strehlow*, 68 Cal. 2d 662, 668-69, 441 P.2d 101, 106, 68 Cal. Rptr. 589, 591 (1968).

27. *Rattray v. Scudder*, 18 Cal. 2d 214, 222-23, 169 P.2d 371, 376 (1946) (real estate broker's license revocation upheld for breach of fiduciary duty).

28. *Batson v. Strehlow*, 68 Cal. 2d 662, 675, 441 P.2d 101, 109-10, 68 Cal. Rptr. 589, 598 (1968). See also RESTATEMENT (SECOND) OF AGENCY § 389, Comment a (1958): "[A]n agent who is appointed to sell or to give advice concerning sales violates his duty if, without the principal's knowledge, he sells to himself or purchases from the principal through the medium of a 'straw'"

29. *Bate v. Marsteller*, 232 Cal. App. 2d 605, 616, 43 Cal. Rptr. 149, 157 (1965). See also 1 B. WITKIN, *supra* note 9, at § 90.

seller's agent, on learning of a buyer who is willing to pay more than the asking price for a property, buys the property from the principal and resells it to the buyer at an immediate profit³⁰—a clear fiduciary breach.

In California, the seller has a duty to disclose facts, materially affecting the desirability or value of the property, known to her or accessible only to her.³¹ Under general agency law, the listing (seller's) agent is under the same duty.³² The agent's duty to the buyer must, of necessity, be exercised at the expense of the broker's duty of loyalty to the seller when the agent possesses negative information about the property.³³ Further, the principal and agent are liable for each other's negligence.³⁴ Any broker who transmits an offer of a prospective buyer is typically deemed a sub-agent of the listing broker with fiduciary obligations to the seller, whether or not the broker had any previous dealings or agreement with the seller.³⁵ Under California statutory law, the listing agent or broker is not liable to third persons for the acts of the sub-agent.³⁶ But to avoid injustices, the courts have been willing to *find* an agency relationship whenever needed to protect the interests of either party damaged by a real

30. *Ward v. Taggart*, 51 Cal. 2d 736, 336 P.2d 534 (1959).

31. *Lingsch v. Savage*, 213 Cal. App. 2d 729, 735-36, 29 Cal. Rptr. 201, 204-05 (1963). See also *Jorgensen v. Beach 'N' Bay Realty, Inc.*, 125 Cal. App. 3d 155, 177 Cal. Rptr. 882 (1981) (duty to disclose that buyers are investors and that listing broker has substantial personal stake in striking a good bargain for them).

32. *Lingsch v. Savage*, 213 Cal. App. 2d 729, 736, 29 Cal. Rptr. 201, 205 (1963). In *Lingsch*, the buyers sued the seller for fraud for failure to disclose conditions of disrepair of an apartment building. The court held the seller liable. The broker, as agent, may be held jointly and severally liable for a failure to disclose material facts to the buyer.

33. Comment, *supra* note 2, at 1352.

34. CAL. CIV. CODE §§ 2338-2339 (West 1954).

35. CAL. CIV. CODE §§ 2349, 2351 (West 1954). "A subagent is a person appointed by an agent empowered to do so, to perform functions undertaken by the agent for the principal, but for whose conduct the agent agrees with the principal to be primarily responsible." RESTATEMENT (SECOND) OF AGENCY § 5 (1958). The sub-agent is an agent of both the listing broker and the principal. *Id.* See *Granberg v. Turnham*, 166 Cal. App. 2d 390, 394-95, 333 P.2d 423, 425-26 (1958) (listing broker held liable to sellers for misrepresentation by cooperating brokers to buyers); *Johnston v. Seargeants*, 152 Cal. App. 2d 180, 313 P.2d 41 (1957) (cooperating broker held liable to sellers for cancellation by buyers because of cooperating broker's misrepresentation to buyers).

Buyers are usually unaware of the sub-agency clause in listing agreements, and do not realize the cooperating broker, who is ostensibly representing them, in fact has confidential and fiduciary duties to the seller. *Romero, supra* note 19, at 772. That clause "seems to be ignored by, if not unknown to, many selling (cooperating) agents." *Id.*

36. CAL. CIV. CODE § 2351 (West 1954). *Contra* RESTATEMENT (SECOND) OF AGENCY § 5, Comment d (1958).

estate broker's actions.³⁷

Agency Agreements

An agency relationship between a broker and a seller may be written or oral, but most are created by one of the three common broker employment contracts or listing agreements: (1) the open listing, authorizing the broker to act as agent for the seller with commission going to any broker who closes the sale on terms agreeable to the seller; (2) the exclusive agency or exclusive right to sell agreement, guaranteeing the commission goes to the broker holding the exclusive position, regardless of who sells the property; or (3) the multiple listing.³⁸ The multiple listing agreement, where available, is probably the most common residential real estate agency agreement because it gives a property the broadest exposure to the market.³⁹ In a multiple listing, the property is listed with a local board of realtors' multiple listing service (MLS), a directory of houses for sale. The public has access to the MLS listing through member brokers. In the typical MLS arrangement, the listing broker splits his commission with any "cooperating" broker who brings in a successful offer and closes the sale.⁴⁰

Each of those agreements provides the opportunity for dual agency relationships⁴¹ as will be explained in the next section.

37. See *Miller v. Wood*, 222 Cal. App. 2d 206, 209, 35 Cal. Rptr. 49, 51 (1963) holding, "Where one of two innocent parties must suffer because of the fraud of a third, the loss must be borne by the person whose negligence and misplaced confidence made injury possible." *Accord*, *Skopp v. Weaver*, 16 Cal. 3d 432, 440, 128 Cal. Rptr. 19, 24 (1976); *Whiteman v. Leonard Realty*, 189 Cal. App. 2d 373, 376, 11 Cal. Rptr. 211, 213 (1961) (implied agency may arise from the words and conduct of the parties and the circumstances of the particular case).

38. CTAA DUAL AGENCY report, *supra* note 17, at 11, 13.

39. *Id.* at 13.

40. *Id.* at 14-15.

41. [I]t is apparent that from the judicial perspective, the broker who negotiates a sale of his own listing to a buyer who has engaged that same broker, and the cooperating broker in the cooperative transaction, will be considered as the agent of the seller, or the buyer, or both, which for all practical purposes makes him a dual agent in such transactions.

1 H. MILLER & M. STARR, *supra* note 1, at § 4:18, at 18. Where one broker represents both parties to a transaction, both buyers rightfully consider the broker *their* broker, and the broker "erroneously" believes it is possible to be in the middle and serve two masters. In the cooperative transaction, each party incorrectly believes that he is represented by his broker alone and that his broker is not also the broker to the other party.

Buyer-Broker Relationship

Express agency relations between a real estate broker and a prospective buyer of residential real estate are not common. The buyer usually deals directly with the seller's agent or with a "cooperating" broker. The real estate industry refers to a broker, other than the seller's agent, who procures a buyer for a piece of real property as the cooperating broker.⁴³ The cooperating broker *cooperates* with the seller's agent as a sub-agent in order to obtain a share (usually half) of the seller's commission. Thus, there is an unsavory relationship between cooperating agents and their buyers in that the cooperating broker has exactly the same financial motivation as the seller's broker to quickly close the deal at any relatively high price.⁴⁵

In practice, there is seldom a written agreement between the buyer and the cooperating broker for representation in procuring a home. The cooperating broker is guaranteed a commission through the seller's listing agreement. The buyer receives free representation to the extent of the presentation of the offer. The courts, however, have generally found an agreement implied from the actions of the parties, based on the reasonable expectations of the parties.⁴⁴

In the ordinary course of business, a buyer looking for a home seldom exercises any selectivity in who will represent her. Buyers typically contact the seller's broker directly in reference to the particular house in which he or she is interested because the listing broker has advertised the listing. Often, the seller's broker shows Blackacre to the buyer, discusses the possibility of an offer, and may even draw up an offer, which is made out in the form of a contract or deposit receipt. The offer is presented to the seller by the seller's broker, and if accepted, the sale may be consummated without the buyer ever having an agent in the fullest sense. If the buyer and seller fail to strike a bargain for Blackacre, the same broker may show the buyer Whiteacre or Brownacre without ever discussing the establishment of agency

Id.

42. The expression is a term of art referring to the clause in multiple listing agreements that permits members of the multiple listing service to assist in or cooperate in procuring a purchaser of a listed property.

43. See note 7 *supra*.

44. See *Anderson v. Thacher*, 76 Cal. App. 2d 50, 65, 172 P.2d 533, 541 (1946).

relations.

B. DUAL AGENCY

Dual agency is created when two essentially adverse principals, i.e., vendor and purchaser, are represented by a single entity or corporate agent.⁴⁵ Dual agency in real estate is created in two ways: either when the listing broker (or two sales agents employed by same broker) represents both sides in the sales transaction, or when a listing broker and a cooperating broker are involved in a transaction. The listing broker has a fiduciary duty, created by the employment contract, to negotiate a sale at the highest price and at the terms most favorable to the seller.⁴⁶ The cooperating broker has an implied agency relationship⁴⁷ to the prospective buyer to make reasonable efforts to negotiate the purchase at the lowest possible price acceptable to the seller. These obviously contradictory duties will be discussed later.

Where buyer and seller are represented by two sales agents of a single broker or brokerage firm, the situation is the same as if the broker himself were representing both principals. Under California law the broker has a duty to exercise reasonable supervision over his sales staff,⁴⁸ who are the broker's agents,⁴⁹ and who typically share in the sales commission.

In the typical multiple listing agreement, the listing broker is expressly the agent of the seller with fiduciary obligations to the seller.⁵⁰ The usual MLS agreement constitutes an offer of sub-agency to all other MLS members.⁵¹ A cooperating broker who submits an offer on behalf of a prospective buyer is deemed to have accepted the listing broker's offer of sub-agency, and thus the cooperating broker has fiduciary obligations to the

45. The courts have carefully distinguished acts performed by the agent of one principal for the opposing principal, such as lending funds for a down payment, from acts that involve at least potential conflicts of interest. See *McConnell v. Cowan*, 44 Cal. 2d 805, 285 P.2d 261 (1955).

46. As to the broker's fiduciary role, see notes 25-30 *supra*.

47. See *Vargas v. Ruggiero*, 197 Cal. App. 2d 709, 715, 17 Cal. Rptr. 568, 570-71 (1961).

48. CAL. BUS. & PROF. CODE § 10177(h) (West Supp. 1981).

49. Cf. *Gipson v. Davis Realty Co.*, 215 Cal. App. 2d 190, 206-07, 30 Cal. Rptr. 253, 262 (1963) (personal injury).

50. CTAA DUAL AGENCY report, *supra* note 17, at 14-15.

51. 1 H. MILLER & M. STARR, *supra* note 1, at § 4:18, at 17-18.

seller.⁵² In *Kruse v. Miller*,⁵³ for example, the buyer sued the seller for misrepresentations made by the cooperating broker about the condition of the property, and the buyer was awarded judgment. The seller then sued the cooperating broker for breach of the duty to inform him of the misrepresentation. The court held the cooperating broker was a sub-agent of the listing broker, and had a duty to act with the utmost good faith toward the seller and breached that duty by concealing the misrepresentation.⁵⁴

The courts have held the cooperating broker to be a sub-agent of the listing broker and an agent of the seller with full fiduciary obligations to the seller,⁵⁵ despite the reasonable expectations of the buyer. It appears agency fiduciary obligations may be imposed by a court long after the transaction has been consummated in an attempt to protect a wronged party.⁵⁶

Disclosure

Dual agency is generally improper as against public policy⁵⁷ because of the prospect of fraud. Dual representation is permitted only when it is done with the full knowledge and consent of both principals.⁵⁸ California has codified that exception and pro-

52. *Id.* at 18.

53. 143 Cal. App. 2d 656, 300 P.2d 855 (1956).

54. *Id.* at 660, 300 P.2d at 857. *See also* *Johnston v. Seargeants*, 152 Cal. App. 2d 180, 313 P.2d 41 (1957) (cooperating broker held to be agent of sellers even though she had never met the sellers).

55. *Skopp v. Weaver*, 16 Cal. 3d 432, 439, n.8, 546 P.2d 307, 312, 128 Cal. Rptr. 19, 24 (1976), *Kruse v. Miller*, 143 Cal. App. 2d 656, 660, 300 P.2d 855, 857 (1956). *See* 3 CAL. JUR. 3D *Agency* § 60. Miller and Starr contend that when the cooperating broker becomes an agent of the seller, the listing agent, under CAL. CIV. CODE § 2351, should no longer be liable for the wrongs committed by the cooperating broker. However, Miller and Starr note *Granberg v. Turnham*, 166 Cal. App. 2d 390, 333 P.2d 423 (1958) and *Johnson v. Seargeants*, 152 Cal. App. 2d 180, 313 P.2d 41 (1957), have held the listing broker liable for wrongful acts of the cooperating broker. 1 H. MILLER & M. STARR, *supra* note 1, at § 4:18, at 18. Ironically, the courts have also held the principal liable for the wrongful acts of the subagent. *Eye v. Kafer*, 202 Cal. App. 2d 449, 454, 20 Cal. Rptr. 841, 844 (1962); *Kruse v. Miller*, 143 Cal. App. 2d 656, 660, 300 P.2d 855, 857 (1956); *Whiteman v. Leonard Realty Co.*, 189 Cal. App. 2d 373, 376, 11 Cal. Rptr. 211, 213 (1961).

56. 1 H. MILLER & M. STARR, *supra* note 1, at § 4:18. *See* note 32 *supra*.

57. 1 B. WITKIN, *SUMMARY OF CALIFORNIA LAW, Agency and Employment* § 97 (8th ed. 1980).

58. CAL. BUS. & PROF. CODE § 10176(d) (West Supp. 1982). *See* *Wilson v. Lewis*, 106 Cal. App. 3d 805, 806, 165 Cal. Rptr. 396, 398 (1980); *Bonaccorso v. Kaplan*, 218 Cal. App. 2d 63, 68, 32 Cal. Rptr. 69, 72 (1962).

vides for sanctions against real estate licensees who violate the code.⁵⁹ A realtor who engages in dual agency without so informing the client may be subject to disciplinary action through the state Department of Real Estate even though the client suffers no pecuniary loss.⁶⁰ However, Miller and Starr, in the 1981 supplement to their treatise on California real estate law, state that "this knowledge and consent is rarely given in the ordinary transaction."⁶¹

Undisclosed dual agency has been held "a species of fraud."⁶² To encourage disclosure, the courts have held that no sales commission may be recovered by the dual agent who fails to disclose the conflicting arrangements.⁶³ Furthermore, where there is undisclosed or unconsented dual agency, either principal may rescind the contract of sale without showing actual injury.⁶⁴

Absent consent, a broker must expressly disavow an agency relation to one of the principals to avert the dual agency problem entirely,⁶⁵ but disavowal of agency is seldom done in practice. Therefore, a large proportion of real estate agreements in California appear to be rescindable on the grounds of undisclosed dual agency.⁶⁶ These rescindable transactions may be quietly waiting for some enterprising lawyer to discover. The numerous reported California cases in which rescission for undisclosed dual agency was granted may be just the tip of the iceberg.⁶⁷ A growing litigiousness, the changing housing mar-

59. CAL. CIV. CODE § 10176(d) (West Supp. 1982).

60. *Buckley v. Savage*, 184 Cal. App. 2d 18, 32, 7 Cal. Rptr. 328, 334-35 (1960), *cert. denied*, 366 U.S. 910 (1960).

61. 1 H. MILLER & M. STARR, *supra* note 1, § 4:18, at 19.

62. *Peyton v. Cly*, 184 Cal. App. 2d 193, 198, 7 Cal. Rptr. 504, 507 (1960).

63. *McConnell v. Cowan*, 44 Cal. 2d 805, 810, 285 P.2d 261, 265 (1955); *Glenn v. Rice*, 174 Cal. 269, 272, 162 P. 1020, 1021 (1917); *Jarvis v. Obrien*, 147 Cal. App. 2d 758, 305 P.2d 961 (1957); RESTATEMENT (SECOND) OF AGENCY §§ 391, 392, 394 (1958).

64. *Gordon v. Beck*, 196 Cal. 768, 771-72, 239 P. 309, 311 (1925).

65. Some listing brokers claim to avoid the dual agency problem by employing a legal fiction in which they refer to the buyer who is interested in a property listed with the broker, as a "customer" rather than a client. CTAA SINGLE AGENCY report, *supra* note 20, at 5. There is no case law to the point, but it seems clear the client-customer scheme is a distinction without a legal difference.

66. 1 H. MILLER & M. STARR, *supra* note 1, at § 4:18, at 20.

67. *Id.* (citing e.g., *Vice v. Thacker*, 20 Cal. 2d 84, 180 P.2d 4 (1947); *Gordon v. Beck*, 196 Cal. 768, 239 P. 309 (1925); *Standard Realty Dev. Co. v. Ferrera*, 151 Cal. App. 2d 514, 311 P.2d 855 (1957); *Baird v. Madsen*, 57 Cal. App. 2d 465, 124 P.2d 885 (1943)).

ket,⁶⁸ the high cost of correcting latent defects such as sagging foundations, etc., and the ongoing consumer movement are catalysts that could produce an explosion in such litigation.

What Must Be Disclosed?

There are two disclosure considerations: The disclosure of the dual agency itself and disclosure by the dual agent of pertinent facts about the nature of the transaction.

Disclosure of dual agency itself was discussed in the prior section. As to the second element, disclosures of pertinent information, general agency law provides that an agent acting for two diverse principals "has a duty to act with fairness to each and to disclose to each all facts which he knows or should know would reasonably affect the judgment of each in permitting such dual agency"⁶⁹ The common law rule is that the dual agent has

If dual agency is not disclosed,

as is the usual case, and neither party is aware of the dual representation, either party may rescind the transaction without proof of actual fraud or injury.

Since the dual representation is not disclosed in the usual real estate transaction, each of the parties and their agents are assuming unknown liabilities in many cases and, as bizarre as it may sound, most such transactions are rescindable as a *matter of law!*

1 H. MILLER & M. STARR, *supra* note 1, at § 4:18, at 19 (emphasis in original).

68. In these times of tight money supply, buyers often take out three to five-year first mortgages with large "balloon payments" due at term, speculating on the continued appreciation of the real estate, and the hope that interest rates will decline and mortgage funds become more readily available. Commentators suggest that many buyers may soon go into default if their gamble does not succeed. See *The Housing Recession*, NEWSWEEK, Sept. 21, 1981, at 85. This alone could create a reservoir of disillusioned purchaser-plaintiffs seeking rescission from obligations they can not fulfill.

69. RESTATEMENT (SECOND) OF AGENCY § 392 (1958). See *Saporta v. Barbagelata*, 220 Cal. App. 2d 463, 474, 33 Cal. Rptr. 661, 667 (1963); *Anderson v. Thacher*, 76 Cal. App. 2d 50, 68, 172 P.2d 533, 543 (1946). According to the Restatement:

The agent's disclosure must include not only the fact that he is acting on behalf of the other party, but also all facts which are relevant in enabling the principal to make an intelligent determination The agent, however, is under no duty to disclose, and has a duty *not* to disclose to one principal, confidential information given to him by the other, such as the price he is willing to pay. If the information is of such a nature that he cannot fairly give advice to one without disclosing it, he cannot properly continue to act as advisor

RESTATEMENT (SECOND) OF AGENCY § 392, Comment b (1958).

a duty to disclose to the principal any material fact that would affect the principal's decision on the subject matter of the agency.⁷⁰ In California, a broker in a dual agency role also has a fiduciary duty to tell the buyer of any latent or patent defects, such as the condition of the foundation, the extent of termite or roof damage, etc.⁷¹ A recent California Court of Appeal case, *Jorgensen v. Beach 'N' Bay Realty, Inc.*,⁷² held that listing brokers acting in a dual capacity have a fiduciary duty to disclose to the vendor that the prospective buyers are investors and that the brokers had a substantial personal stake in striking a good bargain for them.⁷³

These conflicting duties of disclosure put the broker in a position to do disservice to both parties. For example, the listing broker who also represents the buyer should inform the unwary buyer of recent mud slides in the neighborhood, a fact which could be enough to scare off the prudent purchaser. The broker would also be obligated to inform the seller of more advantageous offers of third parties and to notify the seller that a prospective buyer, while solvent, has just lost her job and thus may default on a seller-carried second mortgage. Being privy to confidential information from both principals which could affect the other's position, the dual agent is commonly in the schizophrenic position of having to divulge such information at the ex-

70. *Jorgensen v. Beach 'N' Bay Realty, Inc.*, 125 Cal. App. 3d 155, 177 Cal. Rptr. 882 (1981) (fiduciary breach in non-disclosure by broker of buyers' status as investors and non-disclosure of brokers' stake in striking a good bargain for buyers); *Bate v. Marsteller*, 175 Cal. App. 2d 573, 580-81, 346 P.2d 903, 907-08 (1959) (Seller's broker loses right to agreed upon commission for disclosing to buyers that seller will accept lower price); *Simone v. McKee*, 142 Cal. App. 2d 307, 312, 298 P.2d 667, 671 (1956) ("[F]ailure to disclose [a more favorable offer than the one presented for acceptance] . . . is equivalent to the affirmative representation that no other offer existed.").

71. *Ford v. Cournale*, 36 Cal. App. 3d 172, 180, 111 Cal. Rptr. 334, 339 (1973) (duty to disclose rental income); *Saporta v. Barbagelata*, 220 Cal. App. 2d 463, 474, 33 Cal. Rptr. 661, 667 (1963) (failure to disclose termite damage); *Lingsch v. Savage*, 213 Cal. App. 2d 729, 736, 29 Cal. Rptr. 204, 210 (1963) (duty to disclose state of disrepair to buyers).

72. 125 Cal. App. 3d 155, 177 Cal. Rptr. 882 (1981). In *Jorgensen*, the plaintiff vendors sued their listing broker for fraud, misrepresentation, negligence and breach of fiduciary duty when, after selling their property for \$200,000, they learned the property was immediately resold for \$227,000. The trial court nonsuited the plaintiff and the Fourth District Court of Appeal reversed.

73. *Id.* at 162, 177 Cal. Rptr. 882, 886. The *Jorgensen* court held that if a fact is likely to affect the judgment of the principal in assenting to a transaction, the fact is "material" and must be disclosed. *Id.* (citing *Rattray v. Scudder*, 28 Cal. 2d 214, 224, 169 P.2d 371, 377 (1944)).

pense of one or the other principal.⁷⁴

C. THE BUYER'S WEAK POSITION

The lack of effective representation is one of the main defects of the dual agency system.⁷⁵ The buyer suffers because of the broker's incentive to close the deal quickly, irrespective of the merits (from the buyer's viewpoint) of the terms of the sale agreement, and because "negative factors" that would make a buyer resistant to consummating a deal are often not fully discussed.⁷⁶ Buyers, especially home buyers, are often emotionally anxious to close the sale on their dream home, and will sometimes agree to unfair, last-minute changes in purchase terms.⁷⁷

The buyer's weak position stems particularly from three factors: (1) the choice of broker is often dictated by happenstance rather than rational choice;⁷⁸ (2) the listing broker's pri-

74. See CAL. REAL ESTATE COMMISSIONER'S REGULATION 2785 (a)(3) which makes unlawful:

[T]he failure by a licensee acting in the capacity of an agent in a transaction for the sale, lease, or exchange of real property to disclose to a prospective purchaser or lessee facts known to the licensee materially affecting the value or desirability of the property when the licensee has a reason to believe that such facts are not known to nor readily observable by a prospective purchaser.

See also note 69 *supra*; Stambler and Stein, *supra* note 6. *Contra* 1 H. MILLER & M. STARR, *supra* note 1, at § 4:18 at 19.

75. CTAA DUAL AGENCY report, *supra* note 17, at 50-51. The data for this study is based in part on the responses of 32 brokers, attorneys and academics to extensive and detailed questionnaires. Of those responding to the questionnaire, a majority agreed that the denial of representation to the buyer-transferee in dual agency situations is either an "important" or "very important" problem posed by that practice.

76. *Id.* at 51 (quoting remarks of a panelist).

77. *Id.* at 53.

It would appear that the situation is confusing to all parties concerned and may operate to the detriment of buyers. This interpretation appears valid despite the fact that the cooperating agent must, as a licensee, act honestly, truthfully, and fairly in the absence of a fiduciary relationship. The confusion in the law may make it difficult for listing as well as cooperating agents to discharge their duties properly in real estate transactions. Further, legal uncertainties might entice some agents to seek an advantage from the confusion by 'manipulating' the disclosure of information between seller and buyer.

Id. at 6-7.

78. See R. Hempel, *The Role of the Real Estate Broker in the Home Buying Process*, in STORRS, CONNECTICUT: CENTER FOR REAL ESTATE AND URBAN ECONOMIC STUDIES, UNIVERSITY OF CONNECTICUT, REAL ESTATE REPORTS No. 7, at 43 (1969), *quoted in* CTAA

mary loyalty is to the seller because of his contractual fiduciary relationship,⁷⁹ and the cooperating broker, unless he is working on a fee-for-service basis for the buyer—a rare situation—is a sub-agent of the listing broker;⁸⁰ and (3) the contingent fee system. Because of contingent fees, a real estate broker has little incentive to negotiate the lowest possible price. In fact, the broker's interest is best served with an offer that matches the asking price, as such an offer is most likely to be successful and reduce the need for further negotiations. Thus, any broker's first and understandable instinct would be to persuade the buyer that an overpriced home is actually a bargain, rather than to seek a price reduction from the seller. An additional incentive is that the broker's fee is normally paid from the profits on the sale of the home. Buyers are lulled into a false sense of security that their interests are protected, when in fact there is often no one with a primary interest or legal obligation to them.⁸¹ It is only in retrospect that courts find such obligations in their breach.

D. SINGLE AGENCY AND BUYERS' BROKERS

The real estate industry has responded in a modest way to the problems posed by dual agency in California. A few "alternative brokers" who represent buyers only, or buyers mostly, have been established.⁸² There are also firms that offer a specified or a limited set of services to sellers⁸³ on a flat fee or hourly fee

DUAL AGENCY report, *supra* note 17, at 73. This report shows that the majority of buyers contact three to seven brokers in searching for a house, whereas the seller usually is committed contractually to one broker. The prospective buyer makes an initial contact with a realtor through advertisements of specific house listings. See text accompanying note 42 *supra*.

79. See text accompanying note 40 *supra*.

80. The Berkeley Multiple Listing Service's Authorization to Sell—Exclusive Right Listing form contains the following language: "It is understood Broker is a broker member of Berkeley MLS. Members of said MLS may act in association with Broker in procuring or attempting to procure a purchaser." This creates an implied sub-agency relationship between the listing broker and the cooperating broker.

81. *Hale v. Wolfson*, 276 Cal. App. 2d 285, 290, 81 Cal. Rptr. 23, 27 (1969). See also *Johnston v. Sergeants*, 152 Cal. App. 2d 180, 313 P.2d 41 (1957); *Kruse v. Miller*, 143 Cal. App. 2d 656, 300 P.2d 855 (1956). In *Hale*, the court held the buyer's agent to be an agent of the seller because he split the commission with the seller's broker.

Brokers have a statutory duty to refrain from false representations and fraud, even where there is no fiduciary relationship. CAL. BUS. & PROF. CODE §§ 10176(a) to 10176(c), 10176(i) (West Supp. 1982).

82. CTAA SINGLE AGENCY report, *supra* note 20.

83. Some provide counselling as to price and advertising, but require the owner to

basis.⁸⁴

The buyers brokers avoid the dual agency problem and its inherent conflicts of interest and risk of litigation by establishing a single agency relationship with their clients and explicitly renouncing any agency relationship with the opposing party.⁸⁵ Some buyer's brokers use an exclusive right to buy agreement which guarantees a fee for their service when their client closes escrow on a suitable purchase.⁸⁶ These brokers receive no commission from the seller or listing broker and function as independent contractors representing the buyer in securing the best deal.⁸⁷ However, there are few such agencies in California.

At least one Multiple Listing Service⁸⁸ has re-written its listing agreement to explicitly negate any express or implied agency between the listing broker and the buyer.⁸⁹ The vast majority of brokers in California, however, continue to split fees under a sub-agency agreement. There remains considerable resistance among multiple listing services to adopting single agency arrangements; and brokers who unilaterally adopt such agreements are sometimes shunned by both the MLS and other brokers as mavericks,⁹⁰ despite possible anti-trust violations.⁹¹

show the property.

84. There are actually a variety of fee arrangements in single agency firms. Many still accept a fee split with the listing broker. Some employ a percentage of sale agreement, with the percent ranging from 2 to 15 percent. Flat fees usually depend on the dollar value of the transaction, its complexity and the amount of service to be rendered. Hourly fees range from \$50 to \$225. CTAA SINGLE AGENCY report, *supra* note 20, at 27.

85. *Id.* at 25-26.

86. *Id.* at 26.

87. The CTAA study involved interviews with 29 brokers who used at least some single agency agreements. These were predominately brokers of commercial, industrial or income residential property. Only about a third of their business involved a typical home sale. CTAA SINGLE AGENCY report, *supra* note 20, at 12. Most of these brokers did not limit their business to single agency. By "single agency," the brokers were said to mean that they either refused to represent the buyer in the negotiations for one of the properties they listed or that they would take on the purchaser as a "customer" rather than a client. The customer enjoys no agency relationship, and is expressly notified of that fact. *Id.* at 25.

88. The Menlo Park-Atherton Board of Realtors Multiple Listing Service has such a single-agency agreement which eliminates the sub-agency relation of the cooperating broker to the listing broker. CTAA SINGLE AGENCY report, *supra* note 20, at 21.

89. *Id.* at 27-28.

90. *Id.* at 24.

91. *See* note 116 *infra*.

III. THE DUAL AGENCY DILEMMA: POSSIBLE RESOLUTIONS

Dual representation is a most unfortunate misnomer for the problem presented in residential real estate brokerage. Actually there are three competing interests in the normal real estate sales transaction: the interest of the vendor in the highest price and best terms; that of the purchaser in the lowest price and best terms; and that of the dual agent who desires any acceptable agreement which would bring the principals together and close the deal. Unfortunately, in this pivotal position, the real estate agent has few ethical signposts to follow. Regulations of the California Department of Real Estate⁹² contain prohibitions on obvious fiduciary breaches, such as fraud and misrepresentations,⁹³ non-disclosure of material facts,⁹⁴ inducing the principal to act against her own interest⁹⁵ and self-dealing,⁹⁶ but they do not discuss the dual representation situation.

There are in fact no real estate departmental regulations that provide the general ethical guidance for licensees in representing adverse interests that, for example, the American Bar Association's Model Code of Professional Responsibility⁹⁷ provides lawyers. ABA Canon 5,⁹⁸ including its disciplinary rules and ethical considerations,⁹⁹ provides special guidance to lawyers by prohibiting representation of clients with differing interests¹⁰⁰ "unless it is *obvious* tht he can adequately represent the

92. CAL. ADMIN. CODE, tit. 10, § 2785(a) (1981) deals with unlawful conduct and § 2785(b) deals with unethical conduct. Section 2785(a) contains mandatory sections dealing with fraud, dishonest dealing, and conduct warranting denial or revocation of a real estate license under CAL. BUS. & PROF. CODE §§ 10176, 10177 (West Supp. 1982).

93. CAL. ADMIN. CODE, tit. 10, § 2785(a)(1) (1981).

94. *Id.* § 2785(a)(3).

95. *Id.* § 2785(a)(6).

96. *Id.* § 2785(a)(11).

97. MODEL CODE OF PROFESSIONAL RESPONSIBILITY (amended ed. 1980).

98. Canon 5 provides: "A lawyer should exercise independent professional judgment on behalf of a client." *Id.*

99. *See id.* DR 5-105(A)-(C) and EC 5-15 to 5-20.

100. DR 5-105(A) requires a lawyer to

"decline proffered employment if the exercise of his independent professional judgment in behalf of a client will be or is likely to be adversely affected by the acceptance of the proffered employment, or if it would be likely to involve him in representing differing interests, except to the extent permitted under DR 5-105(C)."

Id.

interests of each and if each consents . . . after full disclosure of the possible effect of such representation"¹⁰¹ Under Canon 5, *all doubts* about such divided loyalties should be resolved *against* the propriety of the representation.¹⁰² The industry and the regulators would do well to investigate the desirability of imposing ethical guidelines for the representation of multiple diverse interests.

Department of Real Estate Study

The California Department of Real Estate commissioned a study of the problem of dual agency in California real estate transactions. The resulting report, issued by California Technical Assistance Associates, Inc. (CTAA) in February, 1981, sheds considerable light both on the impact of dual agency in real estate practice and on the perceptions of real estate industry people, real estate lawyers and academicians as to the scope of the problem.¹⁰³

The report concludes that "[w]ithin the complex web of potential obligations and liabilities between [sic] buyers, sellers, agents, and subagents, the courts have not been reluctant to find an agency relationship when necessary to protect the interests of either party damaged by a real estate broker's actions."¹⁰⁴

101. *Id.* DR 5-105(C) (emphasis added).

102. *Id.* EC 5-15.

103. CTAA DUAL AGENCY report, *supra* note 17.

104. *Id.* at 30. See also *id.* at 26 (citing *Miller v. Wood*, 222 Cal. App. 2d 206, 35 Cal. Rptr. 49 (1963) ("[T]here is a compelling reason to find a real estate agent to be an agent whenever his acts or omissions cause injury in a real estate transaction.")). In *Kruse v. Miller*, 143 Cal. App. 2d 656, 300 P.2d 855 (1956), the court found the innocent seller of a property liable for the misrepresentations of a cooperating broker to the buyer, but permitted the seller to recover the loss from the broker. *Id.* at 660, 300 P.2d at 858. In *Granberg v. Turnham*, 166 Cal. App. 2d 390, 333 P.2d 423 (1958), where the buyer sued the seller for misrepresentations made by the cooperating broker, the court permitted the seller to recover from the listing broker.

The CTAA researchers said the predeliction of the courts to find agency relations and fiduciary obligations, even in situations where the parties had not originally expected or desired to have such relationships, creates unacceptable conflicts for brokers in the most common of real estate transactions.

[T]he broker cannot pursue the interests of both the buyer and seller equally, i.e., he cannot recommend acceptance by the seller of an offer he/she knows is close without violating his/her duty to obtain the best terms for the seller, and alternatively, he/she would violate his/her duty to obtain the best terms for the buyer if he/she did not recommend acceptance.

The CTAA researchers recommend that the Department of Real Estate take several specific actions to cope with the inherent conflicts of interest arising from dual agency,¹⁰⁵ but there is scant discussion of the ethical implications of dual representation,¹⁰⁶ and no suggestion that existing regulations could ameliorate the problems. Notably absent from the CTAA recommendations is the call for outright elimination or limitation of dual agency in residential real estate transactions. Rather, elimination of dual representation was listed merely as one of four policy options for the licensing agency to consider.¹⁰⁷

CTAA DUAL AGENCY report, *supra* note 17, at 32.

However, case law to date has yet to find a cooperating broker liable for *authorized* acts for one principal which were in no way culpable except that they violated a fiduciary obligation to the other principal. *Id.* at 33. The authors state that the decided cases have all dealt with material misrepresentations that were neither known by nor acceded to by the principal.

105. They are:

- [1] The DRE should increase the emphasis on dual agency in licensing examinations; dispense more information on dual agency to agents; and encourage consideration of dual agency in continuing education;
- [2] The department should encourage consumers to explore single agency arrangements when entering the real estate market; develop appropriate standard forms for establishing single agency; and develop guidelines for establishing single agency; and,
- [3] The DRE should develop standard disclosure statements for all types of transactions in which dual agency could arise. The disclosure should specify the duties and obligations of the licensee, issues not subject to agency (e.g. price), and make reference to potential conflicts of interest. It should also institute disclosure requirements for dual agency arrangements in real estate transactions which would be printed on listing agreements and deposit receipts. These disclosure statements should be drafted by the DRE in collaboration with industry representatives.

CTAA DUAL AGENCY report, *supra* note 17, at 70.

106. *Id.* at 49.

107. They are:

- [1] Elimination of dual agency by requiring single agency between agents and clients;
- [2] Establishing single agency under certain conditions (this retains the status quo except to encourage single agency via a policy statement by the Real Estate Commission and a public information campaign);
- [3] Continuation of dual agency but clarification through the use of disclosure statements of the duties and obligations of brokers to principals; and
- [4] Improved education for real estate licensees to increase awareness of legal obligations and liabilities of dual agency

Eliminating Dual Agency By Statute

There are few who absolutely would proscribe dual agency in real estate transactions. Miller and Starr may be alone in their zeal for institution of single agency. The industry as a whole has not taken a position on the subject,¹⁰⁸ though there are, arguably, financial incentives for ending dual agency: the elimination of some of the potential liability for breaches of fiduciary duty, and a greater spreading of sales fees among the smaller brokers. Large brokerages, naturally, handle a proportionately larger percentage of the in-house (one broker) sales because they have the largest number of listings in any given community, and thus may lose some of the advantage of their very size.

A change to single agency, or the elimination of sub-agency, however, would require a significant alteration in the means of doing business for the vast majority of real estate brokers. Brokers would have to refer potential purchasers to competitor firms. Of course, such referrals would be reciprocal if dual agency were barred, thus balancing the benefit and burden of the practice. Multiple listing agreements would have to be rewritten to eliminate sub-agency by cooperating brokers. There is a natural resistance to change in any large industry.

Single agency, which is the norm only in commercial transactions where clients have developed a business relationship with a particular real estate firm,¹⁰⁹ could become the rule in residential sales as well. But this is unlikely to occur through widespread voluntary action of the market. The elimination of sub-agency in the Menlo Park-Atherton listing agreement occurred largely because of the unusual combination of factors peculiar to that extraordinarily affluent, legally sophisticated community.¹¹⁰

arrangements.

Id. at 70-79. Given the seeming ignorance of the licensees of these matters, option four should be implemented regardless of which other courses are followed. If dual agency were eliminated, new educational requirements would have to be developed to incorporate the new rules, but there would be no need for further dual agency disclosure requirements.

108. Officials for the California Association of Realtors said the association has no position on the subject at this time.

109. CTAA SINGLE AGENCY report, *supra* note 20, at 19-22.

110. The acceptance of single agency in Menlo Park was due to the concentration in

Consumers and consumer groups have long favored changes in the agency relationships and have applauded even modest efforts to improve the representation of buyers of real estate.¹¹¹ The Federal Trade Commission (FTC) has responded to comments and complaints from these groups with an investigation. The FTC has published a set of recommendations¹¹² for changes in sales practices to encourage competitiveness in real estate brokerage, to improve consumer awareness of choices currently available in broker-buyer relations, and to clarify the legal duties between brokers and among brokers and consumers,¹¹³ but these have yet to be adopted.

Eliminating dual agency in real estate transactions would require repeal of California Business and Professions Code section 19176(d)¹¹⁴ and changes in the implementing provision of real estate department regulations. A new statute mandating single agency would be required and appropriate administrative regulations would have to be adopted.¹¹⁵ Further, the sub-agency provisions of multiple listing agreements would have to be eliminated.¹¹⁶

that community of very sophisticated brokers, many with Ph.D's and Master's Degrees, who are concerned about making mistakes in representation and who are keenly aware of the responsibilities and implications of real estate law. *Id.* at 22. The realty board counsel's strong advocacy and the currently high selling price of homes in the area (average selling price of MLS-listed homes in 1981 was \$287,000) were also major factors supporting single agency relationships. *Id.*

111. See *Does the 'Buyer's Agent' Represent the Buyer?*, CONSUMER REPORTS, Sept., 1980, at 573. The Federal Trade Commission reports receiving complaint letters, petitions, and public statements from individuals and consumer groups calling attention to the problem of inadequate representation of buyer's and seller's interests. 45 Fed. Reg. 77,959 (1980).

112. 46 Fed. Reg. 25,476 (1981). The FTC has yet to take action on the proposal. The staff report raises the issue of competitiveness of commissions "in light of the commonplace 6 or 7 percent commission rates" and of possible conflicts of interest and consumer under-representation. *Id.*

113. *Id.*

114. (West Supp. 1982). That section states: "The commissioner may . . . temporarily suspend or permanently revoke a real estate license . . . where the licensee . . . has been guilty of . . . [a]cting for more than one party in a transaction without the knowledge or consent of all parties thereto."

115. For example, the statute could read: "A licensee shall represent as agent only one side to a transaction. A broker representing a vendor shall refer all prospective purchasers to another licensee. Licensees representing buyers shall have a primary obligation and duty to the buyer's interests, regardless of who is paying the fee."

116. The advantages of this proposal were identified by the CTAA Dual Agency report. It:

[1] eliminates conflicts of interest inherent in dual agency;

Encouraging Single Agency With Ethical Guidelines or Caveats

The state could take a softer approach to the problem and

[2] facilitates "arm's length" dealing between buyers and sellers;
 [3] reduces the risk of (fraud and malpractice) litigation for brokers;
 [4] improves representation for the buyer and possibly for the seller;
 [5] improves the position of the cooperating broker who was often in a conflict of interest situation;

[6] shifts the viewpoint of real estate agents from that of deal-makers to professionals whose behavior now closely resembles that of other professionals such as attorneys. CTAA DUAL AGENCY report, *supra* note 17, at 70-71.

On the negative side, eliminating dual agency might prevent the buyer from using the remedy of rescission and restitution in the event of a misrepresentation by the cooperating broker. *Id.* at 72. The explanation is that the seller is liable to the buyer for misrepresentations of the listing broker because of the sub-agency relation between cooperating and listing brokers. *Id.* (citing Romero, *supra* note 19, at 773 n.33). Romero notes that the seller is liable to the buyer in tort for misrepresentations of the cooperating broker through the ratification doctrine. RESTATEMENT (SECOND) OF AGENCY §§ 82, 90-100, 218 (1958). Abolishing the sub-agency relation would preclude that liability and eliminate rescission as a buyer's remedy for a breach by seller's broker, and thus would be more harmful than helpful. That is true, but it does not eliminate remedies against the broker for damages. And, if the misrepresentation was ratified by the listing broker, RESTATEMENT (SECOND) OF AGENCY §§ 82, 92-93, 90-100, 218 (1958), that misrepresentation may be imputed to the seller, CAL. CIV. CODE §§ 2338, 2339 (West 1954), giving the buyer a cause of action against the seller. *See also* CTAA DUAL AGENCY report, *supra* note 17, at 65, 67.

Currently, the cooperating broker has a fiduciary relation to the seller, which renders the seller liable for the acts of that broker. *Granberg v. Turnham*, 166 Cal. App. 2d 390, 333 P.2d 423, (1958); *Johnston v. Seargeants*, 152 Cal. App. 2d 180, 313 P.2d 41 (1957). *See also* *Skopp v. Weaver*, 16 Cal. 3d 432, 546 P.2d 307, 128 Cal. Rptr. 19 (1976); *Wright v. Lowe*, 140 Cal. App. 2d 891, 296 P.2d 34 (1956). Of course, without the problems inherent in dual agency, there may be no need for rescission.

The CTAA Dual Agency report makes two other arguments against elimination of dual agency which seem to be red herrings. One is that elimination of dual agency would threaten the rights of cooperating brokers to commissions in the event of a seller's default without cause. Of course, eliminating dual agency does not prevent any broker from contractually obligating the seller to pay the commission in such a situation. The report claims the threat to commissions for cooperating brokers would reduce the number of cooperative sales and increase the potential for "in house" sales, hence, dual agency situations. If dual agency were eliminated, in-house sales would probably be virtually impossible to consummate within the law. CTAA DUAL AGENCY report, *supra* note 17, at 72.

The second point is even more spurious: that elimination of sub-agency relations between listing brokers and cooperating brokers would somehow destroy the MLS program as buyers would gain direct access to it. *Id.* at 72. Since buyers are the major competitor to the broker (because they may learn of a listing independent of MLS), MLS listings are confidential and open to member brokers only. This protects brokers member from direct competition by the buying public. (Although many broker-members of MLS routinely violate the confidentiality of the listings, such breaches of confidentiality are technically grounds for discipline by the local MLS.) CTAA argues that if buyers had unrestricted access to MLS listings, the number of cooperating brokers would diminish, in effect, due to competitive disadvantages. That in turn would lead to the eventual withering away of the MLS, to the detriment of the public, which is served by it as a marketing mechanism.

merely encourage the use of single agency arrangements on a voluntary basis and adopt some ethical guidelines analogous to the ethical considerations in ABA Canon 5.¹¹⁷ This would shield sellers from liability for actions of a cooperating broker, would provide buyers better representation, and give an impetus for the establishment of single agency or buyer's brokerage firms.

The disadvantage of this approach is that dual agency relationships could continue, leaving brokers and sellers liable for the actions of cooperating brokers, and retaining a system in which in the ordinary real estate transaction brokers will continue to have deeply-conflicted loyalties. However, an ethical stricture could bring enormous pressure to bear on licensees to avoid dual agency, because violation of such guidelines could provide a basis for disciplinary action or presumptive evidence of legal liability.¹¹⁸

Alternatively, the Department of Real Estate could place the onus to opt for single agency on the client by requiring that a caveat be added to every real estate purchase offer form, reading: "It is strongly recommended that the buyer seek representation from an agent or lawyer who has no agency relationship with the seller."¹¹⁹

This argument ignores the ruling in *People v. National Ass'n of Realtors*, 120 Cal. App. 3d 459, 174 Cal. Rptr. 728 (1981), which held the policy, adopted by local, state and national real estate associations, of excluding non-members from the residential multiple listing service constituted an illegal group boycott and unlawful restraint of trade under sections 16700 to 16750 of the California Business and Professions Code. 120 Cal. App. 3d at 478, 174 Cal. Rptr. at 738. Even if the confidentiality of MLS listings were not an anti-trust violation, it makes little sense to try to maintain the confidentiality of the listings when the confidentiality rule is so openly flouted. Further, there is no reason for buyers who use the MLS to obtain listing information not to seek the professional representation services and expertise of a broker in considering the relative merits of various properties, preparing an offer, and seeking financing. These services could be offered on flat fee or hourly basis, like those of any other professional.

117. MODEL CODE OF PROFESSIONAL RESPONSIBILITY (amended ed. 1980), Canon 5, at 24.

118. Brokers who want to organize as buyers' brokers would benefit by this type of encouragement, because as these agencies gain acceptance in the industry and receive official sanction, they will gain credibility with the public.

119. A state-mandated caveat of this type would not be unprecedented. CAL. BUS. & PROF. CODE § 10147.5 (West Supp. 1982) requires a statement be appended to any agreement for the payment of a real estate commission: "Notice: The amount or rate of real estate commissions is not fixed by law. They are set by each broker individually and may be negotiable between the seller and broker." *Id.*

Improving the Disclosure Requirements

A clearly-written statement to be signed by both principals, could be added to the offeror's deposit receipt, disclosing and explaining the significance to both principals of the dual agency and spelling out the duties of the agents. This should alert the parties to the advantages of separate representation, and eliminate some misunderstandings of the parties. The disclosure statement could be used either for in-house sales, or in cooperative sales.¹²⁰ Buyers and sellers have a reasonable right to expect some degree of neutrality and professionalism from their agents. Improved disclosure would not provide that neutrality, but it would enhance the professionalism of the industry.

In any case, once the dual agency itself has been properly disclosed, the courts sometimes relieve dual agents of the conflicting duty to disclose to *both* principals material information about the subject property and the transaction.¹²¹ This creates the anomalous situation in which a broker can be held to be an agent while being excused of some of the major fiduciary obligations of an agent, i.e., the duties of absolute loyalty and disclosure.¹²² Thus, merely improving the dual agency disclosure requirements leaves one of the objectionable aspects of dual agency unresolved, and does not eliminate the underlying problem of under-representation of the buyer.

IV. CONCLUSION

Far stricter control is warranted over the dual agency relationship in the real estate business, given the great potential for harm to the parties to the ordinary real property transaction.¹²³ There is a basic duality of interest in the contingent fee system of the real estate business: The sale agent's primary financial interest is to close the sale with the least investment of time, and

120. CTAA DUAL AGENCY report, *supra* note 17, at 76.

121. 1 H. MILLER & M. STARR, *supra* note 1, at § 4:18. *Skopp v. Weaver*, 16 Cal. 3d 432, 439, n.7, 546 P.2d 307, 311, 128 Cal. Rptr. 19, 23 (1976) (citing RESTATEMENT (SECOND) OF AGENCY § 392, Comment b (1958): "[In a dual agency the] agent . . . is under no duty to disclose, and has a duty not to disclose to one principal, confidential information given to him by the other."). *But see Vincent v. Thompson*, 218 Or. 100, 343 P.2d 904 (1959); *Richer v. Burke*, 147 Or. 465, 34 P.2d 317 (1934).

122. *Batson v. Strehlow*, 68 Cal. 2d 662, 674-75, 441 P.2d 101, 109-10, 68 Cal. Rptr. 589, 597-98 (1968).

123. *See Sampson and Kirby*, *supra* note 14, at 10.

that conflicts squarely with the duty to serve the principals in negotiating the best terms for each of the parties at an acceptable price. When dual agency is added to that dual interest, there is great potential for unfair and fraudulent dealing.

Dual agency is preferred by real estate agents because it allows them the flexibility of negotiating purchases and sales from among the clients of their firm, and enables a single agent to capture the entire sales commission. The alternative, single agency, would impose a level of professionalism on the real estate business that the industry has thus far managed to avoid.

The risks of dual agency are borne by the individual least able to appreciate their significance: the consumer seeking to purchase a house. Those who know better, commercial and industrial real estate clients, usually are represented separately.¹²⁴ Home buyers, who are less legally sophisticated, happily accept the free services of the listing broker and are thus effectively unrepresented in the ordinary home sale transaction.¹²⁵

The law makes a feeble attempt to protect the client from outright duplicity by requiring disclosure.¹²⁶ Disclosure of dual agency, however, is perfunctory at best, frequently haphazard, and often overlooked as a legal and ethical imperative largely because of the contingent fee system in real estate brokerage.¹²⁷ Even when there is disclosure and consent to dual agency, the inherent conflict of interest is not resolved, only acknowledged. Under those circumstances, unfair dealing by agents is either rife but unreported, or is uncommon only because of the innate honesty of real estate agents.¹²⁸ Costly and wasteful rescission battles may be the only way for the hapless purchaser to undo the harm done by the lack of representation.

Undisclosed dual agency could become a standard legal ground for rescission if the industry or the state does not enact

124. CTAA SINGLE AGENCY report, *supra* note 20, at 10-14.

125. *Id.*

126. CAL. BUS. & PROF. CODE § 10176(d) (West Supp. 1982).

127. CTAA DUAL AGENCY report, *supra* note 17, at 2. Informal inquiries revealed that there are few California real estate boards that recommend formal written disclosure of dual agency. Rather, disclosure is left to the individual agent and is usually done orally.

128. See note 2 *supra*.

more rigorous requirements. As a minimal first step on the road to curing the ambiguities and conflicts of interest inherent in dual agency, an explicit disclosure statement, spelling out duties, liabilities and even motives of the broker should be required by statute.

The problems of inherent conflict of interest and the underrepresentation of buyers in the realty market are exacerbated by the permissive statutory provisions and common law that allow a single entity to serve conflicting masters. In the interests of justice, the California courts have been willing to expand to a considerable degree the liability of brokers in real estate transactions where divided loyalties have compromised the interests of an innocent party.¹²⁹ The courts have found sub-agency relations and the attendant fiduciary obligations even in situations where neither the industry nor the public had expressly intended them.¹³⁰ This is a two-edged sword: It provides a right of action for wronged parties. But it is remedial in nature and thus wasteful when the problem could largely be averted if each party to a real estate transaction were represented independently.

The legislature must give serious consideration to requiring single agency relations in home sales. The state should either encourage establishment of single agency brokerage houses, or it should eliminate dual agency altogether. Otherwise, the state, in a matter of years, may see an avalanche of litigation by home buyers and sellers against real estate agents for breaches of duty and negligence.

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129. See note 32 *supra*.

130. See *Hale v. Wolfsen*, 276 Cal. App. 2d 285, 81 Cal. Rptr. 3 (1969) (cooperating broker in commercial property exchange held the subagent of the listing broker, with fiduciary obligations to both buyers and sellers).