

Agency Theory and the Changing Role of the Real Estate Broker: Conflicts and Possible Solutions

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Abstract. The evolving multifunction role of the real estate broker and the demands being placed upon brokers by both buyers and sellers is increasingly placing brokers in conflict with the laws governing their conduct as agents. This paper examines the nature of this conflict and evaluates proposed solutions to this problem.

The generally accepted interpretation of agency theory that casts the real estate broker as the exclusive agent of the seller often does not coincide with the actual character of most residential real estate brokerage transactions. The perceptions and expectations of buyers and sellers and the actual performance of the brokers themselves are often at variance with the prescriptions of agency law. Such disparities have become increasingly common as the conveyance process has become more complex and real estate agents have become more deeply involved in the multidisciplinary nature of real estate sales transactions. The resulting conflicts with the application of the "one master" theory of agency, the expectations of buyers and sellers, and the training and functions of real estate professionals are the primary reasons for the increasing legal liability facing this industry. Consequently, there needs to be some type of reconciliation or accommodation between the laws governing real estate conveyances and the role of the residential real estate broker. The purpose of this paper is to examine the scope and nature of this problem facing the real estate industry and the real estate consumer and suggest possible remedies.

This study begins by describing the evolving role of the real estate agent in the conveyance process. We then examine buyer and seller perceptions and expectations regarding the services provided by real estate agents relative to the actual participation of the broker in the conveyance process. In the process we will identify problem areas where the fiduciary obligations of the agent, as interpreted by the courts, may come into conflict with buyer and seller expectations. Finally we will evaluate possible solutions to these conflicts.

The Market for Real Estate Brokerage Services

From an economic perspective, real estate markets are generally considered to be inefficient in that prices are often not indicative of underlying asset values,¹ since all the information

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Date Revised – July 1988; Accepted – August 1988.

necessary to make such determinations is often not available to market participants. Inefficiencies in the real estate market are attributed to the fact that market transactions are complex, the product is nonhomogeneous, information is incomplete and costly to obtain, and even when available, it is often difficult to evaluate given the heterogeneous nature of the properties that are traded. In contrast to public trading of stocks that takes place on organized exchanges, most real estate transactions take place in small, local markets that are often not subject to public disclosure or regulation.² Because the typical home buyer and seller are infrequent and unsophisticated participants in the real estate market, they may not be able to accurately assess available market information or even act on this information in a timely manner because of high transactions costs. When such conditions prevail, buyers and sellers are unable to make informed market decisions and markets fail to allocate products at prices that reflect relative resource scarcity and utility. It is also from such markets that the demand for middlemen and specialists are derived and institutionalized intermediaries evolve. Such intermediaries, by taking advantage of economies of scale in information gathering and dissemination, generate net gains in the form of lower transaction and information costs and more efficient resource allocation. The same type of rationale and evolution lies behind the development of multiple listing services, which were started in the early 1920s as local market clearing houses modeled after stock exchanges [1].

The Changing Role of the Real Estate Broker

Although real estate brokers³ and salespeople obviously perform a middleman function in that they bring buyers and sellers together, they also engage in many other activities associated with the conveyance process. From the seller's perspective, the broker's task is relatively straightforward and objective—to expedite the sale of his home at the highest possible price and most favorable terms. This role is also in accord with the fiduciary relationship that is created between the broker and the seller in the listing agreement, where the fundamental mission of the broker is to effectively market the property. Here the broker is employed as an agent of the seller and must represent the seller's best interests in negotiations with third parties. By definition, such an agency obligation would seem to place the broker in a potentially conflicting relationship with prospective buyers. As an institutionalized intermediary, however, brokers must often seek compromise and concessions from both parties in order to affect the sale, actions that may be at variance with the agency relationship presumed to exist with the seller.

In contrast to the businesslike nature of the broker-seller relationship, buyers often deal with brokers on a much more personal level. In the process of buying a home, buyers also seek out brokers to provide guidance and counsel on the desirability of neighborhoods, assess the quality of local schools, and evaluate the quality of different homes. In addition to helping formulate and prepare an offer and contract for sale, it is also not uncommon for brokers to help structure the financing on the home as well. In periods of high interest rates, brokers, in an attempt to maximize the price of their client's home, sometimes encourage seller financing arrangements — transactions that can result in significant risks to the seller, buyer and the broker [18, 19].⁴ The broker's assistance may even continue well beyond the point at which the contract for sale is signed. Brokers often will advise buyers on the purchase of homeowners

insurance as well as record the deed for the new owners. In fact, brokers are often the only group to which home buyers can turn to for guidance in the home buying process. As a corollary, brokers require and acquire a great deal of personal and financial information from prospective buyers in order to find an affordable home that meets the specific requirements of the buyer both aesthetically and financially.

In part, the growing involvement of the broker in the conveyance process reflects the growing complexity of real estate transactions. New types of ownership arrangements, such as time-sharing, limited partnerships and cooperatives, frequent tax law changes, along with an almost unlimited array of financing alternatives have made what used to be a relatively simple residential sale into a complex transaction requiring specialized knowledge of numerous and often unrelated disciplines such as law, construction, finance and tax accounting – expertise that most brokers do not command given their occupational licensing⁵ requirements, educational background and prior work experience. Sacasas and Wiesner [15] report that in 1984, while 36.7% of brokers and 26.3% of salespersons have college degrees, only about 9% of brokers and approximately 7% of salespersons received college training in real estate, law, and engineering – areas their informal survey indicated created the most liability cases.⁶ As a consequence of the growing complexity of the conveyance process it may well be that brokers are being increasingly put into untenable situations where their training makes it impossible to satisfy all the functions now being required of them by the public.

The increasing participation of the broker in the conveyance process may also reflect increased competition in the industry. Given limited barriers to entry,⁷ brokers have had to diversify and differentiate their product in order to maintain their market share. This is not only reflected in new ways to bring buyers into contact with sellers such as advertising by cable TV programs, discount brokerage, for sale by owner assistance programs [15], relocation services through networking and nationwide franchise operations, but also through the promotion of additional services such as investment counselling, financial planning and mortgage banking. Consequently, it is not surprising that the public and the courts now demand more of the broker than they may have in the past.⁸

The problem with this evolving multifunction role of the real estate broker is that the tasks expressly or implicitly entrusted to the broker by the buyer often place him in conflict with the legal rules governing his conduct as a fiduciary. A cornerstone of fiduciary theory is the rule that once an agent has established a relationship with his principal, he owes the principal the utmost fidelity and good faith.⁹ The principal is viewed as having placed full faith and confidence in the agent, whose advice and professional guidance are sought. Since it is the duty of the agent to act primarily for the principal's benefit, the agent must avoid any conflict of interest which would interfere with the best interests of the principal. In cases where the agent serves only a single master, such as in the attorney-client relationship, the agent is able to pursue the best interests of the principal with a single purpose.

However, the complexity of a real estate broker's position in a typical residential sales transaction – and most particularly the role played by a selling broker – often does not fit well into the single master theory of agency law.¹⁰ For in the many jurisdictions which view the selling broker as a subagent of the listing broker, a serious conflict of interest may result.¹¹ As a subagent, the selling broker owes the same fiduciary duties of loyalty and good faith to the seller, as does the listing broker.¹² However, it is clear that many buyers believe that the selling broker is protecting the best interests of that buyer in the transaction, rather than protecting the interests of the seller.

The Public's Perceptions of the Role of the Real Estate Agent

The Los Angeles Regional Office (LARO) of the Federal Trade Commission conducted a five-year study nationwide of the real estate brokerage industry that was released in 1984. The purposes of the study was "to explain how competition works in this industry and how the consumer is served in the real estate brokerage process"[4].¹³ Although the FTC report indicated that both buyers and sellers were very satisfied with the services they obtained and felt well served by their brokers,¹⁴ the report also noted that a substantial number of both buyers and sellers are misinformed as to the broker's role in real estate transactions and how commissions are determined.¹⁵ In cases of real estate sales in which two brokers were involved, 76.5% of the sellers thought that the listing broker represented the seller and 74.4% believed the other (selling) agent represented the buyer.¹⁶ In similar situations 74.2% of the buyers believed that the agent who they dealt with and who actually handled the sale (selling broker) represented the buyer only. When there was only one agent involved, there was no clear consensus among buyers or sellers regarding who the broker represented.¹⁷

The FTC Consumer Survey also indicated that consumers believe that helping them negotiate is an important part of the broker's function. Over 80% of both buyers and sellers agreed that the brokers involved in their transactions played a major role in the negotiations.¹⁸

The authors of the FTC study (LARO) felt that such misunderstandings concerning the role and pricing of broker services could prove damaging to the consumer. Buyers might reveal confidential information to an agent concerning how much they are able or willing to pay for a property that could prove detrimental to their interests if this information was conveyed to the sellers. Sellers, thinking the commission rate fixed, would not attempt to negotiate for lower rates. When it is considered that over 80% of all the homes sold in this country are sold using the services of a real estate agent, with approximately 90% of these homes listed with a multiple listing service,¹⁹ such misconceptions on the part of buyers and sellers affect the entire residential real estate market. Such public confusion as to the actual role of the broker in the conveyance process not only increases the likelihood that both the buyer and seller will be ill served by the broker, but also increases the probability that the broker will be exposed to greater legal liability.

The Agency Problem

In theory, both home buyers and sellers have a legitimate claim to a broker's loyalty. In practice, however, our legal system most often affords greater protection to the broker-seller relationship. In a majority of jurisdictions, the selling broker is considered to be a subagent of the listing broker. The courts have held this view, relying on both longstanding industry custom and the nature of the broker's role in the multiple listing service.²⁰

This presumption of broker-seller agency is commonly attributed to three factors. First, the seller-broker relationship is generally assumed to be the initial one, preceding any relationship that may develop between the broker and the buyer. Second, the seller and broker are linked by a written contract. Finally, in this listing agreement the seller promises to pay a commission to the broker, thereby making the broker the seller's agent.

There are jurisdictions which view the nature of the buyer-selling broker relationship as a question of fact, to be determined on a case-by-case basis.²¹ Courts in these states recognize that the factors noted above may play only a minor part in determining the nature of the agency relationship, and may themselves be of questionable usefulness as definitive guidelines.

A buyer's claim to an express agency relationship (formal contractual arrangement) with a broker could easily be based upon some of the same factors noted above. It is not uncommon for a buyer to contact a broker seeking information on housing availability and spend weeks or sometimes even months looking at homes. This broker and buyer might well be working together long before the seller's house is listed with the broker or a multiple listing service. Determination of who first initiates the agency relationship becomes even more problematic in a multiple listing context.²² Even if the seller is the first to initiate the agency relationship, agency relationships can change. As Arey points out, "a broker who begins a transaction as the agent of one party often may become the agent of both parties or of the other party at some time during the transaction".²³

A few courts have held that the selling broker is the agent of the buyer, and not the seller. These courts have looked to the particular structure of the transaction to determine whether the buyer contacted the broker to locate property before the seller employed the broker. A few courts have also considered the reasonable beliefs of the buyer, based on the representations made by the selling broker, to determine with whom the agency relationship exists.²⁴

Warnings against the attempt to represent both parties (buyer and seller) in a transaction are given in both the statutes and the case law. Absent full disclosure, any attempt at dual agency is generally prohibited.²⁵ Thus the reluctance to tolerate the concept of dual agency is one more supporting element that has led the courts to find both listing and selling agents to be in a fiduciary relationship with the seller.

Although the buyer may not have a formal contract with the broker, agreements which some writers claim the industry discourages,²⁶ a buyer can, at the very least, assert breach of certain obligations due non-principals, even if an express agency relationship with the broker cannot be proven. Article 7 of the Code of Ethics of the National Association of Realtors states that the broker is obligated to treat all parties to the transaction fairly. Article 9 states that the Realtor must avoid misrepresentations or concealment of pertinent facts and has an affirmative obligation to discover adverse factors that a reasonably competent and diligent investigation would disclose.

That the NAR Code of Ethics recognizes the needs of the buyer and his right to representation would indicate that even the largest professional organization of real estate brokers believes that the broker serves both parties in a real estate transaction. One could also look to the license laws of the fifty states that require brokers to act responsibly and in the public interest for additional support for such a dual agency relationship.²⁷

Although still relatively rare, the courts have begun to recognize the buyer's need for greater protection and have imposed liability on brokers for failing to disclose facts material to real estate transactions.²⁸ For example, the California appellate court ruled in *Easton v. Strassburger*²⁹ that state licensed real estate brokers have an affirmative duty to perform inspections on all listed property and to inform potential buyers of any critical defects.

With respect to the commission, the presence of compensation does not by itself determine whether an agency relationship exists. The fact that the seller agrees to pay the broker in the listing agreement, does nothing more than indicate how the broker is to be compensated. Alternatively, one could argue that part of the commission is paid by the buyer in the form of higher prices for broker-listed properties. "If the superiority of the broker-seller relationship is based on the broker's compensation flowing from the seller, it is therefore undermined to the extent that the commission is buried in the sales price."³⁰

Recent empirical evidence suggests the latter may, in fact, be the case. A study by Jud and Frew [9] indicates that brokers obtain higher prices for the houses they sell and implicitly

shift part of the brokerage commission to the buyer. They explain their finding by hypothesizing that brokers have an effect analogous to that of advertising in markets with imperfect information. In other words, agents, when acting as salesmen, increase the demand for housing. In an empirical study of the Canadian residential housing market Janssen and Jobson [7] found that the choice of real estate broker has an effect on both the listing price and eventual selling price of otherwise comparable housing. In contrast to these findings, Kamath and Yantek [10] found that brokers and their commissions had no effect on selling price. Given the structure of their model, one could conclude that no matter how the home transaction was affected – purchased either through the services of a broker or sold by owner, the buyer always pays a commission – either to the broker or the seller.³¹

The real estate industry itself hints that the commission is included in the price. One reason the NAR recommends employing the services of a broker is that when buyers negotiate with sellers who do not employ a broker they expect to pay less for the house. "In a sale by Owner, the Realtor's commission is always deducted by the buyer and the seller is left to do all the work for nothing."³² In most cases, in fact, the broker collects his commission from the buyer at the closing. If the deal falls through, buyers will often forfeit their earnest money deposit, paying some compensation to the broker as part of the seller's damages.³³

What seems to be apparent is that both the public and real estate industry recognize that brokers serve both parties, but the dual nature of their role in the conveyance process is often not acknowledged in the courts. This problem is aggravated by the fact that real estate agents are often forced to engage in activities outside their particular area of expertise, thereby exposing themselves to even greater legal liability.

Possible Solutions

A review of the cases dealing with potential liability for brokers suggests that commonly, the buyer brings an action after discovering some defect in the house that was not disclosed (and sometimes not known) by the seller or brokers involved in the transaction. The irritation of the buyer usually becomes more acute when he or she discovers – often after the closing – that the broker who led them through the transaction was really an indirect representative of the seller. This characterization of the duties of the listing and selling broker continues to be the view of many in the industry and is upheld in the majority of the jurisdictions around the country. Thus, buyers continue to be misled, often placing great reliance on their broker, who in fact may be operating under the assumption that the fiduciary duty is owed to the seller.

It is clear that if buyers were made aware of the status of the agents in a typical residential real estate transaction, at least some buyers would take greater care to protect themselves, both in the inspection of the premises and in the protections set forth in the written contract for sale.

Any possible solutions to this ongoing misunderstanding must bring the duties and liabilities closer to where the parties reasonably expect them, providing a better balance in the representations and protections provided to both the buyer and the seller.

A number of possible solutions have been offered by commentators, but adoption of these ideas have been slow in coming. Some of the proposals are aimed at providing more information on the physical characteristics and structural integrity of the home which is the subject of the contract. Mandatory inspection is an example of a proposal intended to reduce the likelihood

of a dissatisfied buyer who discovers a latent defect after closing. Related solutions are aimed at improving the product knowledge and skill level of the agent. Other proposed solutions, such as restructuring the fiduciary duties of the agent or mandatory disclosure of the existing fiduciary duties (owed the seller), which is now commonly accepted in the industry, focus on legal parameters in agency relationships.³⁴ The benefits and possible problems with these proposals are discussed below.

Mandatory Housing Inspections

In many of the reported broker liability cases regarding material defects and the condition of improvements, the selling broker operated under the assumption that he or she owed a fiduciary duty to the seller, so that unless the buyer directly questioned the broker on a particular point, the broker was not obligated to speak. Absent active concealment, the selling broker took on no responsibility as to the buyer. This continues to be true in some jurisdictions.

In an effort to provide greater protection for the home buyer, however, a number of courts have shown a greater inclination to impose liability on the selling broker for failure to disclose information deemed critical to the buyer. An extreme example of this trend is the recent California case, where, as noted earlier, the court held that a broker representing the seller has an affirmative duty to investigate the property and disclose material defects to the buyer.³⁵ The rationale for the decision was based, in part, on the courts view that unrepresented buyers rely on selling brokers to protect their interests.³⁶

While the court's concern to protect the home buyer is laudable, the mechanism, mandatory housing inspections, may create confusion, higher costs, and potential conflicts of interest problems for the industry. The typical real estate agent does not possess the skills necessary to conduct an inspection which would provide adequate protection for the buyer. A prudent broker would probably enlist the services of a professional, with the cost being absorbed, in most cases, by the buyer. Furthermore, if the selling broker continues to be viewed as an agent of the seller, an inspection which uncovers defects could place the broker in an almost certain conflict of interest. The selling broker, who stands to be compensated by the seller, must now take on a duty of disclosure to the buyer. The creation of a duty flowing both ways may result in a situation where neither the buyer or the seller receive adequate representation [2] from the broker.

This possible result is in stark contrast to the general tenets of agency law, which require vigorous representation of the principal by the agent. Any regulation which hinders this fiduciary duty in support of the principal can lead to mischief for all of the parties in the transaction. This is an obvious problem and the courts have been warning agents for hundreds of years that it is very difficult to serve two masters, without quickly encountering trouble, and consequent liability. Attempting to avoid such conflicts of interest, brokers could be relegated to little more than escrow agents.³⁷

Buyers' Agents

The growing complexity of residential real estate transactions and the concomitant need of both buyers and sellers for adequate representation, has brought the real estate brokerage industry and the 'one master' theory of agency law increasingly into conflict. If buyers are deemed to require greater protection during the conveyance process, one solution might be for the industry to provide agents for buyers. Although home buyers will occasionally hire

brokers to represent them, it is not common practice within the industry. One potentially comprehensive remedy would be to modify the multiple listing services so that the selling broker could serve as the agent of the buyer. The listing broker would still be the agent of the owner-seller and both parties, through their respective agents, could negotiate at arm's length. Brokers could remain free to solicit listings, while serving as buyers' agents for other clients. This would mean that the broker would be the seller's agent in some transactions and the agent for the buyer in other sales. The costs of the commission could be borne jointly by buyers and sellers through explicit sharing arrangements.

This proposal is one that offers promise, but also raises the prospect of significant structural change within the industry. One firm, employing many agents, might find itself in a conflict of interest situation, if that firm has a house listed that is of interest to a buyer who is represented by another broker in that same firm. Real estate firms might be forced to move toward greater specialization, concentrating in either the buyer or seller segment of the market in order to avoid such problems. At the very least, the industry would have to adopt rules similar to those implemented by law firms, which prevent representation of "adverse" parties.

While the incorporation of buyers' agents into multiple listing arrangements may require some difficult adjustments, such a change would make multiple listing services accord more closely to the public's perceptions and expectations regarding the broker's role in the conveyance process. It would also provide the buyer with the guidance and representation needed to make informed home purchase decisions. It remains to be seen, however, whether demand on the part of potential home buyers will be large enough to support buyer agents and therefore win broad industry endorsement.

Greater Disclosure

Short of a major overhaul of the laws governing real estate conveyances and the fiduciary duties of brokers, a number of states have implemented mandatory disclosure requirements for real estate brokers. Disclosure provisions have been implemented or are under consideration in 25 states.³⁸ The disclosure requirements examined for this study are similar in purpose and usually do not change the nature of the commonly accepted agency relationship, where both the listing and selling brokers are viewed as owing a fiduciary duty to the seller.³⁹ Rather, the forms are meant to notify both parties in the sale, and most particularly the buyer, of this broker-seller agency relationship.

It has already been documented that at least part of the problem facing the industry stems from buyer and seller confusion over the actual role of the broker in a residential real estate transaction. At the very least, mandatory disclosure would help reduce buyer misconceptions of the broker's role and discourage buyers from revealing confidential information to agents that could damage their ability to negotiate with the seller. Such disclosure might also limit law suits directed at real estate agents arising from such misunderstandings as well as provide additional liability immunity by reducing the brokers' multifunction role in the conveyance process. While helpful, mandatory disclosure does little to increase consumer confidence or buyer knowledge about the home buying process and could further limit the ability of the broker to assist the buyer in such transactions.

It is also clear that disclosure per se will not solve all the liability problems of the industry. One particular problem area is the timing of the disclosure to the buyer. Commonly, disclosure

comes too late in the conveyance process to provide any real protection to the buyer. For example, the Georgia regulations provide "disclosure must be made at the time of or before an offer to purchase, to sell, to lease or to exchange real estate is made".⁴⁰ If a buyer has relied on the representations and guidance of the selling agent, both in the examination of the house and in the development of an offer before he is informed of the agency relationship, it will not likely cause the buyer to exercise greater caution or protect him from revealing information that could adversely affect his negotiating position. Such last minute disclosure is of no benefit to the buyer. Equally important, a review of general agency case law suggests that the courts will not react favorably to such eleventh-hour disclosure. For disclosure to be truly meaningful and limit broker liability, it must come as soon as the buyer contacts an agent and asks for assistance in locating and purchasing a house.

Increased Broker Education

As noted earlier, state license laws are primarily aimed at establishing minimum performance standards in order to protect the public against misrepresentation and fraud. Even in states with relatively rigorous pre-license requirements,⁴¹ total education requirements come nowhere close to the classroom hours required for an undergraduate degree or other types of professional certification such as a law degree or doctorate. Some states have no education requirements at all for either salespersons or brokers beyond a high school diploma. While there is some evidence that licensing requirements have had a positive effect on reducing the number of complaints against real estate agents⁴² [16, 8], these requirements were never intended to provide salespersons with the kind of training and expertise now being demanded of them in today's market.

One remedy states are increasingly adopting is enactment of post-license continuing education statutes. These laws typically require licensees to acquire formal education in those fields such as finance, tax, valuation and law, where the incidence of complaints and law suits indicate that agents are insufficiently trained. Post-licensing continuing education requirements are now in place in about half the states.⁴³ As with pre-license requirements, there is considerable interstate variation in the amount of education required. In those states with post-licensing continuing education statutes, education requirements commonly range from 12 to 24 hours every two years.

Theoretically, at least, adoption of continuing education statutes and increasing post-licensing education requirements would certainly help agents better serve the needs of home buyers and sellers. This outcome, however, presupposes that state administrators are effectively able to determine the appropriate amount of continuing education, as well assure quality education. This, in turn, would require real estate commissions to be able to provide qualified instructors and periodically monitor course content.

There is also a risk that post-licensing requirements could result in a disservice to the public. Such formal continuing education and training requirements have high opportunity costs, in terms of both time and money. Consequently, they could reduce competition by restricting entry into the real estate industry, thereby resulting in a loss of consumer welfare.⁴⁴ While no study that we know of has yet to directly examine the effects of post-licensing requirements on industry employment, state administrators charged with regulating this industry should be cognizant of the potential anticompetitive impact of such statutes when implementing or expanding continuing education programs.

Conclusions

The need for adequate representation for both home buyers and sellers and the actual performance of real estate brokers is increasingly placing the broker in conflict with the prescriptions of the 'one master' theory of agency law. This situation has been aggravated by the growing complexity of the conveyance process and the greater demands being placed upon the broker by both buyers and sellers. The result has been an increase in law suits against real estate brokers. While a number of solutions have been proposed, some address only part of the problem and none can be implemented without additional costs to consumers and at least some structural changes for the industry.

Many within the real estate industry have advocated formal or mandatory disclosure of the seller-broker agency relationship to the buyer as a way of reducing broker liability in residential sales transactions. Such disclosure, if it occurs at the initial meeting of buyer and broker, would reduce home buyer confusion about the role of the broker and, thereby, reduce the probability that the buyer will reveal damaging information to the agent. This approach, however, does little to increase buyer knowledge or assist the consumer in purchasing a home. Moreover, if brokers are perceived as agents only of sellers, this might reduce buyer demand for broker services.

Increased product knowledge and a better understanding by brokers of their responsibilities to both buyers and sellers will also help improve the quality of real estate services and reduce the agent's exposure to law suits. Some of the same benefits and additional protection would be afforded the buyers, albeit at increased cost, from housing inspections, either mandated by statute or stipulated as a condition in the contract for sale.

While disclosure and increased training for brokers should help improve the quality of brokerage services and reduce potential liability problems, it is the conclusion of this paper that a restructuring of the agency relationship that recognizes the dual nature of the real estate broker's role in the conveyance process is the best way to reconcile the conflicting roles of real estate brokers and solve the legal and consumer problems facing the industry. Allowing brokers to act as agents for buyers would provide protection and guidance for buyers as well as resolve the conflict of interest currently facing brokers by encouraging specialization within the industry. As more and more real estate companies adopt formal disclosure procedures, buyers are becoming increasingly aware of their lack of representation in real estate transactions. Growing consumer awareness of the need for assistance in the home buying process may, therefore, accelerate industry acceptance of buyer agents. Although the trends and recent case law examined in this paper are encouraging, it remains to be seen whether the courts will broaden their interpretation of agency theory to accommodate the needs of both home buyers and sellers. Failing such a development, brokers may have to fall back on some less comprehensive remedies. How the courts and the industry ultimately resolve this problem will go a long way in determining how well consumers will be served in this market.

Notes

¹For a discussion of the concept of market efficiency as it applies to real estate transactions, see G. Greer and M. Farrell, *Investment Analysis of Real Estate Decisions* [6, ch. 3].

²High information costs and information asymmetries among market participants are the common justifications for government regulatory intervention in such markets and professional certification and licensing requirements for market intermediaries.

³The term 'broker' refers to a person who is licensed to market one or more of the various rights to real

estate. A salesperson is an individual who is licensed to perform brokerage services when employed by and under the supervision of a licensed broker. The term Realtor is a proprietary term identifying a member of the National Association of Realtors, the largest trade group of brokers and salespersons. As used in this paper, broker will be used in a generic sense to refer to both brokers and salespersons.

⁴Brokers are increasingly being held liable for losses sustained by buyers and sellers for failing to point out to the parties the risks associated with various creative financing techniques. In an attempt to overcome this problem California now requires mandatory disclosure of the risks of broker-assisted and seller financing techniques.

⁵The principal rationale for occupational licensing and professional certification is to protect the public by providing some minimum level of professional competence and establishing minimum performance standards for market intermediaries. A review of most real estate licensing statutes indicate that these laws are primarily concerned with enforcing ethical conduct and discouraging misrepresentation and self dealing, rather than providing guidance or instructions for handling specific situations.

⁶Sacasas and Wiesner [15] review of appellate court decisions over an 11-year time period indicated that legal questions (including breach of fiduciary duty), the condition of improvements, finance, and property survey disputes lead the list of liability cases. The picture painted of the educational background reported by Sacasas and Wiesner may distort the true skill levels of brokers and salespersons. 37% of brokers and 31% of salespersons reported business administration as their undergraduate specialization. Most such business degrees will expose the student to basic courses in finance, banking, accounting and legal studies, as well as elective options in tax and real estate. Moreover, many business administration majors can concentrate their studies in such fields as banking, finance and accounting.

⁷For a discussion of the characteristics and competitive status of the market for real estate brokerage services, see Zumpano and Hooks [17].

⁸It is worth pointing out article 11 of the NAR's Code of Ethics discourages realtors from engaging in activities outside their field of expertise "unless the facts are fully disclosed to the client." At the same time, the NAR has encouraged realtors to diversify in order to remain competitive in an ever changing market. See *The Realtors Diversification Handbook: Increasing Profits by Expanding Services* [14].

⁹See *12 American Jurisprudence 2nd, Brokers* § 84 (1980).

¹⁰When a multiple listing is used it is common that two brokers are involved with the sale of a property. The agent with whom the seller initially signs the listing agreement is referred to as the 'listing broker', and the agent, if other than the listing broker, that actually sells the house is designated as the 'selling broker'.

¹¹A subagent is "a person appointed by an agent . . . empowered 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(1)(1957).

¹²*Restatement (Second) of Agency* § 428(1)(1957).

¹³The investigation was initiated in response to complaints from within the industry and consumers about commission rates and anticompetitive practices within the industry.

¹⁴On a scale of zero to 10, the most frequent rating given to brokers by buyers and sellers was a 10, with a mean rating of 7.98. Sellers also indicated that while they thought the price of brokers' services to be expensive, they thought that on the whole the services received were worth the cost.

¹⁵FTC, pp. 115-16. About half the sellers questioned stated that they did not know how commissions were determined, while approximately 20% of the remaining seller respondents believed that brokerage rates were non-negotiable, either fixed by law or local boards of realtors.

¹⁶FTC, p. 122.

¹⁷FTC, p. 121.

¹⁸FTC, p. 137, and buyer question 53 and seller question 60.

¹⁹FTC, p. 17. LARO also reported that approximately 52% of MLS sales were cooperative sales, involving two or more participating MLS firms, while 66% of all sales involve two individual agents (different listing and selling agents).

²⁰See *Marra v. Katz*, 74 Misc. 2d 1010, 347 N.Y.S.2d 143 (1973); *Chamberlain v. North Cent. Inv. Corp.*, 432 S.W.2d 581 (Tex. Civ. App. 1968); *Frisell v. Newman*, 71 Wash. 2d 520, 429 P.2d 864 (1967).

²¹A representative jurisdiction is Alabama, where the Alabama Supreme Court recently reaffirmed its view that whether a real estate broker is an agent of the buyer as well as the seller is a question for the jury. In *Davis v. Brown*, 513 So. 2d 1001 (Ala. 1987), the court noted that if it is determined that a broker is an agent of the buyer, then a fiduciary duty exists between them.

²²Although the National Association of Realtors' *Code of Ethics* and the NAR *Handbook on Multiple Listing Policy* state that the selling agent is the subagent of both the listing agent and the seller, nothing in the structure of the MLS or state laws require cooperating brokers to be subagents of the seller. It could just as easily be argued that the listing broker is the subagent of the selling agent, and therefore responsible to the buyer.

For example, in Alabama, the Supreme Court held in the case of *Cashion v. Ahmadi*, 345 So. 2d 268 (Ala. 1977), that a real estate broker may be hired to find a buyer or a seller. In either case, the broker owes a duty of faithfulness to his principal. The court went on to note that a broker working through a multiple listing arrangement often finds himself in the precarious situation of seeking the trust and confidence of the prospective buyer, while still claiming faithfulness to the seller. The court noted "He cannot have it both ways."

²³Arey, p. 359.

²⁴See *Wise v. Dawson*, 353 A.2d 207 (Del. Super. Ct. 1975) and *Menzel v. Morse*, 362 N.W.2d 465 (Iowa 1985). In the latter case, the court held that the broker is the agent of the party who first employs him.

²⁵See ALA. CODE § 34-27-36(a)(7) and *Cashion v. Ahmadi*, 345 So. 2d 268 (Ala. 1977).

²⁶Currier, p. 664.

²⁷At least two situations immediately come to mind that could place a broker in an untenable position with regard to his respective obligations to buyer and seller. Given that a broker knows that the maximum price a buyer will pay for the seller's house exceeds his current offer, should the broker advise the seller to reject the offer? Alternatively, would revealing the maximum price to the seller, told to him in confidence by the buyer, breach the broker's obligation to deal fairly with all parties? A second common problem area is whether a broker has an obligation to refrain from seeking to discover, and if discovering a defect, disclosing to buyers potential defects in a house. Should brokers remain silent about potential defects, revealing only what has been told them by the seller, or are they obligated to independently verify material facts about the condition of the house? Article 9 would seem to suggest the latter course of action. If a sale falls through because of fears of potential defects, when in fact there are none, would the seller then have recourse against the broker?

²⁸For a good review of this emerging trend, see Gaffney [5].

²⁹Gaffney, pp. 827-29; 152 Cal. App. 3d 90, 199 Cal. Rptr. 3d 383 (1983).

³⁰Currier, p. 664. A related issue concerns the optimal form of compensation for real estate agents. Some researchers have argued that a percentage commission based on market value is price fixing that reduces consumer welfare. Others have countered that such a commission structure is a cost effective way to maximize selling price, especially when principals cannot assess the performance quality of agent services. For a review of this issue, see Zumpano and Hooks [17, pp. 2-5].

³¹The dummy variable used to proxy the presence of a broker was negative and insignificant. Alternatively, this result could imply that the seller always pays a commission, whether or not the property is sold through a broker, even if only to himself as compensation for owner selling costs.

³²National Association of Realtors, *Real Estate Sales Handbook* [13].

³³Currier, p. 664.

³⁴Most of the legal problems that brokers face, whether triggered by material defects in a home, dual agency, breach of contract, or even financing, often stem from confusion on the part all the parties to the transaction as to the nature of the agency relationship and the broker's respective duties to these parties. Other legal problems associated with violation of license laws and errors and omissions on the part of the broker not related to misunderstandings of the agent's fiduciary duties are not examined in this paper.

³⁵*Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984).

³⁶Less extreme, though similar in intent, are suggestions for making the contractual consummation of the sale (by the buyer) contingent upon a satisfactory housing inspection or requiring seller disclosure statements, signed at the time of listing, attesting to the condition of the property.

³⁷This strict intermediary role is in stark contrast to the general tenets of agency law, which require vigorous representation by the agent on behalf of the principal.

³⁸*The Agency Educator*, January 1988.

³⁹Disclosure requirements were examined in the following states: Georgia, Utah, Nebraska, California, South Carolina, Hawaii, Colorado, and Washington.

⁴⁰Rule 520-1-.08, Disclosure of Agency Relationships. Amended.

⁴¹The state of Texas requires 180 hours for the salesperson license and 900 hours of pre-license education

for the brokers exam. Some of the pre-license education hours can be made up of college courses. In contrast it requires approximately 5,040 hours of classroom education for an undergraduate degree. See the 1988 *Digest of Real Estate License Laws*, published by the National Association of Real Estate License Law Officials (NARELLO), for a detailed listing of state education and experience requirements.

⁴²Shilling and Sirmans [16] reported that a 10% reduction in the pass rate on real estate licensing examinations reduced the number of complaints against licensees by 27%. Johnson and Loucks [8], on the other hand, found that the pass rate was not a significant determinant of the number of complaints against real estate agents.

⁴³Continuing education requirements are now in place in twenty-seven states and the District of Columbia. See the 1988 NARELLO *Digest of Real Estate License Laws*.

⁴⁴It has been a common argument [11, 16, 8] that while ostensibly designed to protect the public, the major purpose of occupational licensing and training is to restrict entry by competitors and maintain monopoly profits for existing market participants. For example, Shilling and Sirmans found that while a decline in the pass rate reduced complaints against real estate agents, declining pass rates were also associated with excess occupational demand. Johnson and Loucks, however, found no link between the pass rate and the number of licensees, but did find that the hours of pre-license education was a marginally significant determinant of licensees per capita.

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After this study was written, we discovered that the National Association of Realtors recently revised its Code of Ethics. The important change for this study involves article 9. The old version of article 9 stated that the Realtor must avoid misrepresentation or concealment of pertinent facts and "has an affirmative obligation to discover adverse factors that a reasonably competent and diligent investigation would disclose." In the new version, the last part of the above statement is replaced with "The REALTOR shall not, however, be obligated to discover latent defects in the property or to advise on matters outside the scope of his real estate license." Although we do not know the explicit reason(s) for this change, it could be that the NAR felt that the dual agency relationship implied by old article 9 could place the real estate broker in an untenable position with respect to his fiduciary duties to the seller. It could also reflect recognition by NAR that both buyers and sellers are placing increased demands on real estate agents that may be beyond their technical competence to address.