Summer 5-1997

Real Estate Brokers: Shouldering New Burdens

Ronald B. Brown
Nova Southeastern University - Shepard Broad Law Center, brownron@nova.edu

Joseph M. Grohman
Nova Southeastern University - Shepard Broad College of Law, grohmanj@nsu.law.nova.edu

Real Estate Brokers: Shouldering New Burdens

By Ronald Benton Brown and Joseph M. Grohman

In the 1980s real estate brokers discovered that they risked liability for breaching fiduciary duties they did not know they had if they failed to disclose property conditions to buyers, even though disclosure could violate their duty to sellers. Conversely, they might have breached their duties to sellers if they disclosed to prospective buyers unpleasant facts that stigmatized the property. Brokers reacted by lobbying for legislative protections. As a result, many states adopted statutes allowing brokers to enter into new relationships, shifting the burden of disclosing property conditions to sellers and shielding brokers and sellers who fail to disclose facts that psychologically stigmatize property. These statutory solutions, however, have failed to eliminate material risks to brokers and may have subjected them to new risks.

Brokerage Relationships

Real estate brokers originally acted as independent agents of sellers trying to find buyers. Then brokers learned they could earn more by working together and sharing commissions on many sales instead of keeping whole commissions on fewer sales. Gradually, they developed real estate exchanges to share lists of properties for sale. Under these arrangements, less scrupulous brokers could approach the seller directly and bypass the seller's original broker. Open listings contributed to this practice.

Nevertheless, the opportunity for profit from cooperation was too great to ignore and multiple listing services developed. These services compiled and maintained the member brokers' lists of properties for sale. Only member brokers had access to the "multiple lists." As a condition of membership, a broker agreed that, when trying to sell properties listed by another member broker, the selling broker acted as an agent of the listing broker and, hence, as a subagent of the seller. Member brokers also agreed that, if another member produced the buyer, the listing broker would share the commission according to a prearranged formula—typically, 50-50. Under this system, brokers who entered into listing contracts with sellers were classified as "listing brokers," and brokers who worked with and produced buyers were classified as "selling brokers."

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Buyers generally thought of the brokers who helped them locate property as "their" brokers. But, as a subagent of the seller, a selling broker had a fiduciary duty only to the seller. A selling broker had no duty to the buyer other than the duty not to act in a tortious manner that owes one member of the public to another. That notion was very difficult for buyers to understand or remember, especially when they actively worked with selling brokers to find the right property. Residential buyers were particularly likely to develop a close relationship with the selling brokers.

Good brokers are adept at getting to know people and their preferences. To avoid wasting time or frustrating buyers by showing them properties they cannot afford, brokers prequalify prospective buyers and obtain an accurate picture of their financial ability. Good brokers know their territories and can quickly narrow the search once they know a buyer's likes, needs and price range.

Naturally, the process of discussing sensitive personal matters makes prospective buyers feel close to brokers, and that closeness leads buyers to believe they can and should rely on them. Moreover, as sales-people, brokers recognize that the first step is to establish a rapport with buyers so they will rely on the brokers' recommendations. A 1983 Federal Trade Commission survey showed that 72% of buyers thought that selling brokers who helped them find property were representing them rather than the sellers. Federal Trade Commission, 1 The Residential Real Estate Brokerage Industry: A Staff Report by the Los Angeles Regional Office 69 (1983) (FTC Survey).

The fact that listing brokers also worked with buyers added to the confusion. In fact, listing brokers preferred to find the buyers themselves so they would not share the commissions with other brokers. Listing brokers, too, interviewed prospects to learn about them, especially their finances, and to match them with the

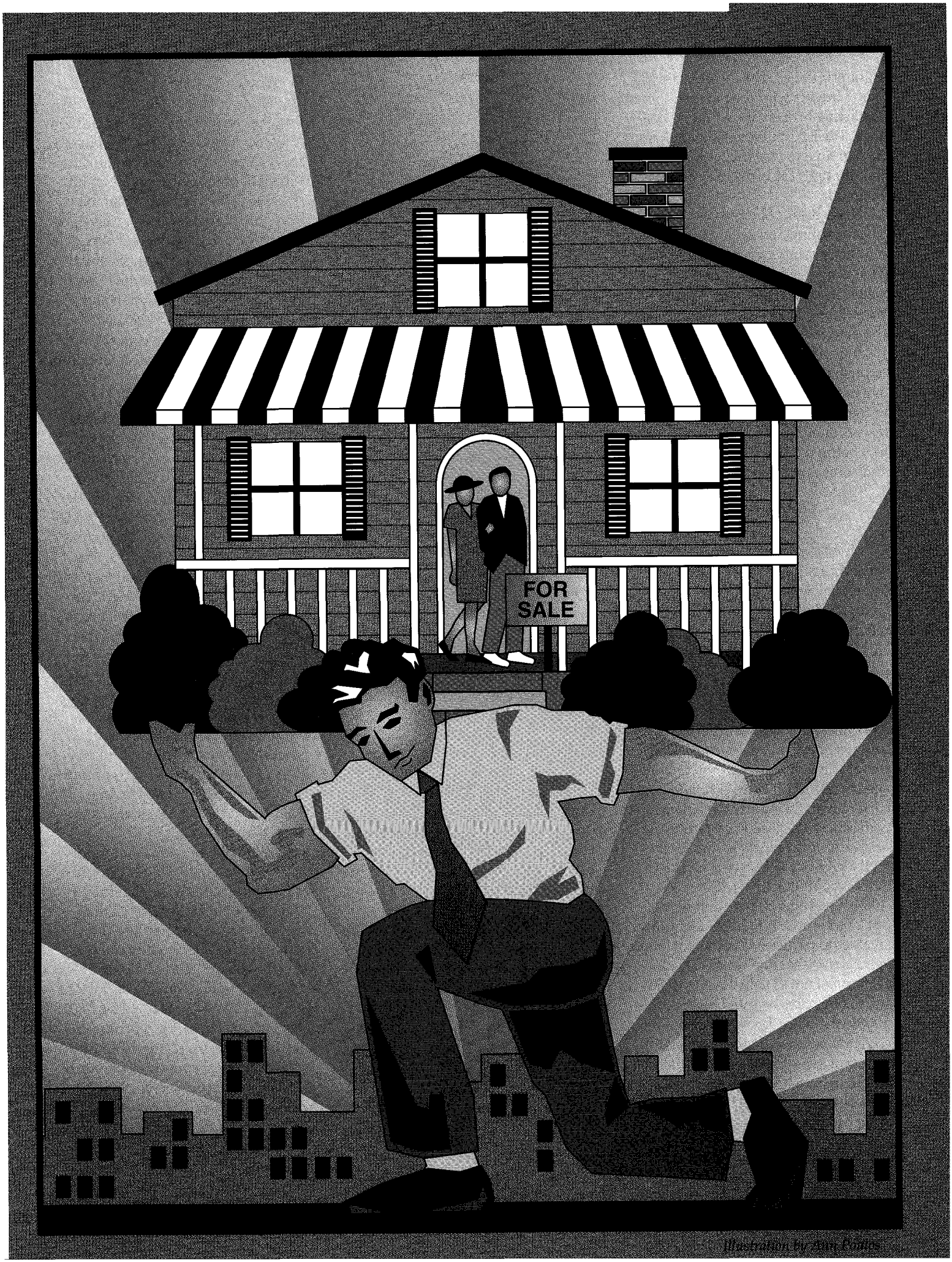

Illustration by Ann Conlon

right properties. This process also left many buyers with the perception that the listing brokers were "their" brokers. The FTC Survey showed that 31% of buyers in a one broker transaction thought the broker represented them. Id.

Regardless of buyers' expectations, by law, listing and selling brokers had a fiduciary duty only to the sellers. That duty included not revealing sellers' secrets to buyers and telling the sellers anything that would lead to the quickest sale at the highest price. Listing and selling brokers had a duty to push a closing that was in the seller's best interest, even if that was not in the buyer's best interest. Many buyers later felt that "their" brokers had betrayed them. They were angry, and some sued.

Changing Roles

Much to the brokers' surprise, some courts did not follow the traditional agency analysis. They recognized that a common law agency relationship is created when the principal manifests an intent that the agent act for him or her, the agent accepts responsibility and the principal has the right to control the venture. After analyzing the selling brokers' conduct, these courts concluded that some selling brokers had entered into agency relationships with buyers concurrent with their agency relationships with sellers. See Joseph M. Grohman, *A Reassessment of the Selling Real Estate Broker's Agency Relationship with the Purchaser*, 61 St. John's L. Rev. 560 (1987). Dual agency was, and is, perilous because it requires identical loyalties to parties with different, often opposite, wishes and needs. The dual agent must not violate the duty of loyalty to one party by fulfilling the same duty to the other. Brokers who inadvertently became dual agents had little chance of avoiding a breach of their duties. In particular, a dual agent must disclose the existence of the dual agency to both principals.

Some brokers thought these developments offered new marketing

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opportunities. They became "buyers' brokers." As such, they offered to act solely as agents of the buyers to ensure their undivided loyalty. When brokers originally structured these arrangements, buyers were to pay buyers' brokers on an hourly basis. Many brokers quickly learned, however, that few buyers were willing to pay an hourly rate when it appeared they could get the same services for free from other brokers who would receive a commission from the seller. As a result, many buyers' brokers changed their approach to an agreement for a share in the commission or a finder's fee.

Agency law does not require that the agent be paid by the principal. Many multiple listing services, however, would not grant membership or multiple list access to buyers' brokers. Many listing brokers refused to share commissions with buyers' brokers because they had not performed as sellers' subagents. Thus, the potential conflict of interest still posed a problem. The buyer's broker, whom the buyer does not pay, has injected a new factor into sales negotiations. The buyer's best interest may not be the broker's primary concern, and getting the seller and listing broker to share the commission with someone other than seller's subagent may result in a higher price.

New Statutory Relationships

With the active support of their trade organization, the National Association of Realtors, brokers succeeded in lobbying 41 states to pass statutes that allow a variety of relationships. Brokers can still enter into a traditional agency relationship with a buyer or seller. A selling broker can still be a subagent of the seller, and it is still possible to be a buyers' agent. Now, however, in these states it is also possible to be a dual agent or a nonagent. For a more detailed analysis of the statutes, see generally Ronald Benton Brown, Joseph M. Grohman and Manuel R. Valcarcel, *Real Estate Brokerage: Recent Changes in Relationships and a Proposed Cure*, 29 Creighton L. Rev. 25 (1995).

Typically under these new statutes, to enter into these relationships, brokers must follow prescribed disclosure procedures. Some statutes created what might be called a "disclosed dual agent." See, e.g., Or. Rev. Stat. § 696.815; Ind. Code Ann. §§ 25-34.1-10-7 and 25-34.1-10-12 (permitting "limited agents"). Under this approach, the broker simultaneously owes a fiduciary duty to the buyer and seller, but the duty to each is limited by the duty to the other. When a lawyer simultaneously represents two parties and a dispute develops, the lawyer is required to withdraw from both representations. No statute appears to require a similar withdrawal by dual agent brokers. Nevertheless, a broker who continues to represent both or chooses one side after a conflict arises seems to be inviting a lawsuit.

In contrast, the nonagent represents neither party. Under the terms of some statutes, the nonagent is a "deal agent" who represents the deal rather than the parties. The nonagent may also be described as a "facilitator," a "transactional broker" or an "independent contractor." See, e.g., Colo. Rev. Stat. § 12-61-802; Fla. Stat. ch. 475.01(k). A broker creates this statutory relationship by following the proper disclosure procedures. Nonagents have obligations prescribed by statutes, perhaps supplemented by regulations. Nonagent brokers are subject to policing by their state licensing authorities to

make sure they have documented their disclosures.

One additional problem is that in many states a licensed real estate salesperson can operate only through a broker. With the automatic offer of subagency for the seller that was common in multiple listing services, the knowledge and duties of each licensee are imputed to the broker and all licensees associated with the broker. For "in-house" transactions in which both the listing agent and the buyer's agent are associated with the same broker, this imputation creates dual agency relationships throughout the brokerage. This problem was addressed in Washington by creating the concept of "split" or "assigned" agency under which each licensee represents only the party with whom the licensee is working; only the broker is a dual agent (to which the parties must consent). R.C.W. ch. 18.86. This 1996 law also codified disclosure and confidentiality duties.

Despite these developments, potential problems remain. Disclosures may not be properly made. Even if they are, a broker may not be able to prove proper disclosure. In that case, the broker may be in an unexpected fiduciary relationship. Also, these statutes generally do not abrogate the common law of agency. Thus, brokers who originally enter into statutory nonagency relationships may find that their conduct has placed them in a fiduciary relationship.

Moreover, the whole statutory scheme is based on a disclosure to the prospective buyer. As evidenced by the FTC survey, buyers did not understand that a selling agent was a subagent of the seller. The brokers might not have explained that to the buyers. Even if they had, it is quite possible that the explanation would have been ineffective. A buyer would need to understand the concepts of agency and subagency and retain that understanding throughout the entire transaction. All the while, the broker's conduct as a good salesperson might have led the buyer to expect that the broker was on the buyer's side.

Today's statutes have replaced one simple relationship, which was not understood, with four equally complicated choices. Under the old agency/subagency system, only buyers were likely to be confused about brokers' roles. Under today's statutes, a broker's relationship with a seller might be any one of several choices. Thus, these statutes may have spread the potential for confusion.

The statutory solution has been to provide consumers a disclosure statement. But a disclosure form is no way to explain agency law. In addition, handing prospective buyers a disclosure statement invites questions. Unless they are lawyers, brokers may not have the training—or be licensed—to make that explanation. Nevertheless, brokers, who are competing for business, cannot realistically be expected to refuse an explanation. Moreover, buyers and sellers cannot compare the services different brokers offer unless they understand the ramifications of the different relationships the brokers are willing to enter.

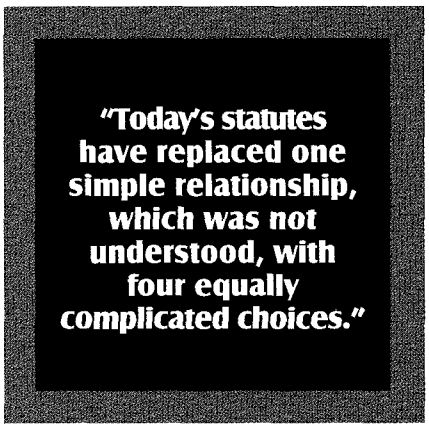
In short, these statutes create more problems than they were intended to solve. Apparently recognizing this, Kansas repealed its multiple-relationship statute and returned to agency/subagency status pending further study. See 1996 Kan. Sess. Laws Ch. 212 (S.B. 710), abolishing Kan. Stat. Ann. §§ 58-30.101-58-30.112, effective July 1, 1997. A different approach is clearly needed to deal with these problems. Until a new solution is adopted, it is necessary to consider some additional problems in disclosure and nondisclosure obligations that these new relationships cause.

Disclosure of Property Conditions

Under the traditional agency/subagency relationship, the broker could not disclose to the buyer any information that was detrimental to the seller. If a court found that a selling broker had become a dual agent, the fiduciary duty to the buyer required the selling broker to disclose property conditions that might affect the decision to buy. One case held that a selling broker also had a duty to diligently inspect the property and disclose to prospective buyers any material facts that the inspection would have revealed. *Easton v. Strassburger*, 199 Cal. Rptr. 383, 387-89 (Cal. Ct. App. 1984).

Brokers responded by lobbying for statutes requiring sellers to disclose these defects to prospective buyers, thus shifting the disclosure burden to sellers and removing brokers from this predicament. This approach had popular appeal because it provided new consumer protection, and case law in many jurisdictions already required sellers to disclose latent defects. California passed the first disclosure statute in 1988, and 27 states had such statutes at the latest count.

Complying with the disclosure requirements is not easy for many sellers. It requires collecting information, recalling events and, in some states, properly completing a complicated form. The seller is likely to turn



to the broker with questions about what and how to disclose. When assisting sellers, listing brokers must be very careful not to offer legal advice or inadvertently enter into an unintended agency relationship. Moreover, a buyer injured by nondisclosure might find that the only readily available defendant is the broker who helped the seller prepare the disclosure statement. Creative legal minds are certain to come up with a

viable theory to hold the broker liable in at least some circumstances.

Nondisclosure of Psychological Stigma

Another disclosure problem is information that might psychologically stigmatize or taint the property, making it difficult to sell. Should or could a listing broker disclose these facts to unaware potential buyers? Traditionally, the answer would have depended on the relationship that the broker had with the buyers.

Brokers who are agents of sellers cannot reveal these facts without breaching their fiduciary duty to sellers. Buyers' brokers owe their sole fiduciary duty to the buyers, so disclose they must. Dual agents generally must reveal every material fact to buyers. If they reveal what sellers consider to be confidences, however, they may be liable to sellers. Non-agents' disclosure duties depend on statutes that generally require the nonagent to reveal every material fact about the property to buyers, even if the broker is the listing broker. The critical question may be whether the fact concerns the property or not; disclosure statutes generally do not address this issue.

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The problem first caught the public's attention when the stigma involved sellers or prior occupants infected with the HIV virus. Although public health officials have assured the public that the next occupant is not at any risk, many buyers would not knowingly buy such a property. If the knowledge is widespread, it could affect the market value of the property. Nondisclosure of HIV infection, however, is apparently protected by the 1988 amendments to the Fair Housing Act. 42 U.S.C. § 3604(f). Furthermore, HUD officials have informally expressed their view that unsolicited disclosure of a seller's HIV infection would violate the Fair Housing Act.

Uncertainty over their obligations made brokers uncomfortable. Many states reacted by providing specific statutory protection for nondisclosure of sellers' or prior occupants' HIV status. Thirty states now have nondisclosure shield laws, and some have gone beyond the HIV issue. For example, Wisconsin protects nondisclosure of an act or occurrence that "had no effect on the physical condition of the property or any physical condition" and specifically includes proximity to a nursing home or community-based residential facility. Wisc. Stat. Ann. § 452.23. North Carolina provides that "it shall not be deemed a material fact that the real property was occupied previously by a person who died or had a serious illness." N.C. Gen. Stat. § 39-50. In contrast, Kentucky only protects against the nondisclosure of a prior occupant's HIV infection. Ky. Rev. Stat. Ann. § 207.250.

Two well publicized cases led some states to enact broader nondisclosure protections. In one case, the buyer learned that his new home had been the site of multiple murders. *Reed v. King*, 193 Cal. Rptr. 130 (Cal. Ct. App. 1983). In another, the buyer, who was not a "local," was surprised to find that his new house had a reputation as being haunted. *Stambovsky v. Ackley*, 572 N.Y.S.2d 672 (1991). Some statutes now shield brokers and sellers who do not disclose such facts as a death or violent crime on the premises or gang activity in the neighborhood. Some of these shield statutes have general catchall categories that might even protect a seller or broker who fails to disclose the suspected presence of a ghost.

For a more detailed discussion of these state statutes, see Ronald Benton Brown and Thomas H. Thurlow, *Buyers Beware: Statutes Shield Real Estate Brokers and Sellers Who Do Not Disclose That Properties Are Psychologically Tainted*, 49 Okla. L. Rev. 625 (1997). Some of these statutes, however, have procedures by which buyers may inquire about stigmatizing facts. If the potential buyer asks the right question the right way, then a response is required. How would buyers find out what to ask and how to ask it? Buyers would logically expect this information from "their" brokers.

In states with affirmative disclosure laws, the receipt of the sellers' mandatory property condition disclosure forms will likely lull buyers into believing they know every material fact. To many buyers, however, these shielded facts may also seem material, as evidenced by the very existence of the shield laws. Arguably, based on the buyers' reasonable expectations, "their" brokers have a duty to warn them that shield laws exist and that buyers cannot expect to learn this information from the normal disclosures. It is clearly in the best interest of brokers, who are paid commissions out of the sales proceeds, not to kill the deal by raising the issue of a psychological stigma. That fact creates the appearance that the brokers have joined the sellers' side, even if they claim to be dual agents or neutral nonagents.

Note that brokers who are nonagents should not owe the buyer or seller any duty other than what is specified by the statutes. For example, nonagent brokers should have no duty to explain shield laws. After all, the buyers received disclosure forms explaining the brokers' nonagency status. It is unlikely, however, that the buyers fully understood those disclosures and more unlikely that the buyers remembered it. As a result, shield statutes create the potential for buyers and sellers to feel betrayed by "their" brokers. This potential may lead to buyers' claims that the brokers, by their conduct, changed their

relationship from nonagent to agent with a fiduciary duty to buyers that would be breached by an inadequate warning of a psychological stigma.

Some courts might find that an agent of the seller, subagent of the seller or dual agent has breached a fiduciary duty to the seller by even pointing out the existence of the shield law. Some courts might find that the shield statute creates an implied duty on the broker's part, even the buyers' broker, not to raise the issue of psychological stigma. Thus, the broker is still faced with a dilemma about what to say and potential liability for making the wrong choice. Buyers who learn of stigmatizing facts after the closing will feel wronged by "their" brokers. Many will look for a remedy. Some may succeed.

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Conclusion

In simpler times, the listing broker was the agent of the seller and the selling broker was the subagent. Both owed their sole duty of loyalty to the seller. The rules were simple: do not commit fraud; tell the seller everything; protect the seller; and tell the buyer nothing except what is needed to make the deal and close it. Those simple times are over. Agency, subagency, dual agency, split agency, disclosed dual agency, nonagency, deal broker, facilitator, independent contractor, relationship disclosures, property condition disclosures and psychological stigma nondisclosures now complicate life for real estate brokers. In shouldering this new world of burdens, brokers must now choose what relationship to have with their clients, satisfy relationship disclosure requirements, not commit the unauthorized practice of law in explaining the relationship and behave consistently with the chosen relationship. These burdens include making the appropriate disclosures about the property and nondisclosures of psychological stigmas. Under the current generation of statutes, real estate brokerage is not simple.

Ronald Benton Brown and Joseph M. Grohman are professors at Nova Southeastern University Shepard Broad Law Center in Fort Lauderdale, Florida.