10 Agency

INTRODUCTION

The subjects of agency and the fiduciary relationships between real estate brokers and their principals are among the most difficult concepts for real estate licensees to understand and apply when engaged in real property or real property secured transactions.

A significant percentage of claims presented to insurance carriers offering errors and omissions coverages involve alleged negligence, professional negligence, negligent misrepresentations and breaches of fiduciary duty by real estate licensees. Equally, civil actions brought against real estate licensees by the public usually include causes of action for negligence, professional negligence, negligent misrepresentations and breaches of fiduciary duty.

The purpose of this Chapter is to provide the reader with an understanding of the concept of agency and fiduciary duty in the expectation that those who practice as real estate licensees will better perform their responsibilities to the public they serve. Fiduciary duties include, among others, loyalty; confidentiality; the exercise of utmost care (and in certain fact situations, reasonable care); full and complete disclosure of all material facts; the obligation to account to the principal; the obligation to act fairly and honestly and without fraud or deceit; and the duty to "explain" and "counsel" about that which has been disclosed or should have been disclosed thereby permitting the principal to make an informed and considered decision to buy, sell, lease, exchange, borrow or lend.

The concept of agency and fiduciary duty is quite old. According to Civil Code § 2295 (which was enacted in 1872), "An agent is one who represents another, called the principal, in dealings with third persons. Such representation is called agency." In an agency relationship, the principal delegates to the agent the right to act on his or her behalf, and to exercise some degree of discretion while so acting. The agency relationship between a real estate broker and his or her principal results in a special agency typically limiting the broker to soliciting and negotiating on behalf of the principal to the real property or real property secured transaction. (Business and Professions Code § 10131 et seq.; Civil Code § 2297). Generally, real estate brokers are neither entitled to act in the place and instead of nor are they entitled to bind their principals.

An agency relationship creates a fiduciary duty owed by the agent to the principal within the course and scope of the agency and the authority granted by the principal. The fiduciary duty owed by real estate brokers to their principals has been compared by the courts to the duty owed to the beneficiaries by a trustee under a trust. (Civil Code § 2322, Probate Code §§ 16000-16105.)

In most real property transactions, the real estate broker acts as an agent for someone else - the principal - who seeks to sell to, buy from, or exchange with a third party real property or a business opportunity. The real estate broker also may be acting on behalf of another or others to negotiate a loan, the repayment of which is secured, directly or indirectly, by real property. As a special agent, the real estate licensee is authorized to represent the licensee's principal with third persons in real property or real property secured transactions. (Business and Professions Code § 10131 et seq.; Civil Code § 2079.13 et seq. and § 2297.)

A real estate broker is a special agent who is authorized by the principal to carry out certain defined acts within the course and scope of the agency established by the principal. The real estate salesperson is an agent of the real estate broker, regardless of whether he or she is an employee for purposes of the Real Estate Law, or an independent contractor of the real estate broker for federal and state income tax reporting purposes. The broker in the real property transaction is responsible for his or her salesperson who acts as an agent of the broker. When a salesperson owes a duty to the buyer, the seller, or to any principal or party in a real property transaction, the duty is equivalent to the duty owed by the real estate broker for whom the salesperson acts. Broker associates act as agents of the responsible broker in the same manner as salespersons. (Civil Code § 2079.13(b).)

The existence of an agency relationship invokes a vast and often complicated body of rules and regulations which govern the rights and duties of principals and agents to each other and the obligations of both principals

and agents to third parties. The following discussion begins with an analysis of the distinctions between general and special agents and the description of those relationships between parties which are other than agent and principal.

THREE RELATIONSHIPS IDENTIFIED AND DEFINED

A party may be authorized to act on behalf of or in relationship to another in various ways:

1. The relationship is that of a principal and agent, whether that of a general agency or a special agency;
2. The relationship is that of an ordinary employer-employee between the principal and the second party;
3. The relationship is that of a principal and an independent contractor who is the second party performing certain defined services.

1. General and Special Agents Defined

General Agents

A general agent is one who is authorized to conduct a series of transactions involving a continuity of service. (Civil Code § 2295; Restatement (Second) of Agency, § 3(1)). General agents tend to be an integral part of a business enterprise and do not require additional authorization for each transaction which they conduct on behalf of their principal. For example, a branch manager of a company may have general authority to transact the business of the branch on behalf of the company and is a general agent to that extent.

Special Agents

A special agent is one who conducts a single transaction or series of transactions not involving continuity of service. (Civil Code § 2297; Restatement (Second) of Agency, § 3(2).) A real estate broker is usually a special agent although, in appropriate circumstances, a form of general agency can arise. The distinction between a general and special agent is important when determining the extent of an agent's authority to bind the principal to agreements made by the agent with third parties, and when defining the course and scope of the agency relationship.

Real estate brokers typically exercise limited authority as special agents to solicit and negotiate on behalf of their principals from whom they must obtain ratification of agreements with third parties. Real estate brokers and associate licensees they have engaged are neither licensed nor regulated to act as general agents. Rather real estate licensees are licensed and regulated as special agents to carry out on behalf of another or others certain defined activities for compensation or expectation of compensation in real property and real property secured transactions.

A real estate broker is ordinarily a special agent who acts on behalf of the principal, but does not act in place or instead of the principal. In order for a real estate broker to act in place and instead of the principal the agent must be designated the attorney in fact pursuant to a power of attorney, which should only be used in exceptional circumstances and with the advice of counsel. For example, the broker is not entitled to convey or encumber title to the real property of his or her principal without the express written authority of that principal. Such authority would typically require a power of attorney. While the listing agreement, known as an exclusive right to sell, grants to the real estate broker the right to receive a commission regardless of whether the principal, the listing broker or any other broker sells the property, such a listing agreement does not convey any power to the listing broker to sell the property. Rather, the authority granted to the listing broker is the right to solicit offers from prospective buyers (offerors) and the right to be compensated regardless of through whom the property may be sold.

Broker Acting for Own Account Whether as a Principal Only or as a Principal and a Special agent of the Other Principal

Not infrequently a real estate broker or salesperson will act in a real property transaction or real property secured transactions for his or her own account. Because of professional background and contacts, a licensee is more aware of investment and profit opportunities in real property or real property secured transactions than are

a majority of the people who do not possess real estate licenses. An effort to exploit these opportunities to personal advantage may involve legal or ethical matters to be carefully considered by the licensee before becoming involved in a transaction as a principal and, therefore, for the licensee's own account.

Even where a broker or salesperson is acting for his or her own account, i.e., as a principal to the transaction, duties are owed to the other principal including the obligation to act honestly and fairly, in good faith, and without fraud or deceit. These duties and obligations are expected of all parties to agreements. Real estate licensees are generally subject to additional defined duties when acting as principals only in real property or real property secured transactions. (Katz v. Departments of Real Estate (1979) 96 Cal.App.3d 895; Prichard v. Reitz (1986) 178 Cal.App.3d 465).

In certain fact situations, brokers or salespersons have added duties to the principal to the transaction even when acting only as principals for their own account. An example is when a broker or salesperson is acting as a principal in a transaction who is an arranger of credit pursuant to Civil Code §§ 2956-2957. Licensees who are principals in such transactions pursuant to Civil Code § 2957(a)(1) and (a)(2) must prepare and complete a seller financing disclosure statement to be delivered to the other principal.

Civil Code § 2079.13(b) imposes a higher standard upon real estate licensees and upon the broker which whom the licensee is associated (both salespersons and broker associates) even when acting as principals for their own account. In particular, the Civil Code provides that: "The agent in the real property transaction bears responsibility for his or her associate licensees who perform as agents of the agent. When an associate licensee owes a duty to any principal or to any buyer or seller who is not a principal, in a real property transaction, that duty is equivalent to the duty owed to that party by the broker for whom the associate licensee functions." (Civil Code § 2079.13(b) emphasis added.)

Numerous complaints are made to the Department of Real Estate resulting from the efforts of licensees to secure profits in real property transactions by purporting to act as principals. In this connection they have resorted to the use of options, net listings, guaranteed sales, and other types of agreements which combine features of a listing with an obligation or right imposed upon or given to the licensee to act as a principal. The use of options, net listings, and guaranteed sales is neither illegal nor unethical in California so long as a full disclosure of the licensee's involvement in the transaction and the legal effect of such an agreement are explained to the persons with whom the licensee is transacting business. The other party to the prospective transaction must be advised and understand that the licensee may be acting as a principal, and potentially as both an agent and a principal in the transaction, rather than simply as an agent.

When a real estate licensee is acting as a principal only in a transaction, it is essential that the other principal to the transaction understand the role of the licensee. The other principal should be aware of the conflicts of interest involved in such transactions and that the dealings with the licensee are at "arms-length" and not that of a special agent and principal. Because of the potential for creating conflicts of interest between the agent and the principal who is the other party to the transaction, some states such as Massachusetts and New York limit or prohibit the use of net listing or agency agreements. Although net listings are not illegal in California, they can easily lead to a breach of the agent's fiduciary obligations and should be used only with highly sophisticated clients, or clients who are independently represented and, of course, with full disclosure of all of the conflicts involved.

Since the broker or salesperson holds himself or herself out as a real estate licensee, the broker or salesperson must be careful when acting as a principal only, or as both a special agent and a principal. It is easy for the public to misunderstand the role of the licensee because the contacts between them usually arise out of the marketing activities of the licensee. For example, office signs, signs on properties, stationery, newspaper advertisements and business cards are all illustrations that the broker or salesperson is acting or intending to act in a licensed capacity. Therefore, great care must be taken to dispel the agency image if the licensee chooses to act as a principal only in a real property or real property secured transaction.

Also, it is important for the licensee to disclose and explain fact situations where the licensee may be acting both as a principal and a special agent. An example of such a fact situation is when the licensee lists his or her property on a multiple listing service, soliciting buyers through that medium, and the real estate firm with whom the licensee is associated later becomes the agent of the buyer. Another example is where a real estate broker

has undertaken on behalf of the borrower to solicit for a lender to make a loan to the intended borrower. The broker later decides to make the loan him or herself or out of broker controlled funds. As a result, the broker is presumptively acting as both a principal and as a special agent in the loan transaction. (Business and Professions Code §§ 10240(b) and 10241(j)).

It is particularly dangerous for as a licensee to start out as an agent in a transaction and then switch status before the transaction is consummated to that of a principal only. In fact, it may not be possible to discharge the responsibilities inherent in the agency relationship in the middle of a transaction. The usual result is the licensee will be acting both as a principal and as a special agent of the other principal to the transaction. The licensee must be scrupulous in informing the other principal of the inherent conflicts of interest when the licensee is acting as a principal, and the licensee should recommend that the principal obtain independent professional advice with regard to and before proceeding with the transaction.

Various court decisions indicate that the burden of proof under these circumstances is upon the licensee to show that the principal was fully informed of this change of status. Obviously, such disclosures must be made in writing (Civil Code § 2079.17 and Business and Professions Code §§ 10176(a) and (d)). Vague or ambiguous disclosures will not be sufficient notice of a change of status by the licensee from special agent to principal only.

Option to Purchase by the Broker as a Special agent

A somewhat similar situation arises when a broker who is employed as a special agent to find a buyer of real property obtains an option to purchase the property by the owner which runs concurrently with the agency. In such a case, the broker cannot ignore the interests of the principal and the broker may not take advantage of the fiduciary relationship with the principal.

The law is well summarized in American Jurisprudence: "If a broker employed to sell property is also given . . . an option to purchase the property himself, he occupies the dual status of agent and purchaser and he is not entitled to exercise his option except by divesting himself of his obligation as an agent by making a full disclosure of any information in his possession as to the prospect of making a sale to another." Again, a broker should not proceed to obtain options to purchase from a principal for whom the broker is acting as an agent unless the principal is highly sophisticated in such transactions, or is independently represented by a professional, and receives full disclosure.

Disclosure of Conflicts and Profits by the Broker as a Special agent

In the language of The Restatement of Agency: "Before dealing with the principal on his own account . . . an agent has as a duty, not only to make no misstatements of fact, but also to disclose to the principal all relevant facts fully and completely. A fact is relevant if it is one which the agent should realize would be likely to affect the judgment of the principal in giving his consent to the agent to enter into the particular transaction on the specified terms. Hence, the disclosure must include not only the fact that the agent is acting on his own account but also all other facts which he should realize have or are likely to have a bearing upon the desirability of the transaction from the viewpoint of the principal." (Restatements (Second) of Agency ' 390)

The very nature of combining listings, options, and guaranteed sale agreements place the licensee in a position where he or she must exercise the utmost caution to avoid violating the fiduciary duties and obligations owed to the principal. Additional problems arise in this context because the Real Estate Law and general principals of agency require that the licensee make full disclosure to the principal of any compensation, commission or profit, claimed or taken by the licensee with respect to the transaction. (Business and Professions Code § 10176 (g)).

2. Employer-Employee Relationship Defined

For centuries, the employment relationship was characterized as the law of Master and Servant. An employee is defined in the Labor Code as one who renders personal services to the employer and who is performing the service under the direction and control of the employer. For instance, a filing clerk in an office, or a machinist in a factory is an ordinary employee. A broker is usually not an employee. Rather, a broker acts as a special agent of his or her principal to accomplish the limited and specific purposes of the agency. In this relationship, the broker is authorized to solicit, negotiate and to act on behalf of the principal within the course and scope of the agency. However, the broker is not typically authorized to act in the place or instead of the principal. For

instance, an officer of a corporation often has the authority to bind his employer to agreements while a broker must obtain a ratification or specific consent of the principal. Although there is some confusion in both the statutes and reported cases, there is a distinction between an agent and an employee.

An employee is an agent of the employer but not all agents are employees. A real estate broker is an agent of his or her principal but not an employee of the principal. On the other hand, the relationship between the real estate broker and his or her licensees is that of a principal and an agent and employee. (Business and Professions Code §§ 10032 and 10132, and Civil Code § 2079.13(b)). With regard to the liability and responsibilities to third parties, it does not matter whether the salesperson or broker associate is classified as an employee or agent. In either case, the supervising broker whether individually or through a real estate licensed corporation is vicariously liable for the actions of the broker's agents and employees. Should the broker be a corporation, the salesperson or broker associate is an agent and employee of the corporation, and not directly an agent of the supervising qualifying broker in his or her individual capacity. (Walters v. Marler (1978) 83 Cal.App.3d 1, 35). However, the broker as the designated officer of the corporation is responsible to supervise the agents and employees of the corporation to ensure full compliance with the Real Estate Law. (Business and Professions Code § 10159.2).

3. Independent Contractor Defined

An independent contractor is one who, in rendering services, exercises an independent employment or occupation and is responsible to the principal only for the results of his or her work. An important factor in establishing independent contractor status is that the contractor determines the method of accomplishing the work for which the contractor has been engaged. Salespersons and broker associates are usually characterized as independent contractors of the broker for purposes of state and federal income tax reporting and for certain other purposes such as Workers' Compensation Insurance coverage. (Unemployment Insurance Code § 650 and 26 USC § 3508). Accordingly, salespersons and broker associates are agents and employees of the supervising broker in connection with dealings with the public but may, at the same time, be independent contractors for income tax reporting and certain other labor related purposes.

To maintain independent contractor status for income tax reporting and related labor law purposes, it is necessary for the supervising broker to specify in contracts with salespersons and broker associates that the associates are independent contractors and not employees for income tax reporting purposes. However, the real estate broker should not be confused by the implementation of independent contractor status for tax reporting, Workman's Compensation, or other labor related purposes. The independent contractor relationship with salespersons and broker associates does not in any way diminish the broker's responsibilities and liabilities for the conduct of the broker's salespersons and broker associates who are acting as agents and employees for other purposes. (Business and Professions Code §§ 10032, 10132, 10177(h) and 10159.2.) (Also, Manning v. Fox (1984) 151 Cal.App.3d 531; Resnik v. Anderson & Miles (1980) 109 Cal.App.3d 569, 572-573; Gipson v. Davis Realty Co. (1963) 215 Cal.App.2d 190, 206-207; Grand v. Griesenger (1958) 160 Cal.App.2d 397, 406).

4. Status of Mortgage Brokers

In view of the turmoil in the mortgage origination industry during the last 10 years, and culminating in the mortgage meltdown of 2008, the legislature has enacted various specialized provisions pertaining to independent contractors in the mortgage loan origination business. (Business and Professions Code §§ 10133.1(c) (1) and (2) and 10177.6, § 10166.03; 10 CCR, Chapter 6, § 2841).

5. Interrelating Factors

A. Independent Contractor Status

For the most part, an independent contractor sells final results rather than time and the methods of achieving those results are not subject to the control of the principal. The independent contractor agrees to do the work contracted for in his or her own way. An independent contractor may also be an agent of the principal. For instance, a real estate broker is typically an independent contractor acting as a special agent of the principal for

a defined limited purpose. On the other hand, office personnel such as secretaries, receptionists, and administrative assistants are typically employees. At the same time, there are many independent contractors who may not be agents. Examples of this relationship are building subcontractors, structural pest control operators and other professionals such as architects and engineers who may be engaged to inspect and issue reports on the condition of a real property, and who are not engaged to accomplish an activity on behalf of the principal.

Many factors bear upon the issue of whether a given agent is an employee or an independent contractor. Further, the agent may be an employee for certain purposes and an independent contractor for certain purposes, e.g., the salesperson or broker associate engaged by the real estate broker. Some of these factors are: existence or nonexistence of an independent calling; limited or unlimited right of principal to hire and fire; extent to which the engagement agreement permits principal to give orders as to time and details; custom in the industry as to scope of control; and payment by time or by job. In addition, real estate licensees have been given certain statutory exemptions which allow salespersons and broker associates to be characterized as independent contractors for income tax reporting, Workers' Compensation, and other labor related purposes when engaged in brokerage sales and related services. (Unemployment Insurance Code § 650 and 26 USC § 3508.)

A legislative objective was pursued by the real estate industry to presumably allow real estate brokers and their salesperson or broker associates to contract distinguishably from existing law regarding the employer’s statutory obligation to indemnify the employee for acts occurring within the course and scope of the employment. While the objective of having salesperson and broker associates indemnify the employing real estate broker has not yet been tested in a reported case, this contractual relationship would not in any event affect third parties, including the Department of Real Estate or members of the public. (Business and Professions Code § 10032). These and many other elements will determine a person's status as an employee, agent, independent contractor or some combination of the foregoing.

B. Public Liability: Broker’s Duty to Supervise

Even though an employer or principal may not be personally at fault, they can be held liable in damages for the negligent conduct of their employees or agents who act within the general course and scope of their employment or agency. This liability finds its most notable illustrations in cases involving automobile accidents of employees while driving on the employer's business. If the wrongdoer is an independent contractor for all purposes, the person who hired him or her would not ordinarily be liable for injuries caused by the negligence of the independent contractor. Brokers should consider carrying general liability and Errors and Omission insurance covering their salespersons, broker associates and office personnel regardless of their contractual and employment relationships with the supervising broker.

The fact that the salespersons and broker associates may be independent contractors for income tax reporting and labor related purposes does not alter the agency and employee relationship for other purposes. In Resnik v. Anderson and Miles, 109 Cal.App.3d 569, 573 the California Second District Court of Appeals held, "a salesman, insofar as his relationship with his broker is concerned, cannot be classified as an independent contractor. Any contract which purports to change that relationship is invalid as being contrary to the law."

Some brokers may be unaware of their responsibilities to supervise the activities of salespersons and broker associates even when the associate licensees are acting as principals. While the duty to supervise salespersons and broker associates when acting as principals may be narrower than the duty to supervise these associates when acting within the course and scope of the real estate license, the scope of the duty to supervise principal transactions has wide-ranging implications. As aforementioned, the seller "carry back" financing is an example of a principal relationship which would require broker supervision. Another example would be when a salesperson or broker associate is acting as a principal to make loans through the supervising real estate broker with the real estate broker being the arranger of the loan transaction. (Business and Professions Code §§ 10240 and 10241(j)).

Although many practitioners may be unaware of their obligations in this regard, the duty of the broker to supervise the transactions of a salesperson or broker associate is well established. For instance, it is clear that salespersons and broker associates are the agents of the broker by whom they are employed or with whom they

are licensed. A real estate salesperson does not have authority to act independently of the broker who employs him. Rather, the salesperson acts on behalf of the broker, who is, in turn, the agent of the principal. (California Real Estate Loans, Inc. v Wallace (1993) 18 CA 4th 1575; Manning v. Fox (1984) 151 Cal.App.3d 531; Resnik v. Anderson & Miles (1980) 109 Cal.App.3d 569, 572-573; Gipson v. Davis Realty Co. (1963) 215 Cal.App.2d 190, 206-207; Grand v. Griesenger (1958) 160 Cal.App.2d 397, 406.).

Recent developments have expanded the scope of civil liability of brokers for the negligent acts of salespersons and broker associates. (Business and Professions Code §10032; Civil Code § 2079.13 (b)) This is true regardless of whether the salesperson treated by the hiring broker as an employee or independent contractor. An employer is required by statute to indemnify an employee for all expenses or losses necessarily incurred in the performance of his or her job or while obeying the directions of the employer, whether or not lawful, unless the employee believed the acts to be unlawful at the time the directions were obeyed. (Labor Code §2802(a)). Any contract made by an employee that purports to waive this right is null and void. (Labor Code §2804).

The Department of Real Estate has published comprehensive regulations pertaining to the broker's duty to supervise independent contractors and requires the supervising broker to establish policies, rules procedures and systems to monitor the conduct of broker and salesperson associates (10 CCR, Chapter 6, § 2725).

C. Liability for Intentional Torts and Criminal Misconduct

Ordinarily, employers and principals are not liable for the intentional torts or criminal misconducts of the employee or agent. However, the law recognizes various exceptions to this general rule. This is a complicated and quickly evolving field and no effort is made here to fully explore the subject.

Under existing law, the supervising broker will be liable for the intentional torts or criminal misconducts of his salespersons or broker associates where the supervising broker ratifies the misconduct, or where the broker knew or should have known of the misconduct but failed to reasonably prevent it, e.g., the conduct was reasonably foreseeable. (Alhino v. Starr (1980) 112 Cal. App. 3d 158, 173-175; also Inter Mountain Mortgage, Inc. v. Sulimen (2000) 78 Cal.App.4th 1434). For instance, when a supervising broker knows a salesperson is committing fraud, the broker must intervene and take necessary and appropriate steps to terminate the misconduct, and the broker would be well advised to consider terminating the relationships with the perpetrators of such misconduct.

D. Workers' Compensation

Under the California Workers' Compensation Act, the broker may not necessarily be required to carry workers compensation insurance covering salespersons and broker associates. However, the failure of the supervising broker to carry workers' compensation coverage may result in liability to the broker if a court later concludes that the real relationship between the parties for the purposes at issue was that of an employer and employee. The broker will minimize the risks inherent in the uncertainties of the law in this field by carrying workers' compensation insurance.

E. Social Security

A similar situation arises under the Federal Insurance Contributions Act and Federal Unemployment Tax Act. Here the broker may submit broker's employment agreements with the salespersons or broker associates together with detailed data as to operating methods to the District Director of Internal Revenue and obtain a ruling whether the salespersons or broker associates are considered employees under these acts. The existing exemptions available to real estate brokers have extended primarily to brokerage sales and related services. Real estate brokers who are engaged in a broad list of licensed and non-licensed activities may wish to review with legal counsel the effect of these activities upon the available exemptions from employee and employee relationships for income tax reporting purposes. (26 USC § 3508; IRS Rev. Ruling 76-136, IRS Rev. Ruling 76-137, and California Attorney General Opinion 59 Ops. A.G. 369.)

The consequences of mischaracterizing the relationship in this context are serious. For example, if the IRS rules that the salespersons or broker associates are employees for income tax reporting purposes, the supervising broker may be liable for income taxes due from the salespersons or broker associates which should have been

withheld by the broker and timely paid to the IRS. Interest and penalties will be typically added to the amount assessed by IRS. Supervising brokers should obtain the advice of a CPA and/or qualified tax attorney when establishing policies and procedures in this regard.

F. Unemployment Insurance

The California Unemployment Insurance Act excludes brokers and salespersons who are remunerated solely by way of commission from the definition of employee for purposes of maintaining unemployment insurance coverage. (Unemployment Insurance Code § 650). The Employment Development Department (EDD) has generally taken a more industry sympathetic view on this issue then has IRS. However, if IRS rules in a given fact situation that salespersons or broker associates are employees of the supervising broker for income tax reporting purposes, EDD is likely to follow the IRS ruling and impose the same relationships on the supervising broker in the subject fact situation.

G. Personal Income Tax

In recent years IRS has been challenging the exemption available to real estate licensees under 26 USC 3508 when the activities involved are other then general sales brokerage and related services, e.g., licensed activities such as mortgage brokerage, mortgage banking, and special project brokering such as new subdivision sales. Real estate licensees may be still treated as independent contractors for both federal and state personal income tax purposes, depending upon the fact situation.

This issue has been addressed in part by (1) the Federal Tax Equity and Fiscal Responsibility Act (TEFRA) and (2) the amendment to § 650 and the addition of § 13004.1 to the California Unemployment Insurance Code. Under these laws real estate licensees functioning on behalf of a supervising real estate broker, in certain fact situations, are and remain exempt from treatment as employees for income tax reporting and other labor related purposes provided that certain conditions are met.

Section 13004.1 provides that an individual will not be considered an employee for state income tax purposes if all of the following conditions are met: (l) the individual is licensed by the Department of Real Estate and is performing brokerage services as a real estate licensee on a commission basis; (2) substantially all remuneration for such services performed is related directly to sales or other output rather than the number of hours worked; and (3) the real estate services by that individual are performed pursuant to a written agreement between the individual and the supervising broker and the agreement provides that the individual will not be treated as an employee with respect to those services for state tax reporting purposes. Similar standards apply for establishing independent contractor status for federal income tax reporting purposes.

It bears emphasis that the characterization of independent contractor status for state and federal income tax reporting purposes has no effect upon the supervising brokers' (whether individual or corporate) civil or public liability for the conduct or misconduct of salespersons or broker associates. (Business and Professions Code §§ 10032, 10132, 10177(h) and 10159.2). (Also, Manning v. Fox (1984) 151 Cal.App.3d 531; Resnik v. Anderson & Miles (1980) 109 Cal.App.3d 569, 572-573; Gipson v. Davis Realty Co. (1963) 215 Cal.App.2d 190, 206-207; Grand v. Griesenger (1958) 160 Cal.App.2d 397, 406).

H. Employment Contract with Salespersons and Broker Associates

Commissioner's Regulation 2726 provides that every real estate broker must have a written agreement with each salesperson or broker associate, whether licensed as a salesperson or as a broker. An engagement agreement between the broker and salesperson is instrumental in establishing the relationship between them, but it is ineffective to the extent that it conflicts with the Real Estate Law, other statutes, and applicable case law. It is important to recognize that a written agreement is required with both salespersons and broker associates if either is given access to and the ability to withdraw monies from the trust accounts of the supervising broker. (10 CCR, Chapter 6, § 2834).

CREATION OF AGENCY RELATIONSHIPS

The relationship of principal and agent can be created by agreement between them, referred to as an actual agency, by ratification or by estoppel, or as the result of the conduct of the parties and the agent's inherent relationship with third parties (i.e., an ostensible or implied agency). Typically, the status of the real estate broker performing as a special agent of a principal in a real property or real property secured transaction is created by an express agreement (an actual agency). When created in this manner, the basic principles of agency law arising out an agreement are applicable.

1. Employment Contract

The duty to know and understand the agency relationship being constructed by an agreement or occurring as a result of the conduct of the parties is placed primarily upon the broker. When a real estate broker and a principal enter into an employment contract authorizing the broker to act on behalf of the principal, an actual agency relationship is created. (Civil Code § 2299). Since a real estate broker draws clients from all walks of life, it is incumbent upon the broker (in view of the broker's knowledge and expertise) to see that the employment agreement with the principal establishes the agency relationship, is in a correct form, and is constructed according to the circumstances and in a fair manner.

2. When is the Agency Relationship Established?

As indicated above, the relationship between an agent and a principal is usually based upon an agreement, either expressed or implied. In the real estate industry, the most common and standardized agency agreement is that which arises between a seller or lessor of property, or an owner of a property who is an intended borrower and his or her broker. Such agency agreements are known as "listings." Agency agreements can also be made between an agent and a prospective buyer, lender, or tenant/lessee. Agreements with buyers, tenants/lessees, or lenders are more common in non-residential transactions, although the use of such agreements for residential sales appear to be increasing. In any case, an agency agreement must be in writing for the agent to be able to enforce a commission claim based upon a breach of contract theory. (Civil Code § 1624(d); Phillippe v. Shapell Industries (1987) 43 Cal. 3d 1247, 1255-1258).

3. Right to Compensation

A. Breach of Contract vs. Tort Theory

The broker's right to compensation and the amount must be clearly set forth in the listing agreement. The obligation to pay compensation to the broker must be in writing. A real estate broker can act upon a letter received from an owner, whether voluntarily sent by the owner or in answer to the broker's solicitation. When relying upon letters, the broker should be very careful to see that the letter contains an employment clause, or authorizes the broker to find or procure a buyer, tenant/lessee, or a lender, and describes the compensation the broker is entitled to receive as a result of accomplishing the purpose and scope of the agency.

Civil Code § 1624(d) and the Phillippe case mean that a broker is not entitled to recover a commission under a breach of contract theory, unless there is a signed agreement between the broker and the principal. The agreement can be a listing agreement, some other form of agency agreement, or the agreement to pay the commission may be set forth in the purchase agreement itself. For instance, one court held that a defaulting buyer was liable to the buyer's agent for a $100,000 commission on the grounds that the broker was a third party beneficiary of the purchase agreement between the buyer and seller. (Chan v. Tsang (1991) 1 Cal.App.4th 1578).

Similarly, loan brokers should have but often do not have written agreements with their principals. Even without written agreements, loan brokers may be able to enforce payment of their compensation by reference to other loan documents and disclosures exchanged between the borrower and the broker that identify the commissions, fees, costs and expenses being paid to or charged by the broker, and which obligate the borrower for the payment of such compensation. However, if there is no written agreement obligating the principal to pay compensation, the real estate broker generally will not be able to recover the compensation, regardless of the extent to which services were rendered for the benefit of the principal.

An example is where a seller and broker enter into a 90 day listing agreement which expires before a buyer is found. The seller instructs the broker to continue working on finding a buyer, but does not sign a written extension of the listing agreement. Can the broker recover a commission if a buyer is procured? Answer: Quite probably not.

An agency agreement and all extensions or modifications of it must be in writing to be enforceable. In this case, the listing agreement expired and the agent is working without an agreement. The broker may very well be a continuing agent of the principal for purposes of soliciting for buyers, but the broker is without a written agreement for compensation. Should the broker be successful in producing a buyer willing, ready, and able to purchase the property pursuant to the terms, conditions, and covenants authorized and agreed to by the principal, unless the broker is able to successfully argue the principal waive the termination date of the listing contract the broker may be unsuccessful in enforcing compensation. The result of the argument may create a conflict with Business and Professions Code § 10176(f).

At least in one case, a real estate broker was successful in obtaining a commission based upon a claim arising out of an intentional interference with a prospective economic advantage. The real estate broker, Mr. Buckaloo, did not have a written commission agreement with the seller. Based upon an oral contract with the seller, Mr. Buckaloo expected to earn a commission if the property were sold. Mr. Buckaloo found a buyer and showed him the property. The seller and the buyer apparently conspired to avoid paying Buckaloo a real estate commission, and closed the sale without informing Mr. Buckaloo. Mr. Buckaloo sued for intentional interference with a prospective economic advantage, based upon his allegation he was the "procuring cause" of the sale.

The Supreme Court saw the inequity in the fact situation and ruled in Mr. Buckaloo's favor. The Court held that Buckaloo had no contractual right to a commission because there was no compliance with the Statute of Frauds (Civil Code § 1624) in the absence of a written agreement for payment of the commission. In this case, the claim for commission was not based upon an alleged breach of contract, but rather it was based upon a tort theory of recovery. The Supreme Court held that the tort theory of interference with an economic advantage arising out of the relationship between the parties would support Mr. Buckaloo's commission claim, even though Mr. Buckaloo would be unable to enforce the underlying oral commission agreement on a breach of contract theory. (Buckaloo v. Johnson (1975) 14 Cal. 3d 815). Notwithstanding the Buckaloo case, the real estate broker is well advised to obtain written agreements for payment of compensation when acting as an agent for a principal in a real property or real property secured transaction.

It is unlawful for any licensed real estate broker to employ or compensate, directly or indirectly, any person for performing any of the acts for which a license is required who is not a licensed real estate broker, or a real estate salesperson licensed under the broker employing or compensating him or her; provided, however, that a licensed real estate broker may pay a commission to a broker of another state. No real estate salesperson shall be employed by or accept compensation from any person other than the broker under whom he is at the time licensed. It is unlawful for any licensed real estate salesperson to pay any compensation for performing any of the acts within the scope of the Real Estate Law to any real estate licensee, except through the broker under whom he or she is at the time licensed. (Business and Professions Code § 10137).

The above prohibition against sharing commissions with unlicensed persons applies only to a payment made by a licensee to a non-licensee as compensation for the performance of acts for which a real estate license is required. Thus, the payment of a portion of a commission by a licensee to a principal in the transaction does not constitute a violation of § 10137, but if there is a commission rebate to the buyer in the transaction that fact must be disclosed by the agent to the seller who has paid the commission. (Business and Professions Code §§ 10138, 10139, and 10139.5).

To summarize the foregoing discussion regarding breach of contract and tort theories, the following conclusions should be considered:

1. Commissions can only be paid to a licensed real estate broker who, in turn, may pay all or a portion of the commission to a licensed salesperson or broker associate provided that the salesperson or broker associate has a written contract with the broker. (Business and Professions Code §§ 10136, 10137, and 10138 and 10 CCR, Chapter 6, § 2726).

2. No salesperson shall be employed by or accept compensation from any person other than the broker with whom he or she is at the time licensed, and no salesperson shall pay compensation for performing any of the acts for which a license is required to any real estate licensee except through the real estate broker under whom the salesperson is licensed. (Business and Professions Code § 10137).

3. The listing broker must have a valid, written contract with the principal for whom the broker is acting, e.g., the seller landlord/lessor, or borrower. (Civil Code § 1624(d); Phillippe v. Shapell Industries (1987) 43 Cal. 3d 1247).

4. The selling broker must either have a valid written agreement with the buyer, tenant/lessee, or lender or be the "procuring cause" of the sale, tenancy or loan. (Civil Code § 1624(d); Phillippe v. Shapell Industries (1987) 43 Cal. 3d 1247; Buckaloo v. Johnson (1975) 14 Cal. 3d 815.)

B. Procuring Cause

In addition to showing that the broker has produced a ready, willing and able buyer, the broker must sometimes show that he or she was the "procuring cause" of the transaction before becoming entitled to a commission. This definition is particularly important in the case of more than one cooperating broker who has been working with a buyer, or where the broker is operating under an open listing and more than one broker may be competing for the payment of the commission. "Procuring cause" may be defined as a cause originating or setting in motion a series of events which, without breaking their continuity, results in the accomplishment of the prime object of the employment of the broker. (Pass v. Industrial Asphalt of California, Inc., (1966) 239 Cal.App.2d 776, 782; Rose v. Hunter (1957) 155 Cal.App.2d 3/9, 323).

The foregoing definition, while often repeated, is somewhat difficult to apply in practice. The broker is certainly the procuring cause if the parties enter into an agreement authorizing the broker to solicit buyers on behalf of the seller, and the broker produces a buyer in conformance with the listing agreement. What if the broker simply introduces the parties who then make their own agreement? Assuming there are no significant lapses of time, the broker is still probably the "procuring cause". (Buckaloo v. Johnson (1975) 14 Cal. 3d 815).

A common problem occurs when an ungrateful buyer, who was shown property by a broker, goes directly to the seller or listing broker to make the agreement to either avoid or reduce the amount of commission paid. Based upon the definition of "procuring cause," the broker who showed the property to the buyer is probably the "procuring cause", although in the practical world the problems of proof that the broker will face suggest that the case may be difficult to win.

4. Essential Elements of an Agency Agreement

The essential terms of an agency listing agreement are: (1) The names of the parties; (2) The identity of the property; (3) the terms and conditions of the anticipated sale, lease or loan; (4) the amount of commission or other compensation to be paid; (5) the expiration date of the agency; and (6) signatures of all parties concerned. In addition, an agency agreement concerning owner occupied residential property must contain a statement in ten point bold print or larger, acknowledging that commission amounts are negotiable and are not set by law.

It is advisable for a real estate broker to include such a statement in all transactions where the broker is acting within the course and scope of the real estate license and is claiming, contracting for, or expecting compensation for his or her services.

5. Types of Listing Agreements

The type of listing agreement and the terminology used to designate the form of listing varies somewhat among localities. The four kinds of listing agreements most commonly used are: (1) the open listing; (2) exclusive agency listing, (3) exclusive right to sell listing and (4) the net listing. In addition, local real estate boards or associations either directly or indirectly provide a service known as a multiple listing which is not a listing agreement. Rather, it is a mechanism and a medium through which information concerning listed properties is

disseminated among a wide group of real estate brokers and their salespersons and broker associates.

When the relationship between the real estate broker and seller results in an exclusive agency, the listing agreement must contain a definite, specified date of final and complete termination. (Business and Professions Code § 10176(f). Regardless of the relationship between the real estate broker and the seller, the description of the real property which is the subject of the listing must be included although it need not be as detailed as required in an instrument of conveyance or encumbrance. The description should, however, identify the property with certainty. A description that can be made certain is sufficient, e.g., "My house on Tenth Street, City," would be acceptable if the owner had but one house on Tenth Street. It would not be acceptable if this person owned two houses on Tenth Street.

A. Open Listing

An open listing is the most informal of the four principal kinds of listing agreements, and is distinguished by the fact that the owner retains the right to revoke the listing at any time, to sell the property him or herself, or to list the property with another broker. Open listings often generate questions regarding a real estate broker's claim to a commission, because the sale of the property by either the owner or any subsequently hired agent will defeat the original broker's right to a commission.

B. Exclusive Agency

An exclusive agency is an agreement by which the owner agrees to employ a particular real estate broker and no other to solicit buyers, tenants/lessees, or lenders. Under an exclusive agency listing, the broker's right to a commission is protected as against other brokers for the duration of the listing agreement. However, under an exclusive agency agreement, the owner retains the right to sell, encumber or rent/lease the property on his or her own and, in that event, the owner can terminate the agency agreement and defeat the broker's claim to a commission or other compensation.

C. Exclusive Right to Sell

The exclusive right to sell listing affords the real estate broker the greatest protection and makes him or her the sole agent for the sale, renting or leasing, or encumbering of the property. Under such an agreement, the broker is entitled to a commission provided only that the property is sold, rented or leased, or encumbered during the listing period, regardless of who procures the buyer, the tenant/lessee, or lender. In other words, under an exclusive right to sell agreement, the owner relinquishes both the right to list the property with other agents and the right to defeat the broker's claim for a commission by selling, renting or leasing, or encumbering the property him or herself.

It should be noted that in "sheltered" loan transactions arranged by real estate brokers pursuant to Article 7 of the Business and Professions Code, commencing with § 10240, the period of time during which exclusive authority may be granted to solicit lenders to procure a loan is limited to 45 days. (Business and Professions Code § 10243).

D. Net Listing

A net listing is one which contemplates the seller realizing a specific net price with the real estate broker's commission consisting of any sum that is received in excess of the seller's net proceeds. For example, if the seller enters into a net listing with a broker for a $100,000 net price, the broker would receive no commission if the net proceeds of the sale are $100,000 or less. On the other hand, if the proceeds of the sale are $125,000, the broker is entitled to a commission of $25,000.

Because of the potential for creating conflicts of interest between the real estate broker acting as a special agent and the principal, some states such as Massachusetts and New York limit or prohibit the use of net listing agreements. Net listings are not illegal in California. However, the net listing can easily lead to a breach of the agent's fiduciary duties and obligations. Therefore, net listing should be used only with highly sophisticated clients, or with clients who are independently represented by another professional and, of course, with full disclosure of all material facts involved in all transactions. (Business and Professions Code §§ 10176(a), (g) and (h)).

E. Multiple Listing

The multiple listing and the multiple listing service (M.L.S.) creates a means by which information concerning individual listings is distributed to all participants and subscribers of the service. For example, a seller lists property for sale with a broker. The broker then transmits a memorandum of the listing which includes information such as the type of property, its size, location, the listed price and other relevant information. This memorandum is then transmitted to the M.L.S. which in turn publishes, either in a booklet and/or computerized data sharing format, the information submitted by the original listing broker. Other brokers throughout the region are thereby made aware of the existence of the listing and can contact the listing agent on behalf of prospective buyers for the property.

When this is done, it is common that the listing broker will split any commission received with the broker who procures the buyer for the property. The broker who cooperates with the listing broker to procure a buyer is known as the selling broker. The selling broker may be acting as a subagent of the seller, an agent of the listing broker, or may be performing as the exclusive agent of the buyer.

F. Legal Significance of the M.L.S.

Two features of the M.L.S. are of legal significance to real estate brokers. The first is that information submitted to M.L.S. may later be admissible in court on the claim that the M.L.S. profile was incorrect and therefore was a misrepresentation. In addition, when a real estate broker or his salesperson or broker associate submits a listing to the M.L.S., the broker typically makes a unilateral offer to compensate the cooperating broker who procures a willing, ready and able buyer. Further, the seller typically authorizes the listing broker to cooperate and share commissions with other brokers who are members of the M.L.S., for the purpose of delegating to the cooperating brokers some of the listing broker's responsibilities, i.e., the assignment to solicit for and procure the buyer.

In such event, the cooperating broker becomes the subagent of the seller, unless the agency relationships are clearly bifurcated in writing limiting the cooperating broker to performing as an agent only of the buyer. Civil Code §§ 2079 et seq. [agency disclosure]; Civil Code §§ 2349, 2350 and 2351).

G. In the Context of a Listing Relationship, Authority of an Agent to Perform Authorized Acts on Behalf of the Principal

A pervasive aspect of agency law involves the agent's authority to act on behalf of the principal. Related to this concept is whether and to what extent will the principal be liable for agreements entered into, conducts of, or misconducts or wrongdoing committed by the agent. For instance, an agent, acting on behalf of an owner of real property, hires a contractor to perform an inspection of and to make certain repairs on the owner's property. Is the owner contractually obligated to pay for the services? Suppose that unknown to the owner, the agent for the owner (who is a real estate broker authorized to solicit for and to procure a buyer) falsely represents to the buyer there is a new roof covering on the property. Is the owner and seller liable for the broker's engagement of the contractor or for the misrepresentation regarding the roof covering? The answer to both of these questions is probably yes, depending upon the extent of the agent's authority.

The real estate broker should not confuse the authority of an agent to act on behalf of the principal under the principal’s express authority, whether written or oral, with the broker's limited authority as a special agent. Real estate brokers are special agents who are licensed and regulated to solicit and negotiate on behalf of their principals, but generally not to bind or act in the place and stead of the principals. As special agents, real estate brokers are authorized within the course and scope of the agency to make certain representations on behalf of owners and sellers of real property.

H. Consideration in the Listing Context

Consideration is not essential to the creation of an agency. One may gratuitously undertake to act as an agent and will still be held to certain standards demanded of an agent for compensation. Under the Real Estate Law, one who acts as a gratuitous agent does not need a real estate license. However, in any transaction subject to the Real Estate Law, and where there is an expectation of compensation, regardless of the form, time, or implicitly source of payment, then a license is required. (Business and Professions Code § 10131. et seq.).

Needless to say, compensation or the expectation of compensation is viewed broadly. For instance, benefits arising out of a joint venture relationship, or even out of the sharing of overhead, have been held to be sufficient compensation to established licensed activity. (Stickel v. Harris (1987) 196 Cal.App.3d 575, 585; James Jones v. Kellman (1988) 199 Cal.App.3d 131-136).

Generally, the agreement between the real estate broker and his or her principal provides for the payment of consideration, usually in the form of a commission. The payment of consideration arises out of the agreement between the principal and the broker. The agreement can be classified as either unilateral or bilateral. A unilateral agreement is one in which one party makes a promise to induce some act or performance by the other party, but the latter can act or not act as he chooses. For example, in the case of an open listing, the intended seller agrees to pay compensation to the real estate broker if the broker procures a buyer, but there is no obligation on the part of the broker to do so.

A bilateral agreement is one in which a promise by one party is given in exchange for a promise by the other party. For example, the exclusive right to sell listing (since the obligation upon the broker to use due diligence and best efforts to procure a buyer is either express or implied) is a bilateral agreement because it involves an exchange of promises. As previously noted in this Chapter, it is essential for the real estate broker to be able to enforce payment of compensation on a breach of contract theory that the agreement retaining the broker be in writing (Civil Code § 1624(a)(3); Phillippe v. Shapell Industries (1987) 43 Cal. 3d 1247, 1255-1258.)

In the relationship established between the listing broker and cooperating brokers under traditional M.L.S. rules, the cooperating broker is appointed as a subagent of the principal (i.e., the seller). As a result of such appointment, the subagent may generally seek compensation from the principal. The more recent M.L.S. rules result in a unilateral offer of payment of compensation and not of subagency. See the discussion in this Chapter regarding subagency.

Where the principal's direct authority to cooperate with other brokers is unclear or contradictory, the cooperating broker has been obligated to seek compensation from the listing broker. (Goodwin v. Glick (1956) 139 Cal.App.2d Supp. 936). When the principal's authority is direct and clear, the cooperating broker has been able to secure payment of the commission from the principal. (Schmidt v. Berry (1986) 183 Cal.App.3d 1299). Although legal theories exist such as "third party beneficiary agreements" to support the payment of commissions to cooperating brokers, the latter may find it difficult to seek compensation directly from the principal because of a lack of privity of contract between the cooperating broker and the principal.

I. Mortgage Brokers

Real estate brokers perform as mortgage brokers when soliciting or negotiating loans, or when collecting payments or performing other related services for borrowers or lenders, including holders of promissory notes, when the loans are secured directly or collaterally by liens on real property. These licensees also perform as mortgage brokers when offering to sell, buy, or exchange promissory notes on behalf of the holders when the loans are secured directly or collateral by liens on real property. (Business and Professions Code §§ 10131(d) and (e), 10131.1 et seq., 10166.01 et seq., 10230 et seq., 10237 et seq., and 10240 et seq., and 10 CCR, Chapter 6, §§ 2840 through 2846).

Mortgage brokers may also engage (when authorized) in the collection of advance fees and in the issuance of securities, as defined in the Real Estate Law. When issuing securities, mortgage brokers are also subject to the Corporate Securities Law of 1968 and the applicable regulations of the Corporations Commissioner. (See, among others, Business and Professions Code §§ 10026, 10085, 10085.5, 10131.2, 10131.3, and 10146, and 10 CCR, Chapter 6, §§ 2970 and 2972; and, among others, Corporations Code §§ 25019 and 25206, and 10 CCR, Chapter 3, §§ 260.115 and 260.204.1).

Mortgage brokers solicit or negotiate loans to be delivered to financial institutions or to licensed lenders, as well as to private parties who invest private equity capital to fund loans or purchase promissory notes or interests therein secured directly or collaterally by liens on real property. When doing so, mortgage brokers act as agents and fiduciaries of the borrower or lender, or both; or the promissory note holder and the purchasers of such notes, or both. When acting for both principals in either circumstance, mortgage brokers are dual agents. (Business and Professions Code §§ 10131 et seq., 10166.01 et seq., 10176(d), 10177(n), 10177(q), 10177.6.,

10230 et seq., 10237 et seq. and 10240 et seq; and Civil Code §§ 2295 et seq., and 2923.1, and 10 CCR, Chapter 6, § 2840 et seq.).

When loans are arranged to be delivered to financial institutions or to licensed lenders, mortgage brokers typically are the agents and fiduciaries of at least the borrowers in such transactions. Depending upon the facts, mortgage brokers may also become the agents and fiduciaries of financial institutions or licensed lenders funding the loans for defined purposes, e.g., obtaining appraisal and credit reports or completing and delivering required disclosures or issuing required notices of rights on behalf of the lenders/creditors. In such fact situations, mortgage brokers are typically dual agents. (Business and Professions Code §§ 10131 et seq., 10176(d) and 10177(q) and Civil Code §§ 2295 et seq. and 2923.1).

When acting within the course and scope of the real estate broker's license, mortgage brokers are not solely performing as facilitators or intermediaries. Pursuant to applicable law, mortgage brokers must generally be agents and fiduciaries of at least one of the principals to the loan transactions or to the purchase and sale of promissory notes. When loans are delivered to private parties, mortgage brokers must be the agents and fiduciaries of the private parties, whether funding loans or purchasing existing promissory notes or interests in either the loans or the notes. Generally, mortgage brokers are also the agents and fiduciaries of the borrowers in such transactions. (Business and Professions Code §§ 10131 et seq., 10176(d), 10177(n), 10177(q), 10230 et seq., 10237 et seq., and 10240 et seq.; and Civil Code §§ 2295 et seq., and 2923.1, and the Real Estate Commissioner's Regulations pertaining thereto, including 2840 et seq., and Corporations Code §§ 25004, 25100(e), 25102.5, and 25206 and the Corporations Commissioner's Regulations pertaining thereto, including 10 CCR, Chapter 3, §§ 260.115 and 260.204.1).

Regardless of the nature of the intended loan transaction or the type of security property, mortgage brokers act as special agents and fiduciaries of their principals pursuant to Civil Code § 2297. When performing mortgage brokerage services, as defined, mortgage brokers are agents and fiduciaries of the borrowers and may be agents and fiduciaries of the lenders/creditors. (Business and Professions Code §§ 10131 et seq., 10166.01 et seq., 10176(d) and 10177(q), and Civil Code §§ 2295 et seq. and 2923.1).

Whether mortgage brokers act as the agents and fiduciaries of the borrowers or the lenders/creditors, or for the promissory note holders or the intended purchasers, or for both principals in the same transaction as dual agents, the common law as well requires mortgage brokers to place the interests of their principals ahead of their own. This duty and obligation to represent and act in the interests of their principals is incumbent upon mortgage brokers, regardless of the nature of the loan transaction, the services being provided, or the type of security property, including when acting as servicing agents, or in connection with loan modifications, extensions, or forbearances. (Business and Professions Code §§ 10131 et seq., 10166.01 et seq., 10176, 10177, 10230 et seq., 10237 et seq., and 10240 et seq.). (Realty Projects, Inc. v. Smith (1973) 32 Cal.App.3d 204, 108 Cal. Rptr. 71 and Wyatt v. Union Mortgage Co. (1979) 24 Cal. 3d 773 [157 Cal. Rptr. 392; 598 P.2d 45] and Montoya v. McLeod (1985) 176 Cal.App.3d 57, 64, 221 Cal. Rptr. 353 and Barry v. Raskov (1991) 232 Cal. App. 3d 447, 283 Cal. Rptr. 463 (Cal. App. 2 Dist.) and California Real Estate Loans, Inc. v. Wallace (1993) 18 Cal.App.4th 1575, 1580).

An agency relationship is established when a person represents a principal in dealings with third persons. Agents are fiduciaries with rare exception when performing within the course and scope of the agency. Mortgage brokers are agents and fiduciaries with prescribed duties and obligations when performing within the course and scope of the real estate broker's license. (Civil Code § 2297). However, fiduciary relationships may exist with principals even when no third persons are involved. Examples include the relationships between doctors and patients (principals) and between lawyers and clients (principals) when the services are performed in the absence of third persons.

Black's Law Dictionary describes a fiduciary relationship as "one founded on trust or confidence reposed by one person in the integrity and fidelity of another". A fiduciary has a duty to act primarily for the principal's benefit in matters connected with the undertaking and not for the fiduciary's own personal interest, including the requirement mortgage brokers place the economic interests of the borrower ahead of the broker's own economic interest. (Business and Professions Code §§ 10131 et seq., 10166.01 et seq., 10176, 10177, including 10177(q), 10230 et seq., 10237 et seq., and 10240 et seq., and Civil Code §§ 2295 et seq. and 2923.1(a)).

Mortgage brokers are providing mortgage brokerage services when acting for compensation or in expectation of compensation (whether paid directly or indirectly) to arrange or attempt to arrange residential mortgage loans as exclusive agents of the borrowers. Mortgage brokerage services are also provided when mortgage brokers act as dual agents for the borrowers and the lenders/creditors. Mortgage brokerage services, as defined, require the residential mortgage loan be made by an unaffiliated third party. (Civil Code § 2923.1(b) (3)).

However, mortgage brokers may not rely solely on the language requiring the residential mortgage loan to be made by an unaffiliated third party. For example, mortgage brokers may undertake to act as agents and fiduciaries of the borrowers to procure lenders/creditors in intended loan transactions and then elect to make the loan with funds the brokers own or control (whether directly or by an affiliated party). In such circumstances, mortgage brokers are acting as principals and as agents and fiduciaries of the borrowers (and are agents and fiduciaries of private parties who may join with the mortgage brokers to fund the loan or purchase the promissory note or an interest therein. (Business and Professions Code §§ 10131 et seq., 10166.01 et seq.,10176(d), 10177(q), 10230 et seq., 10237 et seq., and 10240 et seq., including 10240(b,) and 10 CCR, Chapter 6, § 2840 et seq.; and Civil Code §§ 2295 et seq. and 2923.1(c); and Corporations Code §§ 25019, 25004, 25100(e), 25102.5, 25206 and 10 CCR, Chapter 3, §§ 260.115 and 260.204.1.).

Residential mortgage loans are defined to mean consumer credit transactions secured by residential real properties improved by four or fewer residential units. (Civil Code § 2923.1(b) (4)). Real estate brokers performing as mortgage brokers are licensed and authorized to not only make or arrange residential mortgage loans, but to make and arrange loans secured by other than 1 to 4 residential units, e.g., land, income producing property, and the like. Mortgage brokers are agents and fiduciaries, as well, in non-residential mortgage loan transactions. (Business and Professions Code §§ 10131 et seq., 10230 et seq., 10237 et seq., and 10240 et seq., and Civil Code § 2295 et seq.).

The agency relationships between mortgage brokers and borrowers and lenders/creditors, or promissory note holders or the intended purchasers of such notes, or when providing services to borrowers or lenders/creditors (including acting as loan servicing agents) must be disclosed and consented to by the principals in each transaction. Mortgage brokers are subject to this duty and obligation regardless of the nature of the transaction or the type of security property, including when performing services on behalf or borrowers or lenders/creditors, such as loan modifications, extensions, or forbearances. The appropriate standard of care requires mortgage brokers, in writing, to disclose to and obtain consent from their principals to the agency relationships intended before proceeding to act on behalf of their principals. (Business and Professions Code § 10176(d)).

Significant duties and obligations are imposed on mortgage brokers pursuant to federal and state law when performing as agents and fiduciaries of one or more principals in loan transactions. Even when not acting as agents and fiduciaries of both principals (dual agents) in loan transactions, the duties and obligations imposed upon mortgage brokers include (among others), completing and delivering disclosures and notices of rights required under applicable law. Mortgage brokers are also subject to specified disclosures and notices and may not engage in prohibited conducts or in material loan terms in loan transactions that qualify as “high-cost”, “higher-cost”, or “higher-priced”, as defined. (12 USC 2601 et seq.; and 24 CFR Part 3500 et seq.; USC 1601 et seq. and 12 CFR 226 et seq.; Business and Professions Code §§ 10131 et seq., 10166.01 et seq., 10176, 10177, 10230 et seq., 10237 et seq., 10240 et seq. and 10 CCR, Chapter 6, § 2840 et seq.; and Financial Code §§ 4970 et seq. and 4995 et seq.).

TERMINATION OF AGENCY

Ordinarily an agency may be terminated in the following ways:

(a) The expiration of its term.
(b) The extinction of its subject.
(c) The death of the agent.
(d) The agent's renunciation of the agency.
(e) The incapacity of the agent to act as such. Civil Code § 2355.

1. When Principal May Revoke Agency

Because the relationship between a principal and agent is a personal one founded on the trust and confidence which a principal places in his or her own agent, the principal has an absolute power under the law to revoke the agency at any time unless the agency is coupled with an interest. For example, when the principal owns a real property with the agent who is a real estate broker, and the two principals appoint the broker as the property manager, the purpose and scope of the agency is coupled with the broker's interest as a joint owner of the property.

Nevertheless, while the principal in most circumstances has an absolute power to revoke, the principal does not necessarily have the right to do so and may be liable for breach of contract by revoking the agency without good cause. The Civil Code provides that if the agency was created by a recorded instrument containing a power to convey or execute instruments affecting real property, the revocation of the agency is not effective unless the revocation is in writing and is acknowledged and recorded in the same place as the instrument creating the agency.

2. Effect of Termination

According to Civil Code § 2355, notice of termination of an agency relationship must be given to third persons if the agency is terminated as a result of expiration of the term, extinction of the subject matter or the death, incapacity or renunciation by the agent. If the agency is in fact terminated in any of the ways enumerated in § 2355, the former agent is still an ostensible agent as to those third persons who have not received notice of termination. If the agency is terminated through the death or incapacity of the principal or by the principal's express act of revocation, it is effective as to third persons even though they have no notice. There is an apparent internal contradiction in § 2356 in that it states that a contract entered into with an agent by a third person who does not have actual knowledge of the death, incapacity or revocation by the principal is binding upon the principal, the principal's heirs and other successors in interest.

3. Time When Revocation Can Be Made

As a rule, unless a real estate broker's authority is coupled with an interest in the property, the broker's authorization may be revoked at any time by the principal. A real estate broker's right to earn a commission under a listing agreement is not considered to be an interest in the contract which precludes termination by death, incapacity or revocation on the part of the principal. This is true even if the broker is given a particular time within which to perform under the terms of the listing agreement. On the other hand, the courts have recognized circumstances where the contract of agency is irrevocable because the licensee has an interest in the property which is the subject matter of the agency. While such agency contracts are generally irrevocable, the real estate broker may still be discharged for breaching the fiduciary duties owed by the broker to the principal or by acting adverse to the interests of the principal.

The principal's termination of the agency relationship by revocation may give a real estate broker a right to damages for breach of contract or to the right to receive compensation pursuant to the terms of the listing agreement. (Blank v. Borden (1974) 11 Cal. 3d 963-967). Withdrawal of the property from the market by the owner prior to expiration of the listing is an example of a de facto revocation which may give the broker a cause of action for agreed compensation under the listing contract. The California Supreme Court has held that a clause in an exclusive listing contract providing for payment of the commission to the real estate broker on withdrawal of the property from sale by the principal does not constitute an unenforceable penalty under California law. If the listing is an open one, a sale negotiated by the owner or by a broker terminates the listing and notice of termination need not be given to brokers other than the broker who has presented the offer which has been accepted.

In the event an open listing specifies no fixed term of employment, the listing normally may be revoked by the owner at any time without liability prior to production of a ready, willing and able buyer by the broker. If a

fixed term is specified it is possible that, despite revocation by the owner, the commission will be earned if the broker produces such a buyer within the specified time.

Exclusive listing agreements must contain a definite, specified date of final and complete termination. If the listing does not contain a definite termination date, the listing is unenforceable by the real estate broker and the claim, demand or receipt of any fee under the agreement by the broker is a basis for disciplinary action against that broker's license. (Business and Professions Code § 10176 (f)).

AGENCY RELATIONSHIPS AND DISCLOSURE SUMMARY

Various rules of agency affect real estate licensees. As the principal's agent, the broker has the duty and obligation, among other fiduciary duties, to exercise the utmost care (and depending upon the fact situation, reasonable care), integrity, honesty, and loyalty and to maintain confidentiality. California Law also imposes duties upon the listing agent with respect to the other principal to the transaction. These duties include, but are not necessarily limited to, the exercise of reasonable skill and care, the obligation to act honestly and fairly and in good faith, and the duty to disclose all facts which are known or should be known to the broker and which materially affect the value, desirability or implicitly the intended use of the property.

The seller and the real estate brokers acting as the agents of the seller for the purposes of making disclosures about the property and its conditions do not have the duty to "explain" the practical or legal effect or impact of the disclosures. (Sweat v. Hollister (1995), 37 Cal. App. 4th 603, 609). However, the agent of the principal to whom the disclosures are being made owes fiduciary duties to that principal which include "explaining" the significance and consequences of that which has been disclosed, or should have been disclosed, and the agent is obligated to "counsel" the principal so that the principal can make an informed and considered decision to buy, sell, lease, exchange, borrow or lend. "Counseling" includes conducting any required inquiry or recommending that an inquiry be undertaken to ensure that the principal makes informed and considered decisions. (Field v. Century 21 Klowden-Forness Realty (1998) 63 Cal.App.4th 18; Salahutdin v. Valley of California (1994) 24 Cal.App.4th 555; Galeppi v. Waugh (1958) 163 Cal. App. 2d 507, 511).

Section 2079.13 et seq. of the Civil Code establishes an agency disclosure format where the transaction involves residential property improved with one to four dwelling units. This disclosure format applies to all transactions involving a sale or a lease of such residential property for longer than one year. A "sale" also includes an exchange of the property, or a real property sales contract as defined in Civil Code § 2985. To comply with this law, statutory forms have been provided which the licensee must use.

1. Disclosure and Confirmation of Actual Agency Relationships

The agency disclosure form sets forth the real estate broker's disclosure obligations and describes certain duties a licensee owes to a principal in a real property transaction, whether the broker is the "seller's agent," the "buyer's agent", or is acting as a "dual agent." The form must contain the entire text of § 2079.16 of the Civil Code, and it should be delivered to the principal in a real property transaction as soon as practical and when the relationship between the agent and the principal becomes more then casual. (Civil Code § 2079.14).

The listing broker or his or her agent (the salesperson or broker associate) must deliver the form to the seller before entering into a listing agreement. The cooperating or selling broker or his or her agent (the salesperson or broker associate) must provide the form to the seller as soon as practical and before presenting the offer. Should the cooperating or selling broker not deal face to face with the seller, then the form may be delivered by the listing broker. The agency disclosure form may also be delivered to the seller by certified mail. The cooperating or selling broker must deliver the form to the buyer as soon as practical before signing the offer to buy. Should the offer be not prepared by the cooperating or selling broker, then the form must be delivered to the buyer no later than the next business day following the receipt of the offer from the buyer. (Civil Code § 2079, 14 (d).)

One reported case has discussed the phrase "as soon as practical." (Leendert P. Huijers v. Gordon R. DeMarrais (1992) 11 Cal.App.4th 676). In this case, a listing broker was required to disclose the intended agency

relationship to and obtain consent from the seller at the time of the signing of the listing by the seller. The Leendert case speaks to the practice of some brokers leaving unanswered the agency relationship(s) they intend with the seller until such time as a buyer is procured. Presumably, the listing broker would not know whether he or she would be acting as a dual agent or as an exclusive agent of the seller, and whether the buyer will be separately represented or unrepresented, until the specific buyer is identified. Rather than leaving unanswered the intended agency relationship(s), the listing broker is well advised to disclose to and obtain the consent from the seller to the agency relationship intended at the time of the seller's signing of the listing agreement.

Should the actual facts later prove to be distinguishable from the listing broker's original belief, then the listing broker should make and deliver a new disclosure describing the revised agency relationship(s) and obtain the written consent of the seller to this revision. An example would be where the listing broker believes at the outset that he or she will be acting as a dual agent, (i.e., represent both the seller and the buyer in selling the listed property), but what actually occurs is that the buyer is represented by a cooperating broker. The cooperating broker may present the offer as the exclusive agent of the buyer requesting the listing broker act as the exclusive agent of the seller. In this case, the initial dual agency disclosure and consent would require revision and a new agency disclosure must be prepared and delivered conforming to the facts. In other words, the agency disclosure must be re-disclosed to clarify and confirm any changes in the nature of the agency relationship that arose during the course of the transaction. Practitioners must be mindful of the fact that the dual agency disclosure obligations apply equally to commercial real estate transactions. (L. Byron Culver & Associates v. Joudi Industrial & Trading Corp. (1991) 1 Cal.App.4th 300).

Whether the disclosure form is issued at the outset or as a result of a later revision, the broker must obtain a receipt from the principal receiving the disclosure. When the disclosure form is delivered by certified mail, then no further receipt is required. Should a seller or a buyer refuse to sign the receipt, the broker or his or her agent must "set forth, sign, and date a written declaration of the facts of the refusal." (Civil Code § 2079.15).

Civil Code § 2079.16 includes the required text of the agency disclosure. The disclosures set forth in this statutory framework include a list of duties owed by the real estate broker as an agent and fiduciary of the principal to whom the disclosures are being made. The disclosures are essentially as follows: a duty of utmost care, integrity, honesty and loyalty in dealings with the agent's principal; and the duty to exercise skill and care in performance of the services rendered by the agent; the duty to act honestly and without fraud or deceit and to act fairly and in good faith; and the duty to disclose of all material facts known to or which should be known to the agent affecting the value or desirability of the property not known to or readily observable by the parties to the transaction.

In summary, the real estate broker or his or her salesperson or broker associates shall, as soon as practical and after the relationship becomes more than casual, disclose to the buyer and seller the agency relationships intended by the broker or brokers involved in the transaction. The alternatives are "listing agent" (acting exclusively for the seller), "selling agent" (acting exclusively for the buyer), or "dual agent" (acting for both the buyer and seller). This agency disclosure must be consented to in writing by the seller and buyer. The acknowledgment by and the consent to the intended agency relationships may be in a separate document, and may be confirmed no later than in the purchase agreement. Furthermore, the statutory scheme set forth in Civil Code § 2079.13 et seq and the other duties of disclosure and fiduciary responsibility continue to apply. (Civil Code § 2079.24).

The phrase, "as soon as practical," has been defined to mean at the time the listing broker obtains the signature of the seller on the listing agreement. (Leendert P. Huijers v. Gordon R. DeMarrais (1992) 11 Cal.App.4th 676, 684). Disclosing the agency relationships intended by the parties and obtaining the principal's consent thereto will establish a rebuttable presumption that the relationships disclosed are the actual agency relationships intended between the parties.

2. Statutory Limitations and Definitions

In addition to establishing a disclosure format, Civil Code § 2079.13 et seq. imposes various limitations upon the conduct of and adds definitions regarding the performance of the special agency role of the real estate broker acting in the sale transaction. Among such limitations and definitions are the following:

a. A listing broker who is also a selling broker is a dual agent and may not be the agent for a buyer only. (Civil Code § 2079.18).

b. Payment of compensation to the broker and agent in the transaction does not in and of itself determine who is the broker's principal. (Civil Code § 2079.19).

c. A real estate broker functioning as a dual agent may not disclose to the seller that the buyer is willing to pay more the buyer's written offer to purchase, nor may a dual agent disclose to the buyer that the seller will take less than that which is set forth in the listing agreement, without the express written consent of the party authorizing the disclosure (this limitation in effect prevents the broker, when acting as a dual agent, from negotiating the price and related financial terms on behalf of either the seller or buyer or both). (Civil § 2079.21). Practitioners who issue broker price opinions (commonly called BPOs) should pay particular attention to § 2079.21. For instance, a licensee who issues a BPO at the request of a seller should provide a copy of the BPO to the buyer when acting as a dual agent. Consent of the seller should be obtained. Prudent practitioners should also notify the seller of the prospect that the buyer (in a dual agency situation) may have the right to receive the BPO although it was initially prepared only for the Seller.

d. A listing broker acting as the seller's agent may also sell the property to an unrepresented buyer without necessarily becoming a dual agent. (Civil Code § 2079.22). The licensee may not advise or counsel the buyer and must disclose that the buyer is unrepresented. Prudence dictates that only sophisticated buyers may be unrepresented in these circumstances.

The Real Estate Law includes authority mandating that real estate licensees disclose when they are acting as dual agents. Section 10176(d) of the Business and Professions Code requires that a licensee not proceed to represent more than one party to any real estate transaction without the knowledge or consent of both. Further, Civil Code § 2079.17 requires that the agency relationship intended or any change in the agency relationship regarding the agents of either party to the transaction must be in writing and must be consented to by all principals.

Although Civil Code § 2079.13 et seq. applies only to 1 to 4 residential units, Business and Professions Code § 10176(d) imposes dual agency disclosure requirements in all real property and real property secured transactions. This Business and Professions Code Section is largely a restatement of the common law obligations of an agent to disclose all material facts to a principal. (Business and Professions § 10176(a) and, e.g., L. Byron Culver & Assoc. v. Jaoudi Industrial & Trading Corp. (1991) 1 Cal.App.4th 300, 304.) The real estate licensee, however, when applying 10176(d) should not misunderstand the phrase "knowledge or consent." While the phrase appears in the disjunctive, it can only be read in the conjunctive, i.e., to proceed to act with knowledge implies consent and one cannot consent to that which one has no knowledge.

3. Ostensible or Implied Agency

A broker must recognize that an agency relationship can result from the conduct of the parties even though there is no express employment agreement and regardless of the source of compensation. In addition, the duties of agency can arise even where there is no expectation of compensation. For example, if a relative or friend acts on behalf of another, and agrees to do so without being paid, he or she will be subject to the duties and responsibilities of a gratuitous agent. Agency relationships created from the conduct of the parties are known as ostensible or implied agencies. (Civil Code §§ 2300, 2307, 2308).

In a typical real property or real property secured transaction, the real estate broker enters into a written contract with the seller, lessor or the borrower, and the broker agrees to exercise due diligence to find a buyer, a tenant/lessee or a lender. This is called the listing agreement, and the listing broker is the actual agent of the employing principal. The listing broker is authorized to act as a special agent of the employing principal in dealing with other persons relating to the contemplated real property or the real property secured transaction. Confusion often arises about when and under what circumstances the listed broker might unintentionally become the agent of the buyer, the tenant/lessee, or the lender.

When performing these fiduciary duties on behalf of a principal to the real property or real property transaction, the listing broker must exercise care to avoid unwittingly becoming the agent of the other principal to the transaction. Because agency relationships can arise out of the conduct of the parties, independent of any

express agreement, the listing broker must be aware of the potential that his or her actions may create an ostensible or implied agency relationship with the other principal. To act as an undisclosed agent of the other principal, without the informed consent of both parties may subject the broker to administrative discipline, loss or disgorgement of commission, and may subject the principals to recession of the transaction. (Business and Professions § 10176(a) and (d) and, e.g., L. Byron Culver & Assoc. v. Jaoudi Industrial & Trading Corp. (1991) 1 Cal.App.4th 300.)

The National Association of Realtors (NAR) has provided examples of activities or conducts which a listing broker in a sale transaction may perform without becoming the ostensible or implied agent of the buyer. Some of the NAR examples which the listing broker can perform as the special agent of the seller include, among others, the following:

a. Show the buyer the listed property and describe to the buyer the property's amenities, attributes, condition and status;

b. Present offers made by the buyer to the seller; or

c. Refer the buyer to service providers such as lenders, mortgage brokers, attorneys, inspection companies, title companies, escrow holders or other service providers required or desired by the buyer to complete the transaction.

While it may be possible for a real estate broker to provide any one or all of the foregoing services without establishing an agency relationship with the buyer, as a practical matter avoiding an agency relationship with an unrepresented buyer may be next to impossible. Real estate brokers often become the ostensible or implied agent of the buyer as the result of statements made by and/or conduct of the broker. For example, negotiating on behalf of or in any manner advocating the interest of the buyer when presenting the offer to the seller, or when processing the transaction to the close of escrow, will likely result in the broker becoming the agent of the buyer. The important point is that while disclosures create presumptions regarding the agency relationships and the duties flowing therefrom, these presumptions may be overcome based on the actual conduct of the parties.

4. Subagency

In a typical real property transaction, it is common for the listing broker to seek the cooperation of other real estate brokers to carry out the purpose and objective of the agency. A principal may expressly authorize his or her broker to appoint a subagent and thereby establish a new contractual and fiduciary relationship directly between the principal and the subagent. Under such an appointment, the subagent represents the principal in the same manner as the listing broker. When the listing broker appoints another broker to cooperate without the express or implied authority of the principal, the cooperating broker becomes the subagent or agent of the listing broker and not the subagent of the principal. (Civil Code §§ 2349, 2350 and 2351).

Real property or real property secured transactions typically involve cooperation between and among more than one broker. The legal principles which govern the field of subagency are particularly complex. This is due, at least in part, to the different relationships which exist between the brokers and the principals to the transaction when seeking to carry out the purposes of the agency, (e.g., find a buyer, a tenant/lessee, or a lender).

A critical element in determining the relationships between and among the parties is whether the principal has agreed to allow the listing broker to delegate some portion of his or her authority to another (Civil Code § 2349). The typical listing agreement between the principal and the real estate broker provides that the listing broker may cooperate and share commissions with other brokers to carry out the purpose and scope of the agency (e.g., to find a buyer, a tenant/lessee, or a lender).

When another agent is appointed by the listing broker with the express or implied authority of the principal, the second broker becomes the subagent of the principal. (Civil Code § 2351). On the other hand, where the listing broker appoints another broker without the consent of the principal, the second broker becomes the agent of the listing broker. (Civil Code § 2350).

The rule of subagency has been criticized for a number of reasons and has periodically led to ridiculous results. For example, in one case, the cooperating broker made certain misrepresentations about the property to a prospective buyer. Since the listing broker had express authority under the exclusive listing agreement to

engage the services of the cooperating broker, the court held that the listing and cooperating broker were jointly acting as the agents of the seller. Therefore, the seller was held liable to the buyer for the fraudulent misrepresentations of the cooperating broker, even though it was established that the seller did not even know of the cooperating broker's participation in the transaction. (Johnston v. Seargeants (1957) 152 Cal.App.2d 180). (Also, Kruse v. Miller (1956) 143 Cal.App.2d 656; Hale v. Wolfsen (1964) 276 Cal.App.2d 285; and, Easton v. Strassburger (1984) 152 Cal. App. 3d 90).

The acts, errors and/or omissions (negligence) of a cooperating broker who is the authorized subagent of the seller may be imputed to the seller. For example, certain negligent acts of the cooperating broker who is the authorized subagent of the seller may be imputed to the seller and the seller may be subject to liability to third parties under the legal theory of respondeat superior. Equally, when the cooperating broker is not the authorized subagent of the seller, but rather the authorized agent or subagent of the listing broker, the negligent acts of the cooperating broker may be imputed to the listing broker and the listing broker may be subject to liability to third parties under the legal theory of respondeat superior. (Civil Code § 2338). (Alhino v. Starr (1980) 112 Cal.App.3d 158).

Since negligent misrepresentation by an agent and fiduciary may be characterized as constructive fraud, the principal may well be liable under the theory of respondeat superior for the fraudulent conduct of principal's agent. Should the conduct of the agent arise out of an intentional tort or criminal act, the principal may not be liable for such conduct, unless the principal knowingly ratifies and accepts the benefits of the conduct. (Civil Code § 2339).

A considerable debate occurred within the industry about imposing subagency upon sellers and whether most sellers had any idea about the potential consequences of designating the cooperating broker as a subagent of the seller. Most commentators recognized that subagency was unwise and worked to the disadvantage of both buyers and sellers. The difficulties of subagency in typical real estate transactions were recognized by NAR in the early 1990's. At that time, NAR amended its Multiple Listing Rules and established what has become known as Multiple Listing Plus.

Under these new rules, a listing broker has the option of either extending a unilateral offer of subagency to the cooperating broker, or of merely offering to share the commission with the cooperating broker without extending any offer of agency or subagency on behalf of the seller or the listing broker. The cooperating broker may now elect to solely represent the buyer even though the cooperating broker is sharing in the compensation paid by the seller.

The legislature anticipated this development when it enacted Civil Code § 2079.19 which provides that the payment of compensation does not necessarily determine the nature of the agency relationship between the parties. Common practice in the industry now is to avoid subagency.

5. Offer of Compensation to Cooperating Broker

While a listing broker may offer to share compensation without creating an agency relationship between the seller and the cooperating brokers, the cooperating broker's right to compensation remains somewhat unclear under existing law. As previously discussed in this Chapter, where the principal's authority regarding the payment of compensation to the cooperating broker was unclear, the cooperating broker was held to have no rights against the seller, but could only collect compensation from the listing broker. (Goodwin v. Glick (1956) 139 Cal.App.2d Supp. 936). However, where the seller's authority to pay the cooperating broker was certain, the cooperating broker was able to secure payment directly from the seller. (Schmidt v. Berry (1986) 183 Cal.App.3d 1299).

6. Delegation of Duties

Agents commonly delegate certain of their duties and their responsibilities to others. For instance, a seller may ask a real estate broker to provide an opinion of value regarding the seller's property. The broker may, in turn, engage the services of an appraiser to assist in estimating the market value of the seller's property. Such a delegation may not relieve the real estate broker of liability in the loan transaction. In one case, the court held that a real estate broker has a nondelegable duty to arrive at a value conclusion on behalf of a private trust deed

investor in a loan transaction. The broker was liable for the negligence of the appraiser. (Business and Professions Code § 10232.5(a) (2) and Barry v. Roskov (1991) 232 Cal. App. 3d 447).

There are many other examples of such delegation of duty. Unless the delegation is specifically forbidden by the principal, the general rule is that an agent may delegate certain of the agent's powers to others. The legislature recently amended the Business and Professions Code to allow for real estate brokers to delegate their responsibility to estimate the market value of the security property in a loan transaction to a real estate appraiser licensed or certified by the California Office of Real Estate Appraisers. (Business and Professions Code 10232.6).

The powers which may be delegated by the agent to others are generally limited to the following:

a. When the act is purely mechanical;
b. When it is such as the agent cannot do alone and the subagent can lawfully perform;
c. When it is the usage of the place to delegate such powers, or when the principal authorizes the delegation; or
d. When such delegation is specially authorized by the principal. (Civil Code § 2349).

When delegating a power to another, the agent must exercise care in delegating the authority and in choosing and appointing the delegee. Although an agent may not be authorized to assign a duty of performance to another, the agent may nevertheless be authorized to delegate the actual performance of such duty to others, and thereby discharge the duty through the performance of the delegee. Most agency agreements do not require the personal performance of the original agent, although the original agent will typically remain liable for the details delegated to and executed by others. (Barry v. Roskov (1991) 232 Cal. App. 3d 447).

The doctrine of respondeat superior remains the basis for holding a broker liable for the negligent and even the intentional acts of salespersons or broker associates, when such conduct is reasonably foreseeable, and may apply even where the supervising broker is not aware of the conduct (Business and Professions Code § 10159.2; 10 CCR, Chapter 6, § 2740 et seq.). (Also, Inter Mountain Mortgage, Inc. v. Sulimen (2000) 78 Cal.App.4th 1434, 93)). In addition, the DRE may impose disciplinary sanctions upon a supervising broker based on the doctrine of respondeat superior. (California Real Estate Loans, Inc. v. Wallace (1993) 18 Cal.App.4th 1575).

7. Dual Agency

Dual agency arises where the listing broker who is the actual agent of the seller becomes the actual agent, or ostensible or implied agent of the buyer. The real estate broker who has entered into a listing agreement with a seller, establishes an actual agency relationship with the seller. The listing broker may also establish an actual agency relationship with the buyer as the result of the broker accepting the responsibility to act on behalf of the buyer to locate a property. For instance, a listing broker who meets a prospective buyer at the seller's open house, and who later undertakes with the buyer's consent to help the buyer find a home which is other than the listed property, has established an actual agency relationship with the buyer, notwithstanding the fact that no written formal agreement exists between them.

Regardless of whether the transaction is a sale, a lease or a loan, a real estate broker can become the agent of all principals to the transaction, and the broker should only so act with the knowledge and consent of all principals to the real estate loan, real property or real property secured transaction. (Business and Professions Code §§ 10176(a), (d) and §§10177.6). In fact, Business and Professions Code §§10177.6 requires a broker to provide written disclosure to all parties when representing the buyer or seller and the broker has agreed to also arrange the financing. The failure to disclose and obtain the consent of the principal to the dual agency may result in disgorgement of the broker's compensation and rescission of the transaction. (Culver v. Jaoudi (1991) 1 Cal. App. 4th 300, 304-305, citing Glenn v. Rice (1917) 174 Cal. 269, 272).

Dual agency also commonly arises when two licensees associated with the same broker undertake to represent two or more parties to a real property or real property secured transaction. The real estate broker with whom the two licensees are associated is the dual agent of the principals to the transaction, and the salesperson and broker associate licensees are the agents of the real estate broker. (Civil Code § 2079.13(b)).

In any dual agency situation, the broker owes fiduciary duties to both principals to the real property or real property secured transaction. Dual agents face a particular difficulty with the elements of fiduciary duty which involve loyalty and confidentiality. A common example arises in connection with the negotiation of price and terms between a seller and buyer, and the negotiation of the loan amount and terms between the lender and borrower.

The legislature recognized this conflict when enacting § 2079.21 of the Civil Code. That section states: "A dual agent shall not disclose to the buyer that the seller is willing to sell the property at a price less than the listing price, without the express written consent of the seller. A dual agent shall not disclose to the seller that the buyer is willing to pay a price greater than the offering price, without the express written consent of the buyer." "This section does not alter in any way the duty or responsibility of a dual agent to any principal with respect to confidential information other than price."

As previously described in this Chapter, the practical affect of Civil Code § 2079.21 is to limit the ability of a real estate broker, acting as a dual agent, to engage in the negotiation of price and terms in a sale transaction. The broker should present to the buyer the listed price and terms requested by the seller and ask the buyer to make whatever offer the buyer deems appropriate. Equally, the broker should present to the seller the price and terms set forth on the buyer's written offer to purchase. The seller should be asked to accept the offer or counter the price and terms as the seller deems appropriate.

Should either principal require professional assistance to ascertain the price and terms to request or offer, or the price and terms to present in the form of a counter-offer, the real estate broker who is the dual agent is not in the position of offering that assistance. Rather, the broker who is the dual agent should recommend that the principals seek independent advice from qualified professionals to assist the principals in determining what price and terms are appropriate in the fact situation. The limitation placed upon the real estate broker as a dual agent, pursuant to Civil Code § 2079.21, does not preclude the broker from providing both principals with the same comparative market data (including a BPO prepared by the broker) upon which the principals may independently rely.

The conflict of interest which is inherent in dual agency has been recognized by other authorities. The reasons underlying the rules against dual agency are of ancient origin. "No man may serve two masters; for either he will hate the one and love the other; or else he will hold to the one and despise the other..." (Gospel of Matthew, Chapter vi: 24 quoted in Nahn-Beberer v. Schrader (Mo. App. 1936) 89 S.W. 2d 142). Although dual agency is a common practice in California real property and real property secured transactions, a real estate broker who represents both parties must act with extreme care. One court framed the issue as follows: "A broker so unwise as to place himself in the anomalous position of representing adverse parties must scrupulously observe and fulfill his duties to both". (Martin v. Hieken (Mo. App. 1960) 340 S.W. 2d 161, 165).

The problem is compounded because of the proliferation of large, multi-office brokerages, and because a dual agency can exist unexpectedly. The failure to properly disclose a dual agency and scrupulously honor its limitations may result in the forfeiture of any commission due the broker, and may subject the licensee involved to discipline by the Department of Real Estate. (Business and Professions Code §§ 10176(a) and (d)). In view of the reality that dual agency is a common practice in the industry in spite of its potential for abuse, the California Legislature, the California Department of Real Estate, and the California Association of Realtors have attempted to accommodate the practice while informing principals through written disclosure.

A form of dual agency which has not been specifically addressed in the disclosure statutes is where the broker attempts to present offers on behalf of two different buyers. This can easily happen when a broker is showing the same property to buyer 1 and buyer 2, and both buyers want the broker to write an offer on the property on their behalf. The situation becomes even worse if buyer 1 is in contract and buyer 2 makes a back-up offer. Buyer 1's position is almost certainly weakened and buyer 1 would have good reason to claim that the real estate broker breached the broker's fiduciary duties and obligations by participating in the transaction on behalf of buyer 2.

The better practice would be for the real estate broker to avoid attempting to represent two buyers on the same property without the clear, informed and unequivocal consent of both parties. It is recommended that when acting as an agent for more than one buyer regarding the same property, the buyers should be sophisticated, or

they should be represented by independent professionals. Some have suggested that dual agency conflicts may be mitigated by assigning separate salespersons or broker associates within the same office to each principal to the real property or real property secured transaction. Under these circumstances, each principal would receive the benefit of an individual presumably concerned only about their interest. However, individually assigning salespersons or broker associates to the principals does not alter the fact that the real estate broker by whom the associate licensee is engaged is the dual agent of the principals to the transaction. (Civil Code § 2079.13(b)).

8. Consequences of Undisclosed Agency in Non-Residential Transactions

As previously discussed in this Chapter, Civil Code § 2079.13 et seq. requires agents selling one-to-four unit residential properties to sign a statutory agency disclosure statement. Commercial real estate agents and agents acting in loan transactions must also prepare and deliver to their principals agency disclosure statements. Real estate brokers who act as agents in loan transactions or in the sale or leasing of income producing property must, in addition to the agency disclosure statement, obtain the informed consent of the principals to the transaction. The failure to obtain the informed consent of the principals may result in the broker forfeiting the right to receive a commission, and the transaction may be subject to an action for recession. (Culver v. Jaoudi (1991) 1 Cal. App. 4th 300, 305, citing Glenn v. Rice (1917) 174 Cal. 269, 272).

The court put it this way: one who acts as an undisclosed dual agent is "in a position where his duty to one conflicts with his duty to the other, where his own interests tempt him to be unfaithful to both principals, a position which is against sound public policy and good morals. His contract for compensation being thus tainted, the law will not permit him to enforce it against either party. It does not matter that, in the particular case, the agent acted fairly and honorably to both. The infirmity of his contract does not arise from his actual conduct in the given case, but from the policy of the law, which will not allow a man to gain anything from a relation so conducive to bad faith and double dealing." (Culver v. Jaoudi (1991) 1 Cal. App. 300, 305 citing Glenn v. Rice (1917) 174 Cal. 269, 272).

AUTHORITY OF AGENTS

The authority of agents may be express (actually conferred) or may be apparent or implied (ostensibly conferred). (Civil Code § 2315 and Lyne v. Bonner (1954) 129 Cal. App. 2d 743 and Walter v. Libby (1945) 72 Cal. App. 2d 138). An agent's authority is limited to that which has been actually or ostensibly conferred by the principal. The Civil Code provides that every agent has authority to:

A. Do everything necessary, or proper or usual in the ordinary course of business, for effecting the purpose of the agency; and

B. Make representations as to facts not including the terms of the agent’s authority, but upon which the agent's right to use his or her authority depends, and truth of which cannot be determined by the use of reasonable diligence on the part of the person to whom the representation is being made. (Civil Code § 2319).

The agent has such authority as the principal actually or ostensibly confers upon the agent (Civil Code § 2315). Actual authority is that authority a principal intentionally confers upon the agent, or intentionally, or by want of ordinary care, allows the agent to believe that he or she possesses (Civil Code § 2316). Ostensible authority is that authority a principal intentionally, or by want of ordinary care, causes or allows third persons to believe that the agent possesses. (Civil Code § 2317). Ostensible authority is sometimes referred to as apparent or implied authority. This authority is distinguishable from express or actual authority which is created by an agreement between the principal and agent which specifically identifies the activities which the agent is allowed to undertake.

1. Express Authority

Express authority is created by the contract of the principal which completely and precisely delineates those activities which the agent is authorized to undertake. For example, if the principal authorizes the agent to acquire a particular single-family residence for the price of $100,000, the agent has express authority to do

precisely that and nothing else. The agent would not have express authority to purchase the house for $105,000 or to purchase a different house.

2. Implied Authority

Implied authority exists because it is often impractical or even impossible for the principal to specifically delineate every aspect of the agent's authority. Implied authority may be derived from express authority and exists to the extent that it is reasonably necessary to accomplish the overall objectives of the agency. In the example given directly above, the agent had express authority to purchase a particular property at a special price. The agent might have implied authority to set the time limits for performance of the agreement, receive notifications from the seller, waive conditions in the agreement and possibly undertake efforts to obtain financing for the benefit of the buyer.

Implied authority cannot conflict with expressed authority but it may exist where there is no relevant grant of express authority. The determination of whether implied authority has been given usually involves determining the custom and practice of the community, and whether the specific act was reasonably necessary for achieving the objectives for which the agency relationship was created.

The real estate broker should carefully consider the exercise of implied authority when acting on behalf of principals in real property or real property secured transactions. Real estate brokers are special agents whose actions typically require ratification by their principals.

3. Apparent Authority

Apparent authority depends not upon the express or implied agreement between the principal and the agent, but upon the reasonable expectations of third parties who have been led to believe that the agent is authorized to act on behalf of the principal. Apparent authority is distinctly different from actual or express authority, and is sometimes referred to as ostensible authority by estoppel. Ostensible authority by estoppel arises when the principal, by words or conduct, leads a third party to believe that another person is his agent.

In other words, apparent or ostensible authority will arise and the principal will be estopped to deny the existence of the agency, or the scope of the agent's authority when the principal's actions have created the appearance of authority in the agent, and a third party reasonably relies to his detriment upon this authority. The most common way in which questions concerning apparent authority arise is where the principal has placed a limitation upon the normal and ordinary authority of the agent and fails to communicate this limitation to a third party dealing with the agent. In most cases, the third party will not be bound by this special limitation.

4. Liability of Principal to Third Parties

The principal is liable to persons who have sustained injury through a reasonable and prudent reliance upon the ostensible, whether implied or apparent, authority of an agent. The act of the agent can never alone establish ostensible, whether implied or apparent authority, but silence upon the part of the principal who knows that an agent is holding himself or herself out as vested with certain authority may give rise to liability of the principal.

For instance, when the principal executes and entrusts to the agent a negotiable or non-negotiable instrument containing blanks and the agent fills them in, principal will be bound to third persons who rely upon the instrument, even though the agent was not so authorized. The authority conferred upon an agent to fill in the blanks of a negotiable or non-negotiable instrument does not extend to inserting the name of the other party to the transaction without the knowledge, consent of and disclosure to the principal. For example, to form a contract the name and identity of the lender must be known to the borrower when the borrower executes the promissory note. (Civil Code § 1558, Jackson v. Grant (1989) 876 F2d, 764).

5. Emergency Broadens Authority

An agent has expanded authority in an emergency, including the power to disobey instructions where it is clearly in the interests of the principal, and where there is no time to obtain instructions from the principal. An example of this authority occurs in the relationship between a property manager and an owner when an immediate repair or replacement is required to protect the property and to provide necessary services to the tenant.

6. Restrictions on Authority

An agent who is given the power to sell and convey real property for a principal also possesses the power to give the usual covenants of warranty unless there are express restrictions in this regard in the agent's agreement with the principal. Also, an agent can never have authority, either actual or ostensible, to do an act which is known or suspected by the person with whom the agent deals to be a fraud upon the principal. Unless specifically authorized, an agent has no authority to act in the agent's own name except when it is in the usual course of business for the agent to do so. (Civil Code § 2315 et seq.). Remember, a real estate broker acts as a special agent with limited authority which generally does not include the power to act in the place instead of the broker's principal.

An agency to sell the property does not carry with it the authority to modify or cancel the contract of sale after it has been made. A limited agency as created between a seller and a real estate broker to sell the property ordinarily empowers the real estate broker as a special agent to find or procure a buyer, but does not authorize the agent to enter into a contract to convey title to the property on behalf of a principal. Unless otherwise specified, the authority of a general agent to sell the property only permits a sale for cash, or its equivalency, and the agent is not entitled to accept goods in payment.

An agent who has authority to collect money on behalf of his or her principal may endorse a negotiable instrument received in payment only where the exercise of this power is necessary for the performance of the agent's duty and where the principal has specifically granted the power to endorse the instrument. Where an agent is expressly authorized to collect money, the agent may accept a valid check and the agent's receipt of the check on behalf of the principal will be considered payment to the principal.

A real estate broker who negotiates a loan on behalf of a lender ordinarily has no authority to collect payments from the borrower, except in those instances where the broker as a special agent of the lender has possession of the security and the borrower has knowledge of this fact, or the broker has received written authority from or has entered into a written servicing agreement with the principal delegating the collection of payments (and generally other loan servicing functions) to the broker. The delegation to the broker of loan servicing functions also occurs in the context of administration, management, and operation agreements as part of an investment contract relationship established when issuing securities. (Securities and Exchange Comm. v. W. J. Howey Co., 328 U.S. 293 (1946) and Securities and Exchange Comm. v. Glenn W. Turner Enterprises, Inc., et al., No. 72-2544, 474 F.2d 476; 1973 U.S. App. LEXIS 11903; Fed. Sec. L. Rep. (CCH) P93,748). The borrower must have actual notice of the existence of the servicing agreement and the authority of the real estate broker as the special agent of the lender. (Business and Professions Code §§ 10233, 10233.2 and 10237 et. Seq. and Civil Code § 2937).

7. Ratification of Unauthorized Acts

Occasionally, a person may act as agent without any authority to do so, or the agent may act beyond the scope of the agent's authority. The alleged principal may not be bound by such acts. A principal may under certain circumstances ratify the acts of the agent and thus become bound. Not only must the principal intend to ratify, but:

a. The agent must have professed to act as a representative of the principal;
b. The principal must have been capable of authorizing the act both at the time of the act and at the time of ratification (e.g. sometimes the promoters of a proposed corporation make contracts on its behalf, but the corporation cannot ratify them - though it may achieve the same result by other means);

c. The principal must have knowledge of all the material facts (unless ratification is given with the intention to ratify whatever the facts may be);
d. The principal must ratify the entire act of the agent, accepting the burdens with the benefits;
e. The principal must ratify before the third party withdraws.

(Civil Code §§ 2310 et seq.).

Once ratified the legal consequences are the same as though the act had been originally authorized. Generally an act may be ratified by any words or conduct showing an intention upon the part of the principal to adopt the agent's act as the principal's own. Acquiescence or acceptance of benefits by the principal must be with full knowledge of the facts, unless made with the intention to ratify whatever the facts may be.

Where the principal's ignorance of the fact arises from the principal's own failure to investigate, and the circumstances are such as to put a reasonable person on inquiry, the principal may be held to have ratified the act in spite of lack of full knowledge. A ratification can be made only in the manner that would have been necessary to create the original authority for the act ratified. Accordingly, in real property dealings, the ratification must be generally in writing. (Civil Code § 2310 et seq.).

8. Duty to Ascertain Scope of Agent's Authority

No liability is incurred by the principal for acts of the agent beyond the scope of the agent's actual or ostensible authority. A third party who deals with an agent and knows of the agency is under a duty to ascertain its purpose and scope. If the agent acts beyond the agent's actual authority and the conduct of the principal has not been such as to give the agent ostensible authority to do the act, the third party cannot hold the principal liable for such acts. (La Malfa v. Piomobo Bros. (1945) 70 Cal.App.2d 840, 844-845 citing Ernst v. Stearle, 218 Cal. 233, 240):

"A third person, such as appellant, is not compelled to deal with an agent, but if he does so, he must take the risk. He takes the risk not only of ascertaining whether the person with whom he is dealing is the agent, but also of ascertaining the scope of his powers. The rule is cogently stated in 1 Mechem on Agency, second edition, section 743, page 527, as follows: 'An assumption of authority to act as agent for another of itself challenges inquiry. Like a railroad crossing, it should be in itself a sign of danger and suggest the duty to "stop, look and listen." It is therefore declared to be a fundamental rule, never to be lost sight of and not easily to be overestimated, that persons dealing with an assumed agent whether the assumed agency be a general or special one, are bound at their peril, if they would hold the principal, to ascertain not only the fact of the agency but the nature and extent of the authority, and in case either is controverted, the burden of proof is upon them to establish it.' "

9. Power of Attorney

A power of attorney is a written instrument giving authority to an agent. The agent acting under such a grant of authority is generally called an "attorney in fact". A special power of attorney authorizes the attorney in fact to do certain prescribed acts on behalf of the principal. Under a general power of attorney, the agent may transact all of the business of the principal. Powers of attorney are strictly construed and ordinarily where an authority is given partly in general and partly in specific terms, the general authority is limited to acts necessary to accomplish the specific purposes set forth.

Real Estate brokers should not be given powers of attorney in the same matter for which the broker is acting within the course and scope of the real estate license as a compensated agent. It is a legal maxim that one should not exercise a power of attorney to one's own economic advantage or benefit.

10. Authority to Receive Deposits

The general rule is that when the scope of authority of a real estate broker has been limited to producing a buyer ready, able and willing to purchase the property upon terms prescribed by the broker's principal, the broker has no authority to accept a deposit from the buyer. Even when an agent has express authority to negotiate a sale of real property, this does not give him or her implied or ostensible authority to collect the purchase price. When

an agent does so, the agent is acting as the agent for the buyer and not the seller. Consequently any misappropriation of these funds by the broker would result in loss to the buyer and not the seller.

This general rule of law does not apply, however, where the broker actually had authority to receive a deposit on behalf of the seller. Virtually all listing agreement forms in use today give express authority to the broker to accept an earnest money deposit on behalf of the seller. The authority granted a listing broker also applies to any subagents of the seller. The authority, however, would not apply to a broker who is acting only as an agent of the buyer.

In those cases where a down payment has been paid to the broker and not deposited in escrow, title to such payment vests in the seller when the seller accepts the purchase contract. Further, where an agreement for sale of real property provides that a deposit with the broker is to become a part of the down payment when the seller puts in escrow a deed evidencing good title, the deposit becomes the seller's property when the deed is put in escrow. Thereafter, the broker cannot, except at the broker's own risk, return the deposit to the buyer. Similarly, money received by the seller's agent under a deposit receipt with a valid liquidated damages clause is generally (in the case of the buyer's breach) not recoverable by the buyer. (Civil Code §§ 1057.3 and 1671).

The rationale behind this rule is that money received by a broker as agent or subagent for the seller belongs to the seller when the offer has been accepted. The broker may not return the funds to the buyer without the consent of the seller.

11. Checks

In those cases where an earnest money deposit has been paid to the broker with written instructions to hold and not negotiate the check until acceptance of the offer, the buyer's instructions should be followed. But the seller must be informed in writing that the buyer's check is being held and not negotiated. This disclosure should be given to the seller no later than the actual presentation of the offer to the seller, and the notice must be acknowledged by the seller prior to or concurrent with the seller's acceptance of the offer. (Business and Professions Code § 10176(a)).

It is acceptable practice to include the disclosure as a term and condition of the offer. During the time between the receipt of the check by the broker and the acceptance of the purchase offer by the seller, the broker must enter the fact of receipt of the check into the broker's trust fund records and hold the check in a safe place. (10 CCR, Chapter 6, §§ 2831 and 2832).

Although there may be a custom in real estate transactions for a broker to accept a check or promissory note instead of cash as an earnest money deposit, the existence of such a custom does not justify the acceptance of such instruments, unless there is full disclosure to the seller. While checks have been universally accepted as the equivalency of money in business transactions, promissory notes are not. The maker of a check represents that sufficient funds are in the bank account upon which the check has been drawn, and the failure to have such money may be a crime. The maker of a note does not represent that he or she has sufficient money to pay the sums owing (pursuant to the terms of the note) at the time of its original execution and delivery, and the maker's failure to pay the note when it is due is generally not a crime.

California Law has held that a post-dated check may be considered the equivalent of a promissory note. Therefore, a broker should not accept a post-dated check from a buyer since this may result in mischaracterization of the form of earnest money deposit without adequate disclosure to the seller. As our society moves towards more electronic or wire transfer of funds, other forms of earnest money deposits may well be used in real property transactions. Full and complete disclosure to the seller is required of the form, the amount, and disposition of the earnest money deposit.

12. Promissory Notes

A real estate broker, like a trustee, has an affirmative duty to disclose all material facts which might influence a principal's decision. Thus the broker who impliedly represents to a principal that the broker has received cash from a purchaser as an earnest money deposit (when in fact the broker has accepted a non-negotiable promissory note) has violated the Real Estate Law. The use of promissory notes as earnest money deposits should be reviewed, in advance, by the real estate broker's legal counsel.

13. Escrow Depository

In those cases where an earnest money deposit has been paid by the buyer directly into a neutral escrow under typical escrow instructions which provide for the exchange of money and a deed on stipulated conditions, the buyer is said to have conditionally delivered the money to the escrow holder. Escrow is defined to mean any transaction wherein one person, for the purpose of effecting the sale, transfer, encumbering, or leasing of real or personal property to another person, delivers a written instrument, money, evidence of title, or other thing of value to a third person to be held by such person until a happening of a specified event or a performance of a prescribed condition, when it is then to be delivered to a grantee, grantor, promisee, promisor, obligee, obligor, bailee, bailor, or any agent thereof. (Financial Code § 17003 and Civil Code § 1057).

While it may be argued that the buyer retains title to the money until the conditions imposed by the buyer have been performed, the escrow holder upon receipt of written escrow instructions from the seller will generally not return the earnest money deposit to the buyer without the concurrence of the seller. It is the obligation of the buyer and seller to insure that all funds deposited with the escrow holder are returned to the person who deposited the funds or who otherwise are entitled to the money if the purchase agreement is not completed and the escrow is not timely closed.

The failure to execute any required documents to cause the funds to be returned, unless said funds are being held to resolve a good faith dispute, may result in damages being imposed up to $1000 plus reasonable attorney's fees. (Civil Code § 1057.3). Should the buyer and seller be unable to mutually resolve any disputes regarding the return of earnest money deposits, the escrow holder will generally file an interpleader action seeking declaratory relief from a court of competent jurisdiction. The cost of such action will typically be deducted from the earnest money deposits.

When the buyer and seller have each fully performed under an agreement (all conditions of escrow have been satisfied or waived), the escrow holder becomes the agent of the seller as to the purchase money and the agent of the buyer as to the deed. The escrow holder thereupon delivers the money to the seller and the deed to the buyer.

14. Commingling and Conversion

Commingling occurs when real estate licensees deposit money belonging to another or others into a bank account owned or controlled by the licensee that is other than a properly constructed trust account. Commingling can also occur when real estate licensees join or integrate the property belonging to another or others with property of the licensee in an unauthorized manner and in violation of applicable law. Depending upon the facts, joining or integrating the money or property belonging to another or others with the money or the property of the licensee may be characterized as conversion.

The real estate licensee who is guilty of commingling and/or conversion creates a risk of the funds or the property of the client/principal being included in an attachment for personal or business claims against the licensee. (Business and Professions Code § 10176(e)). Hence, the Real Estate Law requires real estate brokers to place all funds received on behalf of clients/principals in an authorized trust bank account no later than three business days following the receipt of the funds by the broker or the broker’s salespersons or broker associates.

Alternatively, the real estate broker may place the client’s/principal’s funds with a “neutral” escrow depository (e.g., a title company or licensed public escrow), or the broker may promptly deliver the funds to the client/principal who is entitled to receive them. Trust bank accounts of real estate brokers must be established and maintained in compliance with the Real Estate Law and are not available to real estate salespersons. A salesperson or a broker associate must immediately deliver all client/principal funds to the broker, or deliver the funds as instructed by the broker for whom the salesperson or broker associate acts as an agent. (Business and Professions Code §§ 10145 and 10146 and 10 CCR, Chapter 6, § 2830.1 et seq.).

Real estate brokers are required to keep separate records for each beneficiary or transaction, accounting for the funds of the client/principal that are deposited into the trust bank account. These separate records are to include information sufficient to identify the beneficiaries, the transactions, and the parties to the transactions, as required pursuant to 10 CCR, Chapter 6, § 2831.1.

Maintaining proper trust account records is essential for the protection of the public. For example, FDIC insurance coverage available per bank account is extended to each beneficiary identified separately in the broker's trust bank account records. Accordingly, a beneficiary whose trust assets, trust liabilities, and net trust balances are properly maintained on a daily basis as part of the separate records of the broker's trust bank account (whether manually or through software) will be separately recognized by the FDIC under their insurance coverage. Should the bank depository become insolvent or be subject to a regulatory enforcement action, separate FDIC insurance coverage for each beneficiary is extremely important

A real estate broker is authorized to deposit into the broker's trust account certain defined funds belonging to the broker without being in violation of Business and Professions Code 10176(e). These funds of the broker include an amount not to exceed $200, to pay service charges or fees levied or assessed against the trust account by the bank or financial institution with which the trust account is maintained. The broker also may deposit funds into the trust bank account that belong in part to the broker's client/principal and in part to the broker when it is not reasonably practical to separate such funds. The client/principal funds that may be maintained in the same trust bank account with the funds of the broker must be received in connection with debt service on mortgage loans co-owned by the broker and the client/principal, or the funds may represent the proceeds of rental income from a property co-owned by the broker and the client/principal.

Certain predicates apply to this exemption from the definition of commingling, including that the funds belonging to the broker are to be disbursed no later than twenty-five days after their deposit, provided no dispute exists between the broker and the broker's client/principal as to the broker's portion of the funds. Other predicates apply before the broker may rely on this limited exemption. (10 CCR, Chapter 6, § 2835).

If the broker fails to comply with the Real Estate Law regarding the handling of trust funds, the broker is subject to disciplinary action by the Commissioner and may be subject to criminal action for conversion of funds belonging to the public. It is recommended real estate brokers consult with legal counsel and with a certified public accountant before establishing trust fund handling, trust bank account procedures, or when proposing to join or integrate the money or property of the client/principal with the money or property of the licensee.

FIDUCIARY DUTIES OWED TO A PRINCIPAL BY AN AGENT, AN OVERVIEW

1. Loyalty and Confidentially

A real estate broker owes duties of loyalty and confidentiality to the broker's principal for whom the broker is an agent and fiduciary. The broker is prohibited from personally profiting by virtue of the agency relationship, except through the receipt of compensation for services rendered by the broker in accordance with the terms of the employment agreement. This fiduciary duty and obligation of the broker as an agent of his or her principal throughout the agency relationship is probably the most significant aspect of the relationship.

The courts have consistently equated the duty of an agent to a principal with the duty owed by a trustee to a beneficiary. The Probate Code provides that, in all matters connected with a trust, a trustee is bound to act in the highest good faith toward the trustee's beneficiary, and the trustee may not obtain any advantage over the beneficiary by the slightest misrepresentation, concealment, duress or adverse pressure of any kind. (Probate Code 16000, 16015 and Rodes v. Shannon (1963) 222 Cal. App. 2d 721, 725; Whipple v. Haberle (1963) 223 Cal. App. 2d 477, 36 Cal. Rptr. 9; Batson v. Strehlow (1968) 68 Cal. 2d 662, 674-675; Loughlin v. Idora Realty Co. (1968) 259 Cal.App.2d 619, 629; Alhino v. Starr (1980) 112 Cal.App.3d 158, 169).

A broker may not unite his or her role as a special agent of a principal with his or her personal objectives (an agent may not unite the agent's personal and representative characters) in the same transaction without disclosure to and consent from the principal. The act of an agent within the course and scope of the agent's authority is the act of the principal. In exercising that authority the agent is dealing with property or other matters of grave concern to the principal. The agent has the principal's confidence and is, therefore, not permitted to enjoy the fruits of any advantage which the agent might take of this confidential relationship. As a fiduciary, the real estate broker performing as a special agent in relationships with a principal is bound by law to

exercise, among other duties, the utmost good faith, loyalty and honesty.

2. Fair and Honest Dealing

In addition to the fiduciary duties owed to a principal, a real estate broker who is the agent of a principal owes a duty of fair and honest dealing to the other principal to the real property or real property secured transaction. This duty includes, among others, the obligation to make a complete and full disclosure of all material facts. Accordingly, the real estate broker owes the duty of full disclosure to a principal in a real property or real property secured transaction even though the broker is not the agent and fiduciary of the principal to whom the disclosures are being made. This is a duty which the courts have held to exist by reason of the agent's status as a real estate broker. (Lingsch v. Savage (1963) 213 Cal. App. 2d 729, 736).

The duty of disclosure may also be found to exist by way of the agent's fiduciary obligation to the principal upon whose behalf the disclosures are being made. Any misrepresentation or material concealment on the part of the agent may afford the other principal grounds upon which to seek rescission or damages from the principal for whom the agent is acting for purposes of making the disclosures. For example, a real estate broker must not withhold from a prospective buyer material facts regarding the property which are known to, or should be known to the broker, and which are unknown to the buyer or unascertainable by the buyer through diligent attention or observation.

The duty of disclosure of a real estate broker representing the seller also includes the affirmative duty to conduct a reasonably competent and diligent inspection of the residential property listed for sale, and to disclose to prospective purchasers all facts materially affecting the value or desirability of the property that such an investigation would reveal. (Easton v. Strassburger (1984) 152 Cal. App. 3d 90).

3. Disclosure Duties Pursuant to Civil Code § 2079 et seq.

After the Easton v. Strassburger decision, Civil Code § 2079 et seq., was enacted which provides:

a. A real estate broker has a duty to the buyer of residential real property of one to four units (including manufactured homes) to conduct a reasonably competent and diligent visual inspection of property offered for sale, and to disclose to said buyer all facts materially affecting the value or desirability of the property that such an investigation would reveal, if the broker has a written listing contract with the seller to find/obtain a buyer or is a broker who acts in cooperation with such a broker to find/obtain a buyer.

b. The above provision in (a) also applies to leases of such residential property with an option to buy and to real sale property contracts as defined in Civil Code § 2985. (Civil Code § 2079.1).

c. The standard of care owed by a broker under this statute is the degree of care that a reasonably prudent real estate licensee would exercise and is measured by the degree of knowledge through education, experience, and examination, required to obtain a license under Part 1 (commencing at § 10000) of Division 4 of the Business and Professions Code. (Civil Code § 2079.2).

d. The inspection to be performed does not include or involve an inspection of areas that are reasonably and normally inaccessible to such an inspection, and if the property comprises: a unit in a planned development as defined in § 11003.1 of the Business and Professions Code, a condominium as defined in Civil Code Section 783, or a stock cooperative as defined in § 11003.1 of Business and Professions Code.

e. The inspection does not include an inspection of more than the unit offered for sale, if the seller complies with § 1368 of the Civil Code which requires a seller of such properties to furnish the buyer with copies of covenants, conditions, and restrictions, by-laws, delinquent assessments and penalties, etc.

f. The inspection to be performed also does not include an affirmative inspection of areas off the site of the subject property, or public records or permits concerning the title or use of the property. (Civil Code § 2079.3).

This disclosure law provides that in no event shall time for commencement of legal action for breach of duty imposed by this article exceed two years from the date of possession, which means the date of recordation, the

date of close of escrow, or the date of occupancy, whichever comes first. (Civil Code § 2079.4). Nothing in this disclosure law relieves a buyer or prospective buyer of the duty to exercise reasonable care to protect themselves including those facts which are known to or within their diligent attention and observation. (Civil Code § 2079.5).

The two year limitation for the commencement of legal action, and the limitations imposed upon the agent's duties of disclosure (whether of material facts about the property or of the agency relationships intended) do not apply to the agent's fiduciary duties owed to a principal to whom the disclosures are being made. The fiduciary duties of a real estate broker acting as a special agent of a principal in a real property or real property secured transaction are distinguishable from mere disclosure duties.

For example, should the real estate broker be acting as a dual agent or as the exclusive agent of the buyer to whom disclosures of material facts are made, the real estate broker as an agent and fiduciary of the buyer has a duty to "explain" the disclosures to the buyer and to "counsel" the buyer about the disclosures, including recommending that inquiry be undertaken about the material facts to permit the buyer to make an informed and considered decision. (Galeppi v. Waugh (1958) 163 Cal. App. 2nd 507, 511, and Salahutdin v. Valley of California (1994) 24 Cal.App.4th 555). (In Chapter 20, see the seller property condition form to be completed and delivered to buyer in timely fashion before title transfer which indicates the various actual disclosures required.)

4. Real Estate Transfer Disclosure Statement (TDS)

In addition to the common law duties imposed on sellers of residential real property, the California legislature enacted Civil Code §§ 1102-1102.17 that added disclosure duties for sellers of residential real estate. Civil Code § 1102(a) applies to residential property transactions, including any transfer by sale, exchange, lease with an option to purchase, any other option to purchase, or ground lease coupled with improvements “of real property or residential stock cooperative, improved with or consisting of not less than one nor more than four dwelling units, ” including manufactured homes (Civil Code § 1102(b). These provisions are mandatory and cannot be waived by the parties Civil Code § 1102(c). (Realmuto v Gagnard (2003) 110 Cal 4th 193). However, there are certain statutory exceptions, such as sellers who acquire property through foreclosure. (Civil Code §1102.2 (c)).

Sellers must complete and deliver to the buyer a comprehensive real estate disclosure statement. (Civil Code §§ 1102.1, 1102.3-1102.3a, 1102.6). The statutory disclosure form in Civil Code §1102.6 contains an extensive list of items normally found in residential properties about which the seller is required to provide some disclosure. (Alexander v McKnight (1992) 7 Cal 4th 973).

The seller's duty to deliver the disclosure form to a prospective buyer operates as a condition to the buyer's obligation and duty to perform under a real estate purchase agreement. (Realmuto v Gagnard (2003) 110 Cal 4th 193). An action for negligent misrepresentation against a broker for violation of Civil Code §§ 1102-1102.17 must be brought within 2 years after the date of the violation. (Civil Code §2079.4; Loken v Century 21-Award Props. (1995) 36 Cal. 4th 263, 272)

5. Malpractice Insurance Coverage

Because of the foregoing affirmative duties of disclosure being imposed upon real estate brokers when acting as special agents of principals in real property transactions, the legislature was concerned that the codification of these statutory duties may result in insurers seeking to exclude from errors and omissions coverage the duties imposed upon real estate brokers. As a result, an amendment was made to the Insurance Code adding § 11589.5 of the Insurance Code which provides:

a. No insurer who provides professional liability insurance for persons licensed under the provisions starting with § 10000 of the Business and Professions Code shall exclude from coverage under that policy liability arising from the breach of the duty of the licensee arising under Article 2 (starting with § 2079) of Chapter 3 of Title 6 of Part 4 of Division 3 of the Civil Code.

b. An insurer may exclude coverage against liability arising out of a dishonest, fraudulent, criminal, or malicious act, or as the result of an error or omission committed by, and at the direction of, or with knowledge of the insured.

The Legislature also declared that it is desirable to facilitate the issuance of professional liability insurance as a resource for aggrieved members of the public, and declares that the provisions of this act are, and shall be interpreted as, a definition of the duty of care found to exist by the court's decision under Easton v. Strassburger (1984) 152 Cal. App. 3d 90, and the manner of its discharge. (Cal. Civil Code § 2079.12.)

6. General Disclosure Duties

In a fiduciary relationship it is the duty of the agent, in whom such trust and confidence are reposed by the agent's principal, to make full disclosure of all material facts relating to the subject matter of the agency. For example, the courts have held that negotiating a sale to the real estate broker's wife without making a full disclosure to the principal is a violation of the duty which the broker owes to disclose all material facts. A later case was concerned with the failure of the real estate broker to disclose to the seller that the buyer was the broker's mother-in-law.

The court stated that where a seller's real estate agent is obligated to disclose to agent's principal the identity of the buyer, and where the buyer is not the agent but has with the agent such blood, marital or other relationship which would suggest a reasonable possibility that the agent could be indirectly acquiring an interest in the property, such relationship is a material fact which the agent must disclose to the agent's principal.

In addition, a licensee who acts as a principal to a real estate transaction must disclose the fact of his or her licensure to the other principal to the transaction (Business and Professions Code § 10177 (o)).

An agent's duty includes full disclosure and explanation of facts necessary for the principal to make an informed and intelligent decision. In George Ball Pacific, Inc. v. Coldwell Banker & Co. (1981) 117 Cal. App. 3d 248 the court found that the broker had made an inaccurate representation when he arranged a lease without knowing whether the lessor owned the property being leased.

Also, refer to the definition of a fiduciary and to the duties and obligations imposed on fiduciaries as discussed in this Chapter in the section entitled, “Mortgage Brokers”. Fiduciary duties and obligations are equally applicable to real estate brokers as well as to mortgage brokers who are real estate brokers acting within the meaning of Business and Professions Code §§ 10131(d) and (e), 10131.1 et seq. and 10166.01 et seq.

7. Limits on Disclosure/Antidiscrimination Provisions

Licensees who participate in discriminatory practices in the housing market may incur liability under any of a number of fair housing statutes. Brokers have been held to be covered by California's Unruh Civil Rights Act (Civil Code § 51) (Lee v O'Hara (1962) 57 C2d 476).

The Fair Housing Act (FHA) (42 USC §§ 3601-3631; commonly referred to as Title VIII of the Civil Rights Act of 1968) and the Civil Rights Act of 1866 (42 USC §§ 1981-1982) prohibit discriminatory practices in the sale or rental of a dwelling and serve as potential bases for imposing liability for damages on brokers who participate in discriminatory practices.

Another possible basis for imposing liability on brokers for discriminatory practices is the California Fair Employment and Housing Act (Government Code §§ 12900-12996). Government Code § 12920, prohibits discrimination based on “race, color, religion, sex, marital status, national origin, ancestry, familial status, disability or sexual orientation in housing accommodations....” A broker who supplies information on the race, color, sex, religion, ancestry, or national origin of a prospective buyer, even when requested by the seller, violates the California Fair Employment and Housing Act (FEHA) (Government Code §§ 12900-12996).

Brokers are also subject to administrative action under the Real Estate Law (Business and Professions Code §§ 10000-10580) to revoke the broker's license. (Business and Professions Code § 10177(l); 10 CCR, Chapter 6, §§ 2780-2781. (Also, Business and Professions Code §§ 125.6, 10170.5(a) (4); 10 CCR, Chapter 6 § 2725.

In addition, a licensee is not liable for failing to disclose a death at property sold or leased that occurred more than three years before the transfer or if there was a death caused by AIDS at any time (Civil Code § 1710.2).

8. Reasonable Care and Skill

An agent moreover is under a duty to use reasonable care and skill (and depending upon the fact situation, utmost care) to obey directions of the employer, and to render an accounting to the principal. The language in Civil Code § 2079.16 requires "a fiduciary duty of utmost care, integrity, honesty and loyalty. . ." The reasonable care and skill standard is assigned to the party in the transaction who is not the agent's principal. Whether the standard is utmost or reasonable will depend upon the fact situation and the relationship between the agent and the principal. A gratuitous agent (i.e., one who is not paid for the agent's services) cannot be compelled to perform the undertaking, but such an agent who actually enters upon performance must obey instructions and is bound to exercise the utmost good faith in dealing with the principal. This aspect of the fiduciary duty is further embodied in Business and Professions Code § 10177 (g).

9. Agent May Not Act for More Than One Party Without Consent of Both

An agent cannot act for two or more principals in negotiations with each other unless each have knowledge of and consent to the dual agency. Such conduct is opposed to public policy in that it places the agent in a position where the agent may represent conflicting interests. Therefore, regardless of the real estate broker's honesty, or the fairness of the contract in the particular case, the real estate broker cannot recover commissions from the principals unless the dual agency is both disclosed and consented to by the principals. Further, it has been held by the Supreme Court that an undisclosed dual agency is a ground for rescission by any principal without any necessity of showing injury. (L. Byron Culver & Associates v. Jaoudi Industrial and Trading Corp. (1991) 1 Cal. App. 4th. 300, 305; McConnell v. Cowan (1955) 44 Cal. 2d 805, 811; Jarvis v. O'Brien (1957) 147 Cal. App. 2d, 758, 759; and, Glenn v. Rice (1917) 174 Cal. 269, 272).

Even when the dual agency relationship is known and consented to by all parties, the agent owes to each party the same duty of utmost good faith, honesty, and loyalty in the transaction, and the same duty to disclose material facts which would affect the judgment of either principal. This rule of disclosure of dual agency is specifically mentioned in the Real Estate Law, and its violation is cause for revocation or suspension of a real estate license. (Business and Professions Code §§ 10176(a) and (d)). Also, disclosure to and consent by the principals is required by law in transactions involving 1 to 4 residential units. (Civil Code § 2079.13 et seq.). It is important to note that § 10176 (d) applies to any transactions within which a real estate broker or his or her salespersons or broker associates are engaged as special agents acting within the course and scope of their licenses.

10. No Secret Profits or Undisclosed Compensation

The courts have unequivocally held that an agent cannot acquire any secret interests adverse to the principal; that the agent cannot lawfully make a secret personal profit out of the subject of the agency; and that if an agent conceals the agent's interest in the property being conveyed or encumbered, the agent is liable to the principal for all secret profits made by the agent.

In addition, the courts have held that where an agent falsely represents the amount at which a property may be purchased by an offeror and then purchases for him or herself at a lower amount permitting the agent to pocket the difference, the agent will be compelled to disgorge the secret profits. The fact that the offeror was willing to pay the larger amount or that the property may have been worth the amount paid by the offeror is immaterial.

Claiming or receiving a secret profit or any form of undisclosed compensation is cause for discipline under Business and Professions Code § 10176(g). (Ward v. Taggart (1959) 51 Cal. 2d 736). The obligation to disclose all compensation regardless of the form, time, or source of payment is imposed upon real estate licensees whether acting in a real property or real property secured transaction.

11. Attitude of the Courts

The decision in the case of Rattray v. Scudder (1946) 28 Cal. 2d. 214, is a clear exposition of the attitude of the California Supreme Court toward the fiduciary relationship between the real estate broker and the principal. In that case, a real estate broker was retained by an owner of real property to find a buyer for the property. The fiduciary duties of the broker were violated when, without disclosing to the principal that broker had found a buyer, the broker made misrepresentations about the salability of the property at the asking price. The broker made untruthful and misleading statements to induce the principal to reduce the price of the property and to sell it to the brokerage firm of which the broker was a member.

In commenting on duties and good faith of a broker the court held: "The law of California imposes on ... the real estate agent the same obligation of undivided service and loyalty that it imposes on a trustee in favor of his beneficiary. Violation of his trust is subject to the same punitory consequences that are provided for a disloyal or recreant trustee."

A real estate broker when acting as an agent and fiduciary in a real property or real property secured transaction is duty bound to inform a principal of every fact material to the principal. The duty to disclose material facts is not limited to the relationship between the agent and the principal. A real estate broker and his or her salespersons and broker associates each have duties to disclose material facts to the principal in a real property or real property transaction even when the broker owes no fiduciary duty to that principal. For example, a listing broker who is not a dual agent owes the duty of disclosure of material facts to the buyer.

When acting within the course and scope of a real estate license, a real estate broker, whether acting in a fiduciary or nonfiduciary capacity, owes affirmative duties of disclosure. When the real estate broker is acting within a fiduciary capacity, the broker's duty extends beyond mere disclosure to the duty of "explaining" and "counseling" about that which has been disclosed, or should have been disclosed. Of course, the duty to "explain" and to "counsel" is limited by the course and scope of the agency and by the license, knowledge, experience, and training ascribable to real estate brokers. The duty to "counsel" includes the obligation to offer advice and to make recommendations to the principal within the course and scope of the agency to permit the principal to make informed and considered decisions.

Not only does the failure to abide by these fundamentals place the broker in a position of jeopardizing the broker's license, but the courts have held that the broker as an agent of a principal in a real property transaction is not entitled to any profit from the transaction in which such agent is guilty of violating these principles. In the case of Thomas v. Snyder, (1930) 114 Cal. App. 397, 300 P. 117, it was held that "What is required of an agent toward his principal is clearly set forth in the text found in 1 California Jurisprudence, page 789, as follows: 'The proposition is conclusively settled that an agent is charged in full measure with the duty of good faith in his dealings with his principal, touching the subject of his authority. The animating principle in this proposition is that no one should, nor will he be permitted to enjoy the fruits of an advantage taken of a fiduciary relation whose dominant characteristic is the confidence reposed in one person by another. The law requires perfect good faith on the part of agents not only in form but in substance, and not only from agents receiving compensation, but also from gratuitous agents. Indeed, the rule is so familiar as to be trite that the obligation of an agent to his principal demands of him the strictest integrity and most faithful service.' "

The requirements of law governing the relationship between agent and principal is to the effect that the agent cannot be allowed to profit at the expense of the agent's principal, no matter whether the result is reached by misrepresentation, concealment or other fraudulent device. In the case of Rempel v. Kells the court held that an agent obtaining profits by fraudulent conduct and concealment from the principal is not even entitled to recover expenses incurred by the agent in connection with the transaction. The duty of a real estate broker to disclose material facts known by him to the seller employing him was again confirmed in the appellate court case, Jorgensen v. Beach 'n' Bay Realty, Inc., (1981) (125 Cal. App. 3d 155).

In Jorgensen, the listing broker presented an offer to his seller that was only about 7 percent less than the listing price. The broker presented the offer on behalf of a speculator for whom the broker hoped to act in future transactions. When the broker presented the offer, he informed the seller that he was also acting on behalf of the offeror and was therefore a dual agent in the transaction. The seller wished to counter offer on the price, but

the broker recommended that the seller not do so. The seller followed this recommendation. The sale was consummated. Shortly thereafter the purchaser resold the property through the broker at a 13.5 percent profit.

In reversing a nonsuit for the broker, the appellate court held that the broker did not fully discharge his fiduciary obligation to the seller by simply disclosing that he was acting as a dual agent in the transaction. It was the broker's duty to disclose all material facts known to him which might have affected the seller's decision to accept the offer. The court suggested that the facts known to the broker which might have affected the seller's decision included (l) the fact that the buyer was acquiring the property for investment purposes and (2) the fact that the broker had a substantial personal stake in negotiating a bargain purchase for the buyer. (Field v. Century 21 Klowden-Forness Realty (1998) 63 Cal.App.4th 18).

12. Obligations of Real Estate Salespersons or Broker Associates

A real estate salesperson or broker associate is subject to the same duties and obligations arising out of the fiduciary relationship between the broker and the broker's principal. The salesperson or broker associate is the supervised employee or agent of the broker and is employed to carry on licensed activities on behalf of the broker through whom the fiduciary duties of the salesperson or broker associate are owed to the principals of the transaction. When a salesperson or broker associate owes a duty to a principal or, for that matter to a party to a real estate transaction who is not a principal, that duty is the equivalent to the duty owed to the party for whom the salesperson or broker associate functions. The term "broker associate" in this context refers to a real estate broker who has entered into a written contract to act as the agent of another broker in connection with acts requiring a real estate license and to function under the latter broker's supervision. (Civil Code § 2079.13(b)).

In performing the acts for which a real estate license is required, the salesperson or broker associate must disclose to the broker's principal all the information the salesperson has or should have which may affect the principal's decision. A failure on the part of the salesperson or broker associate to fulfill this obligation could result in disciplinary action against the salesperson's license and may result in disciplinary action against the license of the broker with whom these licensees are associated. Moreover, the broker will generally be held liable in damages to the principal or any other party to whom the broker owed a duty for acts and omissions of the broker's salesperson or broker associate.

Since the broker may be subject to administrative disciplinary action or civil liability for the acts of the broker's salespersons or broker associates, the broker should take particular care in instructing salespersons or broker associates about their duties and obligations to the broker's principals and other parties to whom the broker owes a duty. The salespersons or broker associates should also exercise the greatest care in carrying out these instructions of the broker when dealing with the broker's principals or any party to whom duties are owed.

Real estate salespersons and broker associates are subject to the same duties as a broker by whom they are employed, including prescriptions against dual agency, secret profits or undisclosed compensation, and other acts and omissions which violate an agent's duties to the agent's principal. Since a real estate broker has a statutory duty to exercise reasonable supervision over the activities of his or her salespersons or broker associates, it is quite possible for a broker to be disciplined for the acts and omissions of broker's salespersons or broker associates in violation of provisions of the Real Estate Law even if the broker was not aware that specific acts had taken place. (California Real Estate Loans, Inc. v. Wallace (1993) 18 Cal.App.4th 1575, and Business and Professions Code §§ 10159.2, 10176(a), (b), (d), and (g), 10177(h), 10177.5 and 10179).

For purposes of a civil action, the duty of the qualifying broker under a corporate license to supervise salespersons or broker associates is a duty owed to the corporation. In the case Walters v. Marler (1978) 83 Cal. App. 3d 1, a salesperson breached the duty to disclose to the buyer all material facts affecting the buyer's decision. The court held that when a salesperson who is agent for the buyer acting through the supervising broker, breaches a duty owed to the buyer, the qualifying broker's duty to supervise did not make the broker individually liable for the damages suffered by the buyer. The broker's actions are considered the actions of the corporation. Therefore, the corporation remains liable for damages resulting from the acts of its salesperson.

THE DUTIES AND LIABILITIES OWED BY AN AGENT TO THIRD PARTIES, AN OVERVIEW

1. Warranty of Authority

If an agent acts in the name of the agent's principal with authority given by the principal, the principal is bound by the agent's act. When the agent acts without authority or in excess of the agent's authority, the agent may be held liable for resulting damages for having breached the agent's implied warranty of authority. While the agent warrants the agents own authority, the agent does not impliedly guarantee the principal's capacity to contract. The agent is not liable therefore if the principal is incapable of contracting through infancy or incompetency unless the agent has expressly warranted capacity or fraudulently concealed the fact of incapacity.

To protect himself or herself against liability for breach of an implied warranty of authority, the agent should clearly indicate to the third party that he or she is not sure of the authority granted by the principal and does not warrant it or, on the alternative, that the authority granted by the principal is limited to that which has been clearly defined by the principal and disclosed by the agent to the third party.

2. On Contracts

When a contract is negotiated and executed by an agent in the name of the principal, the agent will not ordinarily be held liable for the performance of the contract. If, however, there is a lack of authority on the part of the agent and a lack of a good faith belief on the agent's part that the agent possesses the authority, the agent is liable for the performance of the contract as a principal. The agent is also personally liable for the performance of the contract if the agent fails to reveal the name of the principal, or the fact that the agent is acting in an agency capacity. If the fact of agency is disclosed in the contract, but the name of the principal is not, the rule in California appears to be that the agent is personally liable for the performance of the contract. To avoid the possibility of personal liability of the agent, the name of the principal for whom the agent is acting must appear on the face of the contract.

The failure to disclose the name of the principal by an agent who is known to be acting as an agent is distinguishable from the fact situation where the agent fails to disclose to a principal that there is a principal distinguishable from the agent for whom the agent is acting. In a real property secured transaction, the court held that the loan was rescindable by the borrower since the borrower never knew the identity of the actual lender. For a contract to exist between two principals, it is essential that the principals are able to identify each other. (Civil Code § 1558 and Jackson v. Grant (1989) 876 F. 2d 764, 766).

The manner in which an agent signs a contract with a third party on behalf of the agent's principal may be significant in determining whether the agent has any personal liability to the third party. Ordinarily an agent should enter the name of the principal as the contracting party and should then sign the instrument "by" himself or herself as agent for that principal. By signing the contract in this manner, the agent is virtually assured that he or she will not be held liable for the performance of the contract since the fact of agency and the name of the principal are disclosed. There are other ways in which this double disclosure can be effected, but the method described has the advantage of being time tested.

3. On Torts

Torts are private wrongs committed upon the person or property of another and arising from a breach of duty created by law rather than by contract. An agent is liable to third parties for the agent's own torts whether the principal is liable or not, and in spite of the fact that the agent acts in accordance with the principal's directions. Where a person misrepresents his or her authority to act as agent for another, such person may be liable in tort to the third party who relies on the representation to the third party's detriment.

Real estate brokers and their salespersons and broker associates by the very nature of their business are constantly making representations to prospects concerning the property being offered for sale. A representation may be merely an expression of opinion or "puffing" on the part of the broker but, on the other hand, it may be reasonably understood by both the broker and prospective buyer to be a representation of fact and thus a part of the contract if agreement is reached.

Material representations purporting to be fact which are false or misleading may result in liability of the real estate broker. The same may be said with respect to a failure on the part of the broker to disclose material facts about the property to the prospective buyer. In addition to incurring liability for damages to the buyer, a broker may also be subject to disciplinary action by the Department of Real Estate against the broker's license for overt misrepresentations or for failure to disclose material facts. (Business and Professions Cade § 10176(a) and Pintor v. Ong (1989) 211 Cal. App 3rd 837).

4. Misrepresentations

A misrepresentation by the broker who is the exclusive agent of the seller to a prospective buyer of the lowest price acceptable to a seller is not usually actionable by the buyer, because it is not a representation of a material fact. The seller has a right to obtain the best price available and has hired the agent to achieve that end. Therefore, the seller's agent should not make representations to the buyer about price except with the seller's knowledge and consent. Representations about price to the buyer absent the seller's knowledge and consent may be actionable by the seller. Equally, a misrepresentation about price to the buyer by the real estate broker or his or her salesperson or broker associate who is acting as an agent of the buyer will usually be actionable by the buyer. Practitioners who issue BPOs must be particularly careful. For instance, a licensee who issues a BPO at the request of a seller should provide a copy of the BPO to the buyer when acting as a dual agent. Consent of the seller should be obtained. Prudent practitioners should also notify the seller of the prospect that the buyer (in a dual agency situation) may have the right to receive the BPO although it was initially prepared only for the Seller.

Statements incorporated into the purchase contract are often in the form of promises comprising part of the consideration extending from the seller to the buyer. If such a representation is made in good faith, the fact that it is untrue will ordinarily not render the seller or seller's agent liable in tort. An untrue representation which is a material ingredient of the purchase contract may, however, be the basis for an action for rescission and/or damages by the buyer. The same holds true with respect to mutual mistakes of fact resulting from representations made by the seller's agent. The mutual mistake may be the basis for a rescission of the purchase contract, but neither the seller's agent nor the seller would ordinarily be liable in tort to the buyer.

5. Fraud v. Negligence

Misrepresentation may be either fraudulent or negligent. In either case the agent may be liable civilly for damages incurred by the buyer on account of the misrepresentation or the agent may be subject to disciplinary action against the broker's license. The principal may be vicariously liable in damages for the broker's misrepresentations even where the principal was not the source of the erroneous information conveyed by the broker acting as the principal's agent.

Certain misrepresentations, even though made by an agent with no evil intent, are defined by law as actual fraud if they are positive assertions of that which is not true made in a manner not warranted by the information of the person making the representation notwithstanding that such person believes it to be true. Constructive fraud as defined in the California Civil Code includes any breach of duty which, without an actually fraudulent intent, gains an advantage to the person in fault, or anyone claiming under him or her, by misleading another to his or her prejudice, or to the prejudice of anyone claiming under him or her. (Carl Michel et al. v. Moore and Associates, Inc. (2007) 156 Cal App. 4th 756 and Field v. Century 21 Klowden-Forness Realty (1998) 63 Cal.App.4th 18).

Thus, in the area of misrepresentations, the dividing line between fraud and negligence is often blurred and yet there may be a significant difference in the agent's exposure in damages depending upon whether the misrepresentation is found to be negligent or fraudulent. If found by a court or jury to be fraudulent, punitive damages can be awarded against the person making the misrepresentation. Remember, a real estate broker acting as a special agent in a real property or real property secured transaction may make no representation without a reasonable basis for believing the representation is true, may assert no half-truths, and may not assert a series of independent truths which when interconnected are expressly or inferentially misleading.

Furthermore, if a fraud judgment is entered against a real estate broker based upon the broker's performance of acts for which a real estate license is required, disciplinary action may be taken against the broker based solely

upon the civil judgment. (California Real Estate Loans, Inc. v. Wallace (1993) 18 Cal.App.4th 1575. If on the other hand, the broker's misrepresentation is found to be no more than negligent, a case against the broker for negligence would have to be retried at the administrative level where the standard of proof required in order to discipline is convincing proof to a reasonable certainty as opposed to the preponderance-of-evidence standard in a civil negligence action.

6. Nondisclosures and Constructive Fraud

Civil liability of a real estate broker for misrepresentation and the possibility of disciplinary action against the licensee may arise from the broker's failure to disclose as well as from overt misstatements. Liability for failure to disclose may result where the broker has knowledge of facts materially affecting the value, desirability, or intended use of the property, and which facts the broker does not convey to the prospective buyer knowing that the buyer does not have the same information.

Cases imposing a duty of disclosure usually involve the concealment by the seller of latent defects in the property. These cases have held that the real estate broker acting as an agent of the seller and the seller have a duty to disclose facts materially affecting the value, desirability, or intended use of property, if the broker knows that the buyer is unaware of these facts and they are not within the buyer's diligent attention including the inspection of the property. The courts have sometimes referred to such non-disclosure as negative fraud. (Easton v. Strassburger (1984) 152 Cal.App.3d 9099).

In addition, a fiduciary may be liable to its principal for constructive fraud even if his or her conduct is not actually fraudulent. (Salahutdin v Valley of Cal., Inc. (1994) 24 Cal. 4th 555). In Salahutdin, a real estate agent made affirmative statements about the size and subdivision prospects to the buyer but failed to disclose that he did not investigate accuracy of these statements. Constructive fraud comprises any act, omission, or concealment involving a breach of legal or equitable duty, trust, or confidence that results in damage to another even if the conduct is not otherwise fraudulent. (Salahutdin v Valley of Cal., Inc., supra.).

7. “Puffing”

Even in some situations where a licensee honestly believes that representations to the prospective buyer are nothing more than "puffing" or "sales talk", a problem may develop if the impression made upon the buyer is that the representation is one of fact. Statements by a real estate broker that the property being offered is the "best on the street", or that the buyer "will receive handsome profits from the buyer's investment", were at one time almost universally considered to be mere expressions of opinion. In more recent years, there appears to be a growing tendency on the part of the courts to treat such statements as representations of material fact, because persons of limited expertise and sophistication tend to rely upon such statements and to purchase property as a result of such reliance.

A statement by a real estate broker, salesperson or broker associate that a house was "in perfect shape," while obviously not literally true, has been described as a representation of a material fact by an appellate court considering the question.

8. Gratuitous Agent

In addition to negotiating the "meeting of the minds" of seller and buyer in a real estate transaction, brokers do a multitude of other things in order to consummate sales. For example, they order preliminary reports, complete forms, process loan applications, arrange for pest control inspections, and assist in the preparation of escrow instructions. In a sense, the broker performs many of these functions gratuitously since he or she has earned a commission when he or she has produced an offer from a person who is ready, willing and able to purchase. The standard of the industry, however, is that the broker does not deem the commission to be due and payable until the close of escrow.

If the real estate broker acting in a sales transaction undertakes to aid the buyer in processing a loan application and does not charge the buyer for that service, the broker is a gratuitous agent of the buyer for the purpose of arranging the loan. The broker's failure to use reasonable care while acting in the capacity of a gratuitous agent can result in the liability of the broker, if the buyer sustains an injury as a result of this negligence.

RIGHTS OF AGENT REGARDING A PRINCIPAL, AN OVERVIEW

1. Compensation - Performance Required Under Employment Contract

Generally

To be entitled to a commission the broker must (l) produce a buyer ready, willing and able to purchase upon the terms and at the price stipulated by the seller or (2) secure from the prospective buyer a binding contract upon terms and conditions which the seller subsequently accepts.

In the first situation, the real estate broker's right to compensation is based upon the broker's written employment contract (listing). The listing agreement requires that the broker be the procuring cause of an offer by a buyer ready, willing and able to purchase on the seller's listing terms. A ready and willing buyer generally denotes one who is prepared to enter into a binding unconditional contract while an able buyer is one who has the financial ability to obtain the funds necessary to consummate the transaction at the proper time.

From the broker's standpoint, a listing agreement is very much result oriented. The broker's right to a commission is in no way dependent upon, nor is it affected by, the amount of work put into finding a buyer ready, willing and able to purchase and in negotiating the "meeting of the minds" of buyer and seller. By the same token if the broker expends no time and effort on behalf of the principal and yet is able to produce a buyer who is ready, willing and able to purchase on the terms specified in the listing contract, the broker has earned a compensation.

Payment of Compensation May Be Dependent on Any Lawful Condition

The payment of a commission under a listing contract may be made dependent upon any lawful condition. A seller may be relieved from the obligation to pay a commission if it appears from the language of the contract that the payment of a commission was contingent upon the happening of a condition that did not occur. The burden is upon the broker to establish that he or she has earned a commission by fulfilling all of the conditions of the contract. If the fulfillment of a condition is prevented by the fraud or bad faith of the seller, or through collusion between the seller and other parties, the broker may recover compensation even if the condition has not been met.

The amount or rate of compensation may not be part of a printed or form agreement for sale of residential real property comprised of four units or less or the sale of a mobile home. Such agreements must contain a 10-point boldface type notice that real estate commissions are not fixed by law and may be negotiated. The wording to be used is set out in Business and Professions Code § 10147.5.

If Broker Performs Within Time Limit Broker is Entitled to Commission

Revocation of a broker's authorization cannot operate to deprive the broker of the compensation contracted for or its equivalent in damages, for nonperformance of the owner's contract if, within the time specified in the listing agreement, the broker has found a customer ready, willing and able to purchase upon the price and terms in such contract. The principal will not be relieved from liability by a capricious refusal to consummate a sale where the principal's voluntary act precludes the possibility of performance on the principal's part. This is based upon the familiar principle that no one can avail himself or herself of the nonperformance of a condition precedent who has occasioned its nonperformance. It is well settled that a principal cannot discharge an agent pending negotiations by the agent with a prospective customer, then effect a sale to the customer, without liability to the agent.

When the listing contract is for a definite period, and there is a valuable consideration extending from the broker, e.g., a promise to use due diligence in locating a person ready, willing and able to purchase, the contract is binding upon the seller as soon as executed. The agent cannot be prevented from earning a commission within the period of the appointment by revocation of the broker's authority. However, the distinction must be made between the power to revoke and the right to revoke.

If the principal no longer desires to have the agent act for the principal, then principal has the power to revoke the agency at any time. Should the principal revoke the agency, the principal breaches the promises under the

listing contract and may be liable to the broker for the payment of a commission. The principal may revoke the agency without liability, if it can be proven that the agent failed in the duty to use due diligence, or has breached the fiduciary duties owed by the agent to the principal.

Agreements Between Brokers

An agreement between brokers cooperating in the sale of real property for a division of the fees or commissions is neither illegal nor against public policy. It will be construed and enforced the same as other contracts not required to be in writing, but no partnership or joint venture is created by such an agreement between the cooperating brokers in their endeavors to sell real property listed with one of them.

In the case where a cooperating broker has been the procuring cause of the sale and this broker's services are completed, this broker may be entitled to recover the selling broker's share of the commission from the listing broker. In the case where the original broker fixed the compensation at a certain sum, the original broker cannot deprive the assisting or cooperating broker of a portion of the commission by settling with the principal for a lesser sum.

There is an implied warranty that the owner will pay the amount of the commission as specified, and the original broker is liable to the other broker for the other broker's portion regardless of what the original broker settles for, unless the consent of the assisting broker is obtained. The listing broker is liable to the cooperating broker for the payment of the commission only if the listing broker has received a commission from the seller. If an agreement for the division of a commission has been abandoned by the cooperating broker, the listing broker may then sell the property without being liable to the other broker for a share of the commission earned.

Right of Principal to Secure Buyer

Where the listing is an open one, the sale by the owner of the property to a person who has not been referred to the owner by the broker does not violate the listing agreement and creates no liability to the broker on the part of the principal. Where there is no termination date in an open listing, the owner may not seek to take advantage of a failure on the part of the broker to produce the person willing to purchase on the terms of the listing by attempting to deal directly with the agent's prospect.

An agency contract which provides that the agency is irrevocable for a fixed time does not prevent the owner from selling the property within that time to a person with whom the agent has had no prior negotiations.

Commission Negotiable Between Principal and Broker

The amount of commission is set out in a broker's contract of employment. In the absence of any evidence of incapacity to read or any fraud to prevent the reading or understanding of the agreement to employ and pay compensation, the party signing the written contract is bound by its express terms and conditions. Ordinarily, the compensation of the broker is negotiated at a certain percentage of the purchase price obtained by the owner. If no amount of compensation is mentioned in the contract of employment, the law implies a promise on the part of the owner to pay the usual or customary commission charged in the neighborhood for like services.

If the owner accepts an offer procured by the broker at a price which is less than the price specified in the listing agreement, both the listing agreement and the deposit receipt usually expressly provide for the payment of a commission to the broker.

2. Listing Agreement - No Deposit Receipt Contract. When Agency Is Executed

A broker has earned a commission when, within the life of the contract, the broker has fulfilled the terms of the agency contract. As stated before, a buyer produced must be ready, willing and able to purchase upon the terms and conditions specified by the owner. The readiness and willingness of a person to purchase real property may be shown only by an offer to purchase from that person. Unless such person has made an offer to the seller to enter into such a contract, this person cannot be considered as a person ready, willing and able to buy. The buyer and seller must be brought into communication with each other. Merely putting a prospective purchaser on the track of property which is on the market does not entitle the broker to the commission contracted for and, even though a broker opens negotiations for the sale of the property, the broker will not be entitled to a commission if the broker ultimately fails to induce the prospective buyer to make an offer on the property. This

is true even though the owner may subsequently sell the property to the person originally produced by the broker at the price and upon the terms at which it was originally offered for sale.

The obligation assumed by the broker is to achieve a "meeting of the minds" of the buyer and seller as to the price and other terms for the transaction. Thus, if a valid contract is executed by seller and buyer, the broker is entitled to a commission even though the sale is never consummated.

Seller Responsible When Seller Negotiates Contract

A seller who negotiates the terms of the contract bears the responsibility for its form and contents. The broker does not lose a commission if, after producing a buyer who is ready, willing and able to purchase on the terms set forth in the listing agreement, an unenforceable contract is entered into through the mistake, inadvertence or ignorance of the seller. If the seller undertakes alone to complete the contract, the broker is discharged from any responsibility and the seller is estopped to deny the broker's commission claim on the ground that the contract is unenforceable. (Business and Professions Code § 10147.5 for Negotiability and Notice Requirements for commission agreements.)

Broker Who First Produces A Ready, Willing and Able Offeror Is the Procuring Cause

Where the listing is open, the broker who first produces a customer who is ready, willing and able to buy in accordance with the listing is the procuring cause of the sale, and is entitled to the commission therefor. As soon as a broker has found a buyer, it is the broker's duty to notify the principal. Where the listing is an open one, the seller may accept the first satisfactory offer presented.

There is no duty on the part of the seller to ascertain whether the agent who presented the offer was the procuring cause unless the seller has notice that another broker was the procuring cause. The seller may accept an offer which does not conform to the terms of the listing agreement and will ordinarily be liable to pay a commission to the broker who has presented the offer under the terms of the contract executed.

The owner is entitled to a reasonable time within which to investigate the financial responsibility of the proposed purchaser before accepting the purchaser as such. If the offeror presented by Broker A decides not to enter into a contract, but is thereafter induced by Broker B or another person to enter into the contract on substantially the same terms that offeror originally declined, Broker A is not entitled to a commission under the theory that Broker A is the procuring cause of the sale. On the other hand, Broker A is the procuring cause of the sale if Broker A has negotiated a "meeting of the minds" of offeror and offeree notwithstanding the fact that the written contract for the sale of the property is executed through negotiations by Broker B.

Seller Interference With Competing Agents Under Open Listing

Where competing brokers are endeavoring to negotiate a contract under an open listing, the agents must be permitted to act freely and independently of each other without interference by the owner. Where there is freedom and independence of action on the part of the agents, the owner is under no obligation to the agent who was unsuccessful in effecting a contract for the sale of the property. The owner, on the other hand may not avoid the payment of a commission by personally negotiating a contract with a prospect produced by the agent on terms and conditions substantially similar to those offered through the agent.

3. Deposit Receipt Contract - No Listing

On occasion the only written agreement containing a promise to pay a commission to the broker is in the contract to purchase between buyer and seller. To protect a right to a commission, the broker should attempt to obtain a separate agreement for the payment of a commission, even if the listing is written up to terminate within hours after an offer is presented. If a seller refuses to enter into such a separate agreement, the broker will have to rely upon the deposit receipt and purchase agreement. Where this occurs, a question may arise on the seller's obligation to pay a commission if the sale of the property is not consummated.

Whether there is an enforceable obligation on the part of the seller will often depend upon the wording of the commission clause in the deposit receipt and purchase agreement. Business and Professions Code § 10147.5 sets out the form to disclose negotiability of commission amounts which notice must be provided to the principal at the time commission agreements are executed. Whichever form agreement - listing or deposit receipt - initially establishes, intends to establish, or alters the terms of a previously established right to

compensation by a licensee, it must contain the specified information regarding the negotiability of commission amounts.

4. Both Listing Agreement and Deposit Receipt Contract

The broker's recovery of a commission is based upon the employment contract (listing). The execution of the contract to sell is nevertheless significant in that it evidences the fact that the agent has produced an offer that is acceptable to the owner.

5. Exclusive Listings

An additional basis for the recovery of compensation by the broker is provided where the listing is either an exclusive agency or exclusive right to sell. In these cases the broker need not necessarily comply with the performance requirements set forth under (2), (3), and (4), above. If the broker is prevented from performing under an exclusive contract as the result of a sale by the owner or through another agent or through the withdrawal of the property from the market by the owner, the broker will ordinarily be entitled to a commission under the listing agreement.

6. Sale to Broker's Prospect After Termination of Listing

To recover a commission under a listing contract, the broker must have produced an offer satisfying the terms of the listing contract within the time limit of the listing. The broker's negotiations during the life of a listing with a prospect who ultimately purchases the property does not necessarily entitle the broker to a commission. Special circumstances may nevertheless dictate that the agreed commission be paid to the broker.

For example, where the sale is consummated directly by the buyer and seller after the expiration of the listing on the same terms as proposed through the broker, or with only a price reduction to the buyer, there is every reason to believe that the broker was the procuring cause of the sale. Accordingly, the broker should be entitled to the agreed compensation for these services.

The broker may also protect his or her commission by a so called protective or savings clause in the listing agreement. Under this clause, the seller agrees to pay a commission to the broker if the property is sold within a period of so many days after expiration of the listing to a person with whom the broker negotiated while the listing was in effect. Ordinarily, the terms of a listing contract which includes such a protective clause requires that the broker furnish the owner of the property with a list of prospective buyers with whom the broker has negotiated within a prescribed number of days after expiration of the listing.

Even though the broker may not have negotiated with anyone during the term of the listing, the seller may waive the expiration of the contract by encouraging the broker to continue efforts to find a buyer. If the broker continues in reliance upon such a waiver and does produce an offeror to whom the property is ultimately sold, the broker may be entitled to a commission even without literal compliance with the terms of the listing contract. The broker will face the issue of waiver of the termination date of the listing agreement as compared to compliance with Business and Professions Code § 10176(f). (See discussion this Chapter regarding Breach of Contract v. Tort Theory.)

7. Intentional Interference with Prospective Economic Advantage

A broker may be entitled to recover a commission under a tort rather than a contractual theory of liability by proving that the actions of the owner of the property constituted intentional interference with the prospective economic advantage of the broker. In one such case, a broker negotiated with a prospective buyer of real property without any kind of a listing agreement solely on the strength of a sign erected on the property by the owner which read "FOR SALE - CONTACT YOUR LOCAL BROKER". The broker was aware of the merits of the property from a previous listing of the property with him. After his discussions with the prospective buyer, the broker informed the owner of the property in writing that he was the procuring cause should an offer be made by the group with whom he had discussed the property.

Notwithstanding this notice, the owner sold the property to the group with whom the broker had negotiated without his participation. While the court denied the broker's right to a commission under a contractual theory for lack of any written agreement to pay the commission signed by the owner, it upheld the broker's right to sue

for commission under the theory that the owner and buyers had intentionally interfered with his reasonable expectation of a commission for having negotiated the sale of the property. (See discussion this Chapter regarding Breach of Contract v. Tort Theory.)

Criteria for Duty of Care

Although an agent's interests in prospective economic advantage may be protected against injury occasioned by negligent conduct, there are six criteria for determining whether a duty of care is owed: l) the extent to which the transaction was intended to affect the agent, 2) the foreseeability of harm to the agent, 3) the degree of certainty that the agent suffered injury, 4) the closeness of the connection between the principal's conduct and the injury suffered, 5) the moral blame attached to the principal's conduct, and 6) public policy regarding the prevention of future harm.

SPECIAL BROKERAGE RELATIONSHIPS

From time to time a broker may have occasion to make a sale of property included in the estate of a decedent. Less frequently a broker may represent a Board of Education or the State of California. Finally, a broker may be innocently embroiled in a lawsuit by merely holding assets claimed by two or more contesting parties. The following comments throw some light on these special situations.

1. Probate Sales and Commissions

The representative of the estate of a decedent may initiate a probate sale by seeking offers to purchase directly or through one or more brokers. (Probate Code § 10150.) The executor or administrator may sell the real property of an estate where it is found to be in the best interests of the estate. Whether the sale is public or private, it must be advertised by publication or posting of notice. (Probate Code §§ 10300 et seq.) Acceptance of an offer by the estate representative is subject to probate court confirmation. The representative of the estate of the decedent with court permission may grant an exclusive right to sell the property for a period of not to exceed 90 days. (Probate Code § 10150.)

The broker's compensation and the court confirmation procedure is set forth in Probate Code § 10160 et seq. Initial information concerning the property, the broker's compensation, and the court confirmation procedure, if any, can be furnished by the attorney for the estate. If a bank or trust company has been appointed representative, interested persons may apply directly to the trust office of the institution for information. If a public administrator is the estate representative, inquiry may be made at that office. The broker should ask about the Independent Administration of Estates and whether the administrator is entitled to sell the property without the court's confirmation, but with notice to all beneficiaries. (Probate Code § 10400 et seq.).

An offer to purchase must be for a price which is not less than 90% of the property's appraised value (appraisal date within one year of sale) and it must conform to statutory requirements, the rules of the local superior court governing probate sales and the terms stated in the public notice of sale. The court will make efforts to assure the executor or administrator of the estate has exposed the property to the market. (Probate Code § 10160 et seq.).

The person making the offer returned to court for confirmation, and the broker representing that person, should attend the confirmation hearing whether or not that person plans to participate in higher bidding for the property. All prospective bidders and brokers should be familiar with local rules of court governing advance bidding, deposits required and similar matters. Ordinarily after court confirmation of a sale, normal escrow procedures are used to consummate the transaction on the terms and conditions approved by the court.

The payment of commissions to brokers participating in probate sales is generally within the discretion of the probate court subject to certain standards prescribed by statute. For example, § 10162 of the Probate Code provides that the compensation of the agent producing a successful bidder shall not exceed one-half of the difference between the amount of the bid in the original return and the amount of the successful bid provided that the limitation shall not apply to any compensation of the agent holding a contract with the estate representative pursuant to § 10150 of the Probate Code.

It is obviously important that the broker who procures the offer which is accepted by the estate representative and returned to the court for confirmation have a written contract with the representative. In the case of an over bid in open court at the confirmation hearing, it is a matter of importance to the broker that the court be informed that a licensed broker has produced the bid in question. If a purchaser not represented by an agent has his overbid confirmed, the listing broker may receive a full commission on the original bid only. (Probate Code § 10162.5).

The court in its order confirming the sale will set forth the amount of commission to be paid and the division of the commission if more than one broker is to be compensated. (Probate Code § 10160 et seq.)> Needless to say, where an agent is also the purchaser, the court will carefully examine "the substantiality" of the agent's acts in putting together "the best deal," for the estate, especially where the agent expects a commission. Estate of Levinthal v. Silberts, 105 Cal. App. 3d 691 (1980).

2. Board of Education Sales Commissions

The Education Code provides that the governing body of any school district may pay a commission to a licensed real estate broker who procures a buyer for real property sold by the board. The sealed bid for the property must be accompanied by the name of the broker to whom the commission is to be paid and by a statement of the rate or amount of the commission.

In the event of a sale on a higher oral bid to a purchaser procured by a qualified licensed real estate broker, other than the broker who submitted the highest written proposal, the board will allow a commission on the full amount for which the sale is confirmed.

Note: One-half of the commission on the amount of the highest written proposal will be paid to the broker who submitted it, and the balance of the commission on the purchase price to the broker who procured the purchaser to whom the sale was confirmed.

3. State of California Sales Commissions

From time to time, the State of California has real property for disposal. When bids received for this property, after advertising, do not equal its appraised value, the Department of Finance may authorize employment of a licensed real estate broker to effect the sale on a commission basis. This procedure does not apply to surplus real property of the State Division of Highways.

4. Dismissal of Broker-Stakeholder from Suit

The real estate broker as escrow holder has often been named as a defendant in a law suit to recover money which the broker is holding as a trustee in a transaction. All too often the licensee must retain counsel and pay the expense of defending in such a suit.

Under the Code of Civil Procedure, where the only relief sought against one of several defendants is payment of a stated amount of money, such defendant may upon affidavit that he or she is a mere stakeholder with no interest in the amount and that parties to the action have made conflicting demands upon the defendant, and upon notice to the other parties, apply to the court for an order discharging said broker from liability and dismissing defendant-broker from the action. This is known as an interpleader action. The defendant must however deposit the amount in dispute with the clerk of the court. The court may then dismiss this suit as to defendant-broker.

The broker need not wait to become a defendant in a lawsuit. If there is a fund disputed by two or more persons, the holder of the fund may file an interpleader action. The holder would deposit the fund with the clerk. The pleading would allege that the holder has no interest in the fund, and it would require the other parties to litigate their claims. The holder of the fund may be awarded attorney fees and costs. The complaint in interpleader can be used when there is a dispute between buyer and seller concerning a deposit in a failed transaction.

CONCLUSION

The subject of agency and fiduciary duty is complex and has proven to be difficult to understand and apply, particularly by real estate brokers and mortgage brokers when performing as special agents of the principals they serve. The discussion in this Chapter is intended to enhance the knowledge of the real estate and mortgage brokerage industries regarding the duties and obligations owed by brokers and their salespersons and broker associates when acting as principals only in real property transactions: as principals and special agents, or as special agents of the principals to real property transactions (buying, selling, leasing, exchanging or property managing), and to real property secured transactions (the making and arranging of loans).