

11 Agency

The Agency Relationship
Fiduciary Duties
Forms of Real Estate Agency
Agency Disclosure Rules

THE AGENCY RELATIONSHIP

Basic roles
Types of agency
Creating an agency relationship
Terminating an agency relationship

The most primary of relationships in real estate brokerage is that between broker and client, the relationship known in law as the **agency relationship**. In every state, a body of law, generally called the **law of agency**, defines and regulates the legal roles of this relationship. The parties to the relationship are the **principal** (a client), the **agent** (a broker), and the **customer** (a third party).

The laws of agency are distinct from laws of contracts, although the two groups of laws interact with each other. For example, the listing agreement -- a contract -- establishes an agency relationship. Thus the relationship is subject to contract law. However, agency law dictates how the relationship will achieve its purposes, regardless of what the listing contract states.

The essence of the agency relationship is *trust, confidence, and mutual good faith*. The principal trusts the agent to exercise the utmost skill and care in fulfilling the authorized activity, and to promote the principal's best interests. The agent undertakes to strive in good faith to achieve the desired objective, and to fulfill the fiduciary duties.

It is important to understand that the agency relationship does *not* require compensation or any form of consideration. Nor does compensation define an agency relationship: a party other than the principal may compensate the agent.

Basic roles

In an agency relationship, a principal hires an agent as a *fiduciary* to perform a desired service on the principal's behalf. As a fiduciary, the agent has a legal obligation to fulfill specific *fiduciary duties* throughout the term of the relationship.

The **principal**, or **client**, is the party who hires the agent. The agent works *for* the client. The principal may be a seller, a buyer, a landlord, or a tenant.

The **agent** is the fiduciary of the principal, hired to perform the authorized work and bound to fulfill fiduciary duties. In real estate brokerage the agent *must* be a licensed broker.

The **customer** or **prospect** is a third party in the transaction whom the agent does not represent. The agent works *with* a customer in fulfilling the client's objectives. A seller, buyer, landlord, or tenant may be a customer. A third party who is a potential customer is a **prospect**.

Types of agency

According to the level of authority delegated to the agent, there are three types of agency: *universal, general, and special*.

Universal agency. In a universal agency relationship, the principal empowers the agent to perform any and all actions that may be legally delegated to an agency representative. The instrument of authorization is the power of attorney.

General agency. In a general agency, the principal delegates to the agent ongoing tasks and duties within a particular business or enterprise. Such delegation may include the authority to enter into contracts.

Special, or limited, agency. Under a special agency agreement, the principal delegates authority to conduct a specific activity, after which the agency relationship terminates. In most cases, the special agent *may not* bind the principal to a contract.

In most instances, real estate brokerage is based on a special agency. The principal hires a licensed broker to procure a ready, willing, and able buyer or seller. When the objective is achieved, the relationship terminates, although certain fiduciary duties survive the relationship.

Creating an agency relationship

An agency relationship may arise from an express oral or written agreement between the principal and the agent, or from the actions of the parties by implication.

Written or oral listing agreement. The most common way of creating an agency relationship is by listing agreement, which may be oral or written. The agreement sets forth the various authorizations and duties, as well as requirements for compensation. A listing agreement establishes an agency for a specified transaction and has a stated expiration.

Implied agency. An agency relationship can arise by implication, intentionally or unintentionally. Implication means that the parties act *as if* there were an agreement. For example, if an agent promises a buyer to do everything possible to find a property at the lowest possible price, and the buyer accepts the proposition, there may be an implied agency relationship even though there is no specific agreement. Even if the agent does not wish to establish an agency relationship, the agent's actions may be construed to imply a relationship.

Whether intended or accidental, the creation of implied agency obligates the agent to fiduciary duties and professional standards of care. If these are not fulfilled, the agent may be held liable

Terminating an agency relationship

Full performance of all obligations by the parties terminates an agency relationship. In addition, the parties may terminate the relationship at any time by *mutual agreement*. Thirdly, the agency relationship automatically terminates on the *expiration* date, whether the obligations were performed or not.

Involuntary termination. An agency relationship may terminate contrary to the wishes of the parties by reason of:

- ▶ death or incapacity of either party
- ▶ abandonment by the agent
- ▶ condemnation or destruction of the property
- ▶ renunciation
- ▶ breach
- ▶ bankruptcy
- ▶ revocation of the agent's license

Involuntary termination of the relationship may create legal and financial liability for a party who defaults or cancels. For example, a client may renounce an agreement but then be held liable for the agent's expenses or commission.

FIDUCIARY DUTIES

Agent's duties to the client
Agent's duties to the customer
Principal's duties
Breach of duty

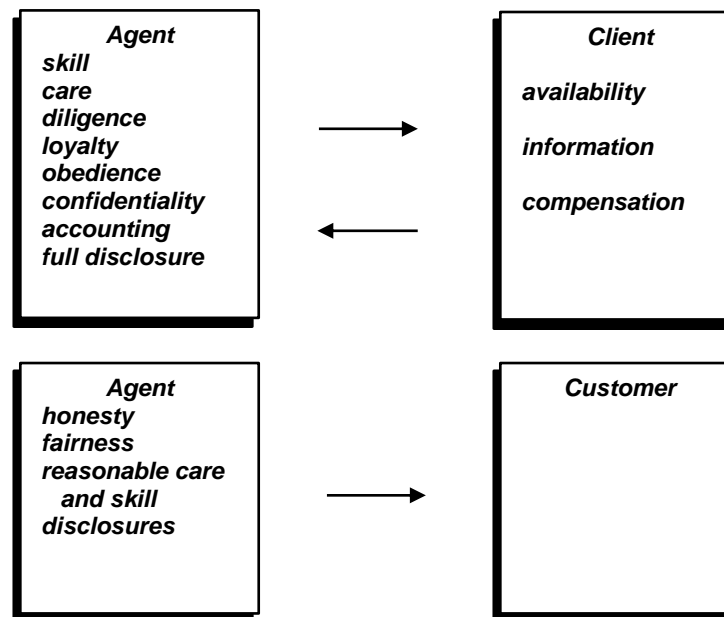
The agency relationship imposes fiduciary duties on the client and agent, but particularly on the agent. An agent must also observe certain standards of conduct in dealing with customers and other outside parties.

Agent's duties to the client

Skill, care, and diligence. The agent is hired to do a job, and is therefore expected to do it with diligence and reasonable competence. Competence is generally defined as a level of real estate marketing skills and knowledge comparable to those of other practitioners in the area.

The notion of care extends to observing the limited scope of authority granted to the agent. A conventional listing agreement does not authorize an agent to obligate the client to contracts, and it does not allow the agent to conceal offers to buy, sell, or lease coming from a customer or another agent. Further, since a client relies on a broker's representations, a broker must exercise care not to offer advice outside of his or her field of expertise. Violations of this standard may expose the agent to liability for the unlicensed practice of a profession such as law, engineering, or accounting.

Exhibit 11.1 Fiduciary Duties



Loyalty. The duty of loyalty requires the agent to place the interests of the client above those of all others, particularly the agent's own. This standard is particularly relevant whenever an agent discusses transaction terms with a prospect.

Obedience. An agent must comply with the client's directions and instructions, *provided they are legal*. An agent who cannot obey a legal directive, for whatever reason, must withdraw from the relationship. If the directive is illegal, the agent must also immediately withdraw.

Confidentiality. An agent must hold in confidence any personal or business information received from the client during the term of employment. An agent may not disclose any information that would harm the client's interests or bargaining position, or anything else the client wishes to keep secret.

The confidentiality standard is one of the duties that extends *beyond the termination of the listing*: at *no time* in the future may the agent disclose confidential information.

An agent must exercise care in fulfilling this duty: if confidentiality conflicts with the agent's legal requirements to disclose material facts, the agent must inform the client of this obligation and make the required disclosures. If such a conflict cannot be resolved, the agent must withdraw from the relationship.

Accounting. An agent must safeguard and account for all monies, documents, and other property received from a client or customer. State license laws regulate the broker's accounting obligations and escrow practices.

Full disclosure. An agent has the duty to inform the client of all material facts, reports, and rumors that might affect the client's interests in the property transaction.

In recent years, the disclosure standard has been raised to require an agent to disclose items that a practicing agent *should know*, whether the agent actually had the knowledge or not, and regardless of whether the disclosure furthers or impedes the progress of the transaction.

The most obvious example of a "should have known" disclosure is a property defect, such as an inoperative central air conditioner, that the agent failed to notice. If the air conditioner becomes a problem, the agent may be held liable for failing to disclose a material fact if a court rules that the typical agent in that area would detect and recognize a faulty air conditioner.

There is no obligation to obtain or disclose information related to a customer's race, creed, color, religion, sex or national origin: anti-discrimination laws hold such information to be immaterial to the transaction.

Some states have recently enacted laws requiring a seller to make a written disclosure about property condition to a prospective buyer. This seller disclosure may or may not relieve the agent of some liabilities for disclosure.

Exhibit 11.2 Disclosure of Material Facts

Critical material facts for disclosure include:

- the agent's opinion of the property's condition
- information about the buyer's motivations and financial qualifications
- discussions between agent and buyer regarding the possibility of the agent's representing the buyer in another transaction.
- adverse material facts, including property condition, title defects, environmental hazards, and property defects

Agent's duties to the customer

The traditional notion of *caveat emptor*-- let the buyer beware-- no longer applies unequivocally to real estate transactions. Agents *do* have certain obligations to customers, even though they do not represent them. In general, they owe a third party:

- ▶ honesty and fair dealing
- ▶ reasonable care and skill
- ▶ proper disclosure

An agent has a duty to deal fairly and honestly with a customer. Thus, an agent may not deceive, defraud, or otherwise take advantage of a customer.

"Reasonable care and skill" means that an agent will be held to the standards of knowledge, expertise, and ethics that are commonly maintained by other agents in the area.

Proper disclosure primarily concerns disclosure of agency, property condition, and environmental hazards.

An agent who fails to live up to prevailing standards may be held liable for negligence, fraud, or violation of state real estate license laws and regulations. Agents should be particularly careful about misrepresenting and offering inappropriate expert advice when working with customers.

Intentional misrepresentation. An agent may intentionally or unintentionally defraud a buyer by misrepresenting or concealing facts. While it is acceptable to promote the features of a property to a buyer or the virtues of a buyer to a seller, it is a fine line that divides promotion from misrepresentation. Silent misrepresentation, which is intentionally failing to reveal a material fact, is just as fraudulent as a false statement.

Negligent misrepresentation. An agent can be held liable for failure to disclose facts the agent was not aware of if it can be demonstrated that the agent *should have known* such facts. For example, if it is a common standard that agents inspect property, then an agent can be held liable for failing to disclose a leaky roof that was not inspected.

Misrepresentation of expertise. An agent should not act or speak outside the agent's area of expertise. A customer may rely on anything an agent says, and the agent will be held accountable. For example, an agent represents that a property will appreciate. The buyer interprets this as expert investment advice and buys the property. If the property does not appreciate, the buyer may hold the agent liable.

Principal's duties

The obligations of a principal in an agency relationship concern the following:

Availability. In a special agency, the power and decision-making authority of the agent are limited. Therefore, the principal must be available for consultation, direction, and decision-making. Otherwise the agent cannot complete the job.

Information. The principal must provide the agent with a sufficient amount of information to complete the desired activity. This may include property data, financial data, and the client's timing requirements.

Compensation. If an agreement includes a provision for compensating the agent and the agent performs in accordance with the agreement, the client is obligated to compensate the agent. As indicated earlier, however, the agency relationship does not necessarily include compensation.

Breach of duty

An agent is liable for a breach of duty to client or customer. Since clients and customers rely on the expertise and actions of agents performing within the scope of their authority, regulatory agencies and courts aggressively enforce agency laws, standards, and regulations.

A breach of duty may result in:

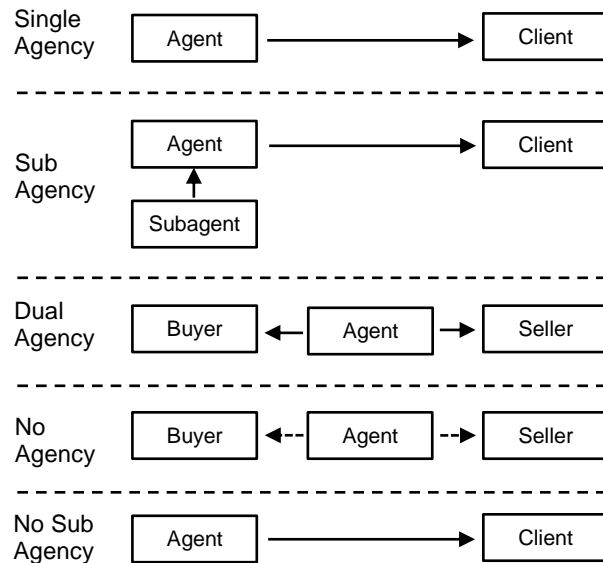
- ▶ rescission of the listing agreement (causing a loss of a potential commission)
- ▶ forfeiture of any compensation that may have already been earned
- ▶ disciplinary action by state license law authorities, including license suspension or revocation
- ▶ suit for damages in court

FORMS OF REAL ESTATE AGENCY

Single agency
Subagency
Dual agency
No agency
No subagency

The primary forms of agency relationship between brokers and principals are: *single agency, dual agency, and subagency*. In a fourth kind of relationship, referred to as *transaction brokerage*, no agency relationship exists in the transaction. Finally, some states are beginning to disallow subagency altogether. Students are advised to ascertain which agency relationships are allowed and practiced in their particular state.

Exhibit 11.3 Forms of Agency and No Agency in Real Estate Brokerage



Single agency

The agent represents one party in a transaction. The client may be either seller or buyer.

Seller agency. In the traditional situation, a seller or landlord is the agent's client. A buyer or tenant is the customer.

Buyer agency. Recently, it has become common for an agent to represent a buyer or tenant. In this relationship, the property buyer or tenant is the client and the property owner is the customer.

Real estate vernacular calls an agent of the seller or owner the **listing broker**. An agent who works for the listing broker and who obtained the listing is the **listing agent**. A broker who represents a buyer is the **buyer's broker**. One who does this as a specialization is a **buyer broker**. A broker or salesperson who represents tenants is a **tenant representative**.

Subagency

In a subagency, a broker or licensed salesperson works as the agent of a broker who is the agent of a client. Subagents might include a cooperating licensed broker, that broker's licensed salespeople, and the listing broker's licensed salespeople, all of whom agree to work for the listing broker on behalf of the client. In effect, a subagent is an agent of the broker who is agent of the client. The subagent owes the same duties to the agent as the agent owes to the client. By extension, a subagent owes all the fiduciary duties to the client.

Outside "co-brokers" and agents. It is common practice for brokers and salespersons to "cooperate" with a listing broker in finding buyers or tenants. A listing broker, in return, agrees to share the commission with a cooperating broker.

It is cooperating brokers who form multiple listing services to facilitate the process of bringing together buyers and sellers.

The broker's salespersons. All of the listing broker's salespeople who have agreed to work for the broker to find a customer are subagents of the listing broker and owe the fiduciary duties to the broker and, by extension, to the broker's client.

Dual agency

Dual agency means representing both principal parties to a transaction. The agent represents both buyer and seller or tenant and owner. For instance, if a salesperson completes a buyer agency agreement with a party on behalf of a broker, and the party then becomes interested in a property listed by the broker, the broker becomes a dual agent.

Dual agency has become increasingly prevalent with the advent of buyer and tenant representation. Dual agency may arise from voluntary, specific agreement between the principal parties or from the parties' actions, much like implied single agency.

Conflict of interest. Dual agency contains an inherent conflict of interest. Since many of an agent's fiduciary duties can only be rendered to one party, dual agency is, by definition, difficult, if not impossible.

Written, informed consent. In states that permit dual agency, the agent must meet strict disclosure requirements, and principals must agree *in writing* to proceed with the dual agency relationship.

Disclosed (voluntary) dual agency. The parties to a transaction may create a dual agency by giving written consent in disclosure forms, confirmation forms, and sale contract forms. For example, an agent represents a buyer who becomes interested in a property that the agent has listed with the seller. The agent then discloses the relationship with the principals to both principals, and the principals agree in writing to move ahead. A disclosed dual agency is thus voluntarily created.

Implied and undisclosed dual agency. If a broker or agent acts in any way that leads a customer to believe that the agent is representing the customer, a dual agency has potentially been created. For example, a buyer makes confidential disclosures to the agent who works for the seller and exhorts the agent to keep them confidential. The buyer wants the house but knows he is going to lose his job in a month and probably will not qualify for financing. If the agent agrees to keep the information confidential, the agent has not only created an agency relationship with the buyer, but is now in a dual agency situation. Moreover, if the agent fails to disclose the buyer's confidence to the seller, the agent has violated fiduciary duty to the seller.

Duties of a disclosed dual agent. A dual agent's first duty is to disclose the agency relationship to both principal parties or to withdraw from one side of the duality. After disclosing, the agent must obtain the written consent of both parties.

If both parties accept the dual agency, the agent owes all the fiduciary duties to both parties except full disclosure, undivided loyalty, and exclusive representation of one principal's interests.

No agency

In recent years, the brokerage industry has striven to clear up the question of who works for whom, and who owes fiduciary duties to whom. A recent solution allows a broker to represent *no one* in a transaction. That is, the broker acts as a **transaction broker**, or **facilitator**, and is not an agent of either the buyer or seller. In this relationship, the facilitator does not advocate the interests of either party.

Duties of the transaction broker, or facilitator. In the role of transaction broker, the broker's duties and standards of conduct are to

- ▶ account for all money and property received or handled
- ▶ exercise reasonable skill and care
- ▶ provide honesty and fair dealing
- ▶ present all offers in a timely fashion
- ▶ assist the parties in closing the transaction
- ▶ keep the parties fully informed
- ▶ advise the parties to obtain expert advice or counsel
- ▶ disclose to both parties in residential sale transactions all material facts affecting the property's value
- ▶ protect the confidences of both parties in matters that would materially disadvantage one party over the other.

Duties not imposed on the transaction broker. Since there are no fiduciary duties binding the transaction broker, the broker is held to standards for dealing with customers as opposed to clients. These include honesty, fair dealing, and reasonable care. The transaction broker is under no obligation to inspect the property for the benefit of a party or verify the accuracy of statements made by a party.

As state regulatory authorities formalize the facilitator role, it is expected that brokers will have to obtain written consent from the principal parties, just as in the case of dual agency.

No subagency

As another response to the problem of 'who works for whom,' some states have recently moved in the direction of disallowing subagency. In this scenario, subagency is replaced by buyer agency and seller agency *only*. In other words, an agent either represents the buyer directly, or the seller directly. An agent who shows a buyer a property either represents the buyer, or is in fact the listing agent. Note that this arrangement need not change traditional compensation structures: an agent may represent a buyer and still receive a portion of the commission paid by the seller.

AGENCY DISCLOSURE RULES

Objectives of disclosure
Seller agent disclosures
Buyer agent disclosures
Dual agent disclosures
Facilitator disclosures

Traditionally, brokers and agents have disclosed to customers whose interests it is that they are serving. This traditional ethic is now, in many states, required by law. Agents must know what agency disclosures they have to make, to whom, and when in the business relationship they must make them.

Objectives of disclosure

Disclosure removes confusion about who an agent is working for. It may obviate complaints arising from customers and clients who feel they have been deceived.

Specifically, the requirement to disclose aims to:

- ▶ notify clients and customers about whom the agent represents
- ▶ inform clients and customers of the fiduciary duties and standards of care the agent owes them
- ▶ inform prospective clients and customers that they have a choice in how they are represented
- ▶ obtain acknowledgement and acceptance of the disclosure from the principal parties

Recent legislation requires an agent to disclose to all parties the fact that the agent represents one party and does not represent the other. In other words, an agent must inform client and customer that the agent represents the client and does not represent the customer (unless it is a dual agency). An agent must disclose agency relationships whenever there is a transfer of a real estate interest, whether the interest is a fee, partial fee, exchange, leasehold, sublease, assignment, air right or subsurface right.

Seller agent disclosures

Client disclosure. Depending on state regulations, an agent who intends to represent a seller or owner must disclose the import of the proposed agency relationship in writing before the listing agreement is executed. The agent must inform the seller or landlord in writing that the agent will be representing the client's interests as a fiduciary, and will not be representing the interests of any potential buyer. Any subsequent sale or lease contract with a customer should confirm this disclosure.

Customer disclosure. A listing agent must disclose in writing to a buyer or tenant that the agent represents the owner in the transaction. This disclosure must occur before or at the first "substantive contact" with the customer prospect. The disclosure must also be confirmed in any subsequent sale or lease contract.

Substantive contact. Subject to variations in state regulation, "substantive contact" between listing agent and customer occurs whenever the agent is:

- ▶ showing the prospect a property
- ▶ eliciting confidential information from a prospect regarding needs, motivation, or financial qualification
- ▶ executing a contractual offer to sell or lease

Exclusions. Interaction between a seller's agent and a customer is not always substantive. Possible instances that might be excluded from the requirement of disclosure are:

- ▶ attendance at, or supervision of, an open house, providing the agent does not engage in any of the contacts described above
- ▶ preliminary "small talk" concerning price ranges, locations, and architectural styles
- ▶ responding to questions of fact regarding advertised properties

Oral disclosure. If an agent becomes involved in a substantive contact over the phone or in a such way that it is not feasible to make written disclosure, the agent must make the disclosure orally and follow up with a written disclosure at the first face-to-face meeting.

Buyer agent disclosures

Client disclosure. An agent who plans to represent a buyer or tenant must disclose the import of the proposed agency relationship in writing before the representation agreement is executed.

Customer disclosure. A buyer agent must disclose the agency relationship to the seller or seller's agent on first contact. Substantive contact is assumed.

Dual agent disclosures

Informed written consent. An agent who desires to operate in a dual agency capacity must obtain the informed written consent of all parties. Subsequent contracts should confirm the disclosure. "Informed written consent" means both parties have read, understood, and signed an acceptable disclosure form.

Prohibited disclosures. State regulations prohibit a dual agent from making certain disclosures. For instance, a dual agent, unless expressly instructed by the relevant party, usually cannot disclose:

- ▶ to the buyer that the seller will accept less than the listed price
- ▶ to the seller that the buyer will pay more than the price submitted in a written offer to the seller
- ▶ the motivation of any party concerning the transaction
- ▶ that a seller or buyer will agree to financing terms other than those offered

Facilitator disclosures

Rules for disclosing a transaction broker's status of non-agency are similar to those of dual agency. The agent must provide written notice to all parties or their agents on first becoming a transaction broker or on the first substantive contact, whichever comes first.

11 Agency Snapshot Review

THE AGENCY RELATIONSHIP

- Basic roles**
- principal, or client, hires agent (broker) to find a ready, willing, and able customer (buyer, seller, tenant); client-agent fiduciary foundations: trust, confidence, good faith
- Types of agency**
- universal: represent in business and personal matters; can contract for principal
 - general: represent in business matters; agent can contract for principal
 - special: represent in single business transaction; normally agent cannot contract for principal; the brokerage relationship is usually special agency
- Creating an agency relationship**
- created by express written or oral agreement or as an implied agreement by actions of either party
- Terminating an agency relationship**
- causes: fulfillment; expiration; mutual agreement; incapacity; abandonment; or destruction of property; renunciation; breach; bankruptcy; revocation of license

FIDUCIARY DUTIES

- Agent's duties to the client**
- skill, care, diligence; loyalty; obedience; confidentiality; disclosure; accounting
- Agent's duties to the customer**
- honesty and fair dealing; exercise of reasonable care and skill; proper disclosures; danger areas: misrepresentation; advising beyond expertise
- Principal's duties**
- availability; provide information; compensation
- Breach of duty**
- liabilities: loss of listing, compensation, license; suit for damages

FORMS OF REAL ESTATE AGENCY

- Single agency**
- seller agency; buyer agency; tenant representation
- Subagency**
- outside brokers and agents who help listing agent; listing broker's own agents
- Dual agency**
- representing both sides; potential conflict of interest; must disclose, obtain written consent; types: voluntary by consent; involuntary by actions of parties (implied agency); duties: all but full disclosure and loyalty
- No agency**
- "facilitator" or "transaction broker"; representing neither party in the transaction; duties to both parties: accounting; skill, care and diligence; honesty and fair dealing; disclosures affecting property value

AGENCY DISCLOSURE

- Objectives of disclosure**
- declare; explain; offer choice; obtain documented consent
- Seller agent disclosures**
- to client: in writing on or before listing is executed; to customer: prior to substantive contact, in writing; oral permitted but must have written follow-up
- Buyer agent disclosures**
- in writing; upon first contact with listing agent or seller
- Dual agent disclosures**
- "informed, written consent"; may not disclose: price or financing positions or motivations unless authorized
- Facilitator disclosures**
- on becoming transaction broker or on substantive contact whichever is first