Manning & Kass, Ellrod, Ramirez, Trester LLP

Real Estate Legal Update

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Another Bad Case for Brokers: Sales Agents, Not Only the Broker, Owe Fiduciary Duties to Buyer and Seller in Dual Agency Transactions

By Fredric W. Trester

The recent case of *Horiike v. Coldwell Banker Residential Brokerage Company* complicates the duties of a real estate salesperson representing both the buyer and the seller.

Facts

In *Horiike*, Coldwell Banker represented both the buyer and seller in a high-end property transaction, through two different sale agents. The buyer alleged a breach of fiduciary duty against Coldwell Banker claiming its listing agent significantly overstated the property's square footage in advertising materials. The listing agent listed the property as being approximately 15,000 square feet, notwithstanding the building permit listed the total square footage as 11,050 square feet. After one cancelled transaction, the listing agent deleted the square footage from the MLS. When the buyer made an offer, he was given a flyer by his agent, which contained the 15,000 square foot representation. The buyer's agent also provided the buyer with the permit which specified the smaller square footage.

In This Issue

Firm News

Manning & Kass, Ellrod, Ramirez, Trester LLP is celebrating its 20th Anniversary. This important milestone is a reflection of the tireless work of MKERT's dedicated team of attorneys and staff, as well as a validation of the strong dedication to the community and California's businesses forged over two decades.

The Trial

At trial, Coldwell Banker took the position that it could not be liable to the buyer for breach of fiduciary duties arising from the listing agent's conduct, even in a dual agency situation, because the listing agent was not a fiduciary to the buyer.

The trial court accepted that position. The jury found that there was no intentional misrepresentation or concealment by the listing agent. Although he made a negligent misrepresentation, he had a reasonable basis for believing the representation was true (apparently based on a letter from the architect confirming the higher square footage).

The Appeal

The Court of Appeal reversed the decision to the extent the court ruled Coldwell Banker and the listing agent could not be liable for breach of fiduciary duty. The court analyzed the statutory scheme and found if a broker is the fiduciary to a particular principal, then so are both agents in a dual agency situation.

The Impact of the Decision on Brokers

The *Horiike* decision is palpably a bad decision for brokers. Most agents do not fully comprehend when they are representing the seller in a dual agency situation, they owe the same duties to the buyer. And, why would they?

Civil Code § 2079.16 provides for the dual agency disclosure. It states in the section describing dual agent as "agent representing both seller and buyer." It continues "a real estate agent, either acting directly or through one or more associate licensees, can legally be the agent of both the seller and the buyer in a transaction." Further, in a "dual agency situation, the agent has 'affirmative obligations to the both the seller and the buyer,' " including "[a] fiduciary duty of utmost care, integrity, honesty and loyalty in dealings with either the seller or the buyer." *California Civil Code* § 2079.16.

These provisions are confusing because of the use the term "agent." To understand the meaning of the term, one must consult definitions in *Civil Code* § 2079.14 through 2079.24 which include:

> "'agent' means a person acting under the provisions of Title 9 ... in a real property transaction, it includes a person who is licensed as a real estate broker under Chapter 3 ... of the Business and Professions Code, and under whose license the listing is executed or an offer to purchase is obtained." *Civil Code* §2079.13(a).
>
> "'associates licensee' means a person who is licensed as a real estate broker or sales person ... and who is either licensed under a broker or who has entered into a written contract with a broker to act as the broker's agent ..." *Civil Code* § 2079.13(b).
>
> "'dual agent' means agent (*i.e.* broker) acting, either directly or through an associate licensee, as agent for both the seller and buyer in a real property transaction." *Civil Code* § 2079.13(d).

The Real Estate Reference book published by the DRE, states:

> "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 ...

> transaction. Under the 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. ..."

In view of the above, it can be argued only the broker is the dual agent as the "agent" includes a person who is licensed as a real estate broker. In *Horiike*, the "agent" was Coldwell Banker. The associate licensee was the listing agent. As such, under the associate licensee definition, when an associate licensee (*i.e.* a sales person) owes a duty to a principal, the broker owes an equivalent duty to the principal. In other words, the broker owes the same duty to a party to the transaction that the broker's associate licensee owes to that party. However, there is nothing in this statute that says any two associate licensees, even in a dual agency transaction, owe equivalent duties - only that the broker for whom the associate licensee's function owed such duty.

Impact on Associate Licensees

If associate licensees have fiduciary duties to parties to a transaction in addition to their own client, the scope of the licensees agency responsibilities would expand significantly and unreasonably. In the *Horiike* transaction, it would mean not only would the listing agent have fiduciary duties to a seller, but to the buyer as well. Similarly, buyer's agent would owe fiduciary duties to the seller.

Continuing Challenges Created by Horiike

This presents an almost impossible situation for an agent, as under NAR ethical rules salespersons are not supposed to communicate directly or coordinate with other parties who are represented by another agent. Indeed, the practical effect of this case will prevent future dual agency from occurring in the future because such broad and amorphous duties will cause professional liability insurers to exclude dual agency transactions from coverage.

Coldwell Banker's attorney argued that while duties of the sales associate are imputed to his/her broker (*respondeat superior*), the converse is not true (there is no "respondeat inferior doctrine"). Further, the fact Caldwell Banker may have been the buyer's fiduciary should not, by operation of law, render every sales associate affiliated with Coldwell Banker the buyer's fiduciary. Instead, a more practical rule, and one that could be better understood by sales associates and their clients, is that only the sales associate would owe the fiduciary duties to their principals (who the sales associate agreed to represent and who the principal hired). This is consistent with the laws of agency where a principal may be liable for the acts of an agent, but an agent is not liable for the acts of a principal. Imagine if any agent's knowledge in a corporate broker with a thousand agents, became the knowledge of every agent in the entire corporate brokerage.

Recommendation

In view of the above, and until this bad case is reversed, salespersons need to be aware that when they believe they are representing a buyer in a dual agency situation they are also representing the seller. As if it was not hard enough to understand all the legal complexities of agency relationships in real estate transactions, this case just made it harder.

Court Says MLS Information Updates are Unnecessary if True When Initially Posted

By David Gorney

Saffie v. Schmeling, (March 7, 2014) CA 4th District Court of Appeal, Division 2, Case No. E055716.

All real estate licensees should know they need to be scrupulously truthful and accurate about information placed into the Multiple Listing Service ("MLS") to avoid incurring personal responsibility "to anyone injured by their falseness or inaccuracy."

Civil Code, section 1088 holds a broker " ... *responsible* for the truth of all representations and statements made by the agent [in an MLS] ... of which that agent ... had knowledge or reasonably should have had knowledge"[emphasis added].

But what happens if that information becomes inaccurate, incomplete, misleading or is superseded over time? Does the seller's broker need to update, correct or supplement the MLS?

According to the recent court ruling in *Saffie v. Schmeling*, as long as the information was not "false or inaccurate" when listed, there is no duty to supplement new information, even if the information is outdated or becomes inaccurate over time.

Facts

In June 2006, a seller's broker made the following statement in the MLS about some raw land for sale:

> This parcel is in an earthquake study zone but has had a Fault Hazard Investigation completed and has been declared buildable by the investigating licensed geologist. *Report available for serious buyers*. (Emphasis added)

The May 20, 1982 Fault Hazard Investigation report (FHI) prepared by a registered geologist found "no evidence of an active fault," stating, "any ground rupture and displacement on a fault are unlikely to occur on the subjects property." Two months later, a Riverside County Planning Department engineering geologist issued a "final approval" letter based on the FHI report affirming the FHI report was "performed in a competent manner" consistent with state and county law.

Before escrow closed, seller's broker gave buyer's broker copies of the FHI report and the Riverside County letter which, in turn, were given to buyer who wanted to build a commercial structure on the site. Buyer's broker did not read the information and claims to have told buyer to "check out" the information. Neither buyer nor buyer's broker performed a further seismic investigation before escrow closed.

Unfortunately, when buyer began development work, the County told him the FHI report and County letter no longer applied since County standards and rules had changed after the 1994 Northridge earthquake. The additional development costs associated with complying with new earthquake standards made development financially unfeasible and buyer sued the seller and the both brokers for damages.

Trial and Appellate Court Proceedings

Both the trial and appellate court exonerated the seller and his agent based on observing the information in the MLS was accurate and true despite the contention the MLS information was false and inaccurate due to the passage of time and changed events.

The court noted the seller's broker never declared the property was currently "buildable", only the property "*has been*

declared buildable" by a licensed geologist, and those statements were true. To the extent this parsing of words could be viewed as a mischaracterization, the court said it was "cured" by actually providing the FHI report and County letter to buyer and his broker, whose dates were readily apparent.

Conclusion

The court concluded there was no law imposing the responsibility on the seller's broker to make certain that the statements in the MLS were not misinterpreted, or to ensure that the buyer and the buyer's broker "perform the appropriate due diligence to evaluate the significance of such true statements for the buyer's particular purpose."

What Happened to the Buyer's Broker?

Where was the buyer's broker in all this? The trial court record reveals the buyer's broker was *found liable*, and was ordered to pay $232,147.50 (plus court costs), to the buyer for improperly influencing and misrepresenting to buyer he should rely on the FHI report as being 'current' and not outdated or stale. The trial court found the buyer's broker should not have made such representations without checking it out "personally." There are no detailed discussions of this point in the published court of appeal decision because, following the judgment, the buyer's broker declared bankruptcy. This left the buyer with no alternative but to pursue the seller's broker having elected not to appeal the trial court's finding in seller's favor. It appears the buyer's broker had no E&O insurance and, consequently, the seller's broker was forced to spend time and treasure litigating because the buyer's broker was judgment proof.

Statutory Transfer Disclosure Statement is Required in Mixed Use Property Transactions

By Fredric W. Trester

If you are selling mixed used property, don't forget the Statutory Transfer Disclosure Statement (TDS) required under California law. The seller in the case of *Richman v. Hartley* learned this the hard way.

Facts

Hartley contracted to buy Richman's property consisting of a commercial building and a residential duplex. An AIR Contract was used which includes a standard form entitled "Seller's Mandatory Disclosure Statement." Hartley backed out before the close of escrow. Richman sued him for breaching the agreement. Hartley prevailed because he did not receive a TDS.

Analysis

The court analyzed the statutory language of California Civil Code §1102(a) which states that the transfer disclosure law applies to sales of "real property...improved with or consisting of not less than one nor more than four dwelling units."

The court distinguished other statutes, such as California Civil Code § 2079, which references the term "Residential Real Property" and specifically apply to "sales of residential real property" defined as containing only 1-4 family residences.

Conclusion

The property at issue in the instant case was a mixed use property. The court found that since the applicable statute refers to "real property" – as opposed to "residential real property" – the seller was required to deliver the TDS.

It should also be noted that under California law, there can be no waiver of the delivery of a TDS. A failure to provide the TDS gives the buyer an absolute right of rescission.[1]

The court's straight-forward analysis of the TDS statute clarifies the scope of the disclosure requirements under California law, finding that a TDS is required in mixed use property transactions.

What is New in the Realm of Real Estate: Trends in Claims and Coverage

By Rinat Erlich

In the last seven years, we have seen the housing market reach unimaginable extremes.

With the market currently on the rise, real estate professionals who previously abandoned the industry are back and the same old practices have re-emerged. This has changed the landscape of how carriers approach claims and coverage.

Fraudulent Activities

With the real estate market on the rise, so too are incidents of fraudulent transactions resulting from appraisers, brokers, and property managers who stretch their limits to remain competitive in an oversaturated market.

Brokers entice investors with pocket listings. Multiple offers are made on the same transaction. And real estate professionals are forced to push the boundaries of their responsibilities in order to close a deal.

[1] *See Realmuto v. Gagnard* (2003) 110 Cal App 4th 193; *Loughrin v. Superior Court* (1993) 15 Cal App 4th 1188; and Civil Code § 1102(c) ("any waiver of the requirements of this article is void is against public policy.")

Consequently, carriers focus more attention on the possibility of such activities when underwriting coverage.

Expanding Role of Brokers

While crash of the housing market weeded out inexperienced real estate professionals, the current market upswing demands brokers to expand their roles which, in turn, expands their legal risks.

Nowadays, brokers find themselves acting as property managers or preservationists increasing potential exposure to negligence lawsuits (e.g. a slip and fall that occurs on the property).

In another trend, lenders frequently require brokers to sign indemnity agreements favoring the lender. This poses a new risk for brokers who may find themselves liable for someone else's wrongdoing.

Occurrences of dual agency—when a broker or salesperson represents adverse parties — are also more prevalent. Unfortunately many real estate professionals may not even be aware of the subtle situations in which this relationship arises.

New Types of Claimants

Claims made by third parties—other than the traditional buyer or seller—are also on the rise. For example, the FDIC is bringing a larger number of actions against real estate professionals who procure bad loans. Disgruntled borrowers continue to sue appraisers while trust managers are going after brokers.

Curiously, despite the increased number of third party claims and expanding broker duties, the frequency of such claims has yet to increase. The lack of increased claims is arguably a result of fewer transactions over the past three years and the departure of many real estate professionals. Another

theory is that when property values go up, parties are happy and there is no reason to complain.

Tighter Regulatory Control

Today, real estate professionals are subject to tighter regulatory control. The Bureau of Real Estate (BRE), California State Bar, and Attorney General have brought actions against a significant number of real estate agents under new regulations, such as those imposing liability for a broker's failure to report fraudulent conduct. The trend also includes pursuing property managers and their trust accounts.

The California Secretary of State (SOS) and Bureau of Real Estate Appraisers (BREA) have also increased their efforts to combat fraudulent transactions. For example, the SOS now issues citations to notaries for losing their notary books. Likewise, the BREA is now issuing citations for appraisers making mistakes in their appraisal reports.

New Challenges In Underwriting

As one could imagine, the recent industry trends create many challenges to the underwriting process. Carriers must analyze insurance applications more cautiously and insist on new exclusions.

Insurance applications include questions such as:

- Is the broker related to a developer?
- Is there a potential for FDIC claims?
- How many transactions does the broker act as a dual broker?
- What procedures are in place to avoid liability arising from dual agency?
- Did the agent act as an appraiser?
- Did the agent provide Broker Price Opinions?
- Did the agent or broker act as a property manager?

Carriers Aim for Profitability and Creativity

In the past, carriers have avoided California. They are now beginning to return and seek for new avenues to profit. In doing so, they cautiously evaluate certain factors including:

- Does the carrier have a choice of counsel?
- Should the panel be smaller or larger?
- Is self-insured retention higher?
- Does the policy cover administrative grievances?

All of these trends in the marketplace required more creative benefits including offerings like vanishing deductibles, environmental hazard coverage, personal injury, discrimination, and a broader definition of professional services.

Whether these trends benefit consumers has yet to be seen, but even if they do not, there is one thing we know about California–that change will come.

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