

# 10 Agency

## INTRODUCTION

The primary purpose of this chapter is to provide a general understanding of the concepts of agency and fiduciary duty so that real estate licensees may better fulfill their responsibilities to the public.

The concepts of agency and fiduciary duty are quite old, being derived from Common Law. According to Civil Code Section 2295 (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.

## CREATION OF AGENCY RELATIONSHIPS

A principal and agent can create an agency relationship by:

- agreement between them;
- by ratification;
- by estoppel; or
- as the result of the conduct of the parties and the agent’s inherent relationship with third parties (i.e., ostensible or implied agency).

(Regarding ratification and estoppel, see the discussion titled “AUTHORITY OF AGENT” below.)

### Actual Agency

Most often, a real estate broker and a principal in a real property or real property secured transaction place the broker in the capacity of *agent* by an express agreement. This is called an actual agency. (Civil Code Section 2299)

A broker has a duty to know and understand the agency relationship being constructed. The broker must be certain that the employment agreement with the principal (typically termed a “listing”) is in a correct form and is constructed according to the circumstances and in a fair manner.

An agency agreement must be in writing for the agent to enforce a commission claim based upon a breach of contract. [Civil Code Section 1624(d)]

### Elements of an Agency Agreement

An agency agreement/listing typically includes:

1. the names of the parties;
2. effective identification of the property;
3. 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 (An exclusive listing *must* include a definite, specified date of final and complete termination.); and

6. signatures of the parties to the listing.

In addition, an agency agreement/listing concerning the sale of residential property of one to four units, or a mobilehome, must contain, immediately before the commission clause, a statement in ten point boldface type or larger that commission amounts are not set by law but are negotiable between seller and broker. Business and Professions Code Section 10147.5 sets forth the exact wording which must be used. A real estate broker may deem it prudent to include such a statement in all transactions where the broker is acting within the course and scope of the real estate license.

### Types of Listing Agreements

The four kinds of listing agreements most commonly used are:

- the open listing;
- the exclusive agency listing;
- the exclusive right to sell listing; and
- the net listing.

**Open listing.** An open listing is the least restrictive 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 could defeat the original broker's right to a commission.

**Exclusive agency.** An exclusive agency is an agreement by which the owner agrees to employ a particular real estate broker to solicit prospective 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 the broker has no claim to a commission or other compensation.

**Exclusive right to sell.** The exclusive right to sell listing affords a real estate broker the greatest protection and makes him or her the sole agent for the sale of the property. The broker is entitled to a commission provided only that the property is sold during the listing period, regardless of who procures the buyer. 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 the property him or herself. An exclusive right listing may also be used in a rental or loan transaction.

**Net listing.** A net listing is one which contemplates the seller realizing certain net proceeds. The real estate broker's commission is any sum received in excess of the seller's net. For example, if the seller enters into a net listing with a broker for a \$100,000 net, the broker would receive no commission if the net proceeds of the sale are \$100,000 or less. On the other hand, if the net proceeds of the sale are \$125,000, the broker is entitled to a commission of \$25,000. This type of listing has more to do with the type of compensation than with whether it is exclusive or not.

**Unilateral and bilateral agreements.** An 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 an open listing the seller agrees to pay

compensation to a real estate broker who procures a buyer, but there is no obligation on the part of any 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, an exclusive right to sell listing includes a broker's promise to use due diligence in attempting to find a buyer. In exchange, the seller promises to pay the broker a commission if the broker is successful.

### **Multiple Listing**

A multiple listing service (MLS) is a means by which information concerning individual listings is distributed to all participants and subscribers of the service. For example, assume a seller lists property for sale with a broker. Pursuant to the listing, the broker transmits to the MLS information about the property which includes information such as the type of property, its size, location, listed price and other relevant information as well as the compensation offered to other brokers who procure a buyer. The MLS publishes the information in a database and sometimes in book format. Other brokers throughout the region are thereby made aware of the listing and can show the property and contact the listing agent on behalf of prospective buyers.

When a resultant sale closes, the listing broker makes good on his unilateral offer to split the commission with the selling broker.

### **Ostensible or Implied Agency**

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. Agency relationships created from the actions or conduct of the parties are known as ostensible or implied agencies.

For example, a listing broker can unintentionally become the agent of the other principal to a transaction by leading the buyer to believe they are negotiating on behalf of or advocating the interest of the buyer when presenting the offer to the seller, or when processing the transaction to close of escrow. [To act as an undisclosed agent of the other principal (i.e., without the informed consent of both parties), may subject the broker to administrative discipline and/or loss of commission, and may be grounds for rescission of the transaction. [Business and Professions Code Section 10176(a) and (d)]

(See also "AUTHORITY OF AGENT" below.)

### **Compensation**

Compensation is not essential to the creation of an agency. One may undertake to act gratuitously as an agent and 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 source of payment, a license is required. (Business and Professions Code Sections 10130, et seq.)

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 establish licensed activity.

## AUTHORITY OF AGENT

An agent has authority to:

- Do everything necessary, proper or usual in the ordinary course of business to effect the purpose of the agency; and
- Make representations as to facts, not including the terms of the agent's authority, on which the agent's right to use his or her authority depends, and the 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 Section 2319)

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 Section 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 Section 2317) Ostensible authority is sometimes referred to as apparent or implied authority.

### Express Authority

Again, express authority is created by a contract which completely and precisely delineates those activities the agent is authorized to undertake. For example, if the principal authorizes the agent to acquire a particular single-family residence for \$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.

### 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 objectives of the agency. In the example above, the agent had express authority to purchase a particular property at a certain price. The agent might have implied authority to set 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 buyer.

Implied authority cannot conflict with express 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.

### Apparent Authority

Apparent authority depends not upon the express or implied agreement between principal and 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 could 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/her detriment, upon this authority. The most common causes of questions concerning apparent authority are the principal's placement of a limitation upon the normal and ordinary authority of the agent and failure to communicate this limitation to a third party dealing with the agent.

**Liability of principal to third parties.** The principal is liable to persons who have sustained injury through a reasonable reliance upon the ostensible, whether implied or apparent, authority of an agent. The act of the agent can never alone establish ostensible 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.

### **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.

### **Restrictions on Authority**

An agent who is given the power to sell 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.

An agency to sell 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 to find a buyer, but does not authorize the agent to enter into a contract to convey title to the property on behalf of the principal.

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.

### **Ratification of Unauthorized Acts**

Occasionally, a person may act as agent without authority to do so, or an 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:

1. The agent must have professed to act as a representative of the principal.
2. The principal must have been capable of authorizing the act both at the time of the act and at the time of ratification.

3. The principal must have knowledge of all material facts unless ratification is given with the intention to ratify no matter what the facts are.
4. The principal must ratify the entire act of the agent, accepting the burdens with the benefits.
5. The principal must ratify before the third party withdraws.

Generally, an act may be ratified by any words or conduct showing an intention on the part of the principal to adopt the agent's act as the principal's own. Once ratified, the legal consequences are the same as though the act had been originally authorized.

### **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 the purpose and scope of the agency.

### **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 (limited) 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.

### **Authority to Receive Deposits**

Virtually all listing agreements now 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.

Except for a check to be held uncashed until acceptance of the offer, as discussed below, a broker must place funds accepted on behalf of another into the hands of the owner of the funds, into a neutral escrow depository or into a trust fund account in the name of the broker as trustee at a bank or other financial institution not later than three business days following receipt of the funds by the broker or the broker's salesperson.

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. Similarly, money received by 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.

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. In general, the broker may not return the funds to the buyer without the consent of the seller.

**Check.** A broker who accepts a check (or promissory note) as an earnest money deposit must make full disclosure to the seller.

If a buyer has given a check to the broker as an earnest money deposit with written instructions to hold 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.

During the time between receipt of the check by the broker and acceptance of the purchase offer by the seller, the broker must record receipt of the check on broker's trust fund records and hold the check in a safe place. (Real Estate Commissioner's Regulations 2831 and 2832)

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 more often uses electronic 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, amount, and disposition of the earnest money deposit.

**Promissory note.** While checks are universally accepted as equivalent to cash 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 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 as the note requires, and failure to pay is generally not a crime.

A broker violates the Real Estate Law if he/she directly or impliedly misrepresents to broker's principal/seller that a purchaser has given cash or a check as an earnest money deposit when in fact the broker has accepted a non-negotiable promissory note.

**Escrow depository.** When a buyer deposits earnest money directly into a neutral escrow, the delivery is conditional. While it may be argued that the buyer retains title to the money until the conditions have been performed, the escrow holder will generally not return the earnest money deposit to the buyer without concurrence of the seller. If a transaction does not close as agreed, it is the obligation of buyer and seller to insure that all funds deposited into escrow are given to the person who is entitled to the money.

If the buyer and seller are unable to resolve a dispute regarding an earnest money deposit, the escrow holder may file an interpleader action seeking declaratory relief from the court. The cost of such action will typically be deducted from the earnest money deposit.

If buyer and seller perform as agreed, the escrow holder becomes the agent of the seller as to the purchase money and the agent of the buyer as to the deed. At closing, the escrow holder delivers the money to the seller and the deed to the buyer.

### **Dismissal of Broker/Stakeholder From Suit**

A real estate broker may be named as a defendant in a law suit for recovery of money the broker is holding as a trustee in a transaction. If the only relief sought against one of several defendants is payment of a stated amount of money, such defendant may, after notice to the other parties, apply to the court for an order of discharge from liability and dismissal from the action. Again, this is known as an interpleader action. The defendant

broker must deposit with the clerk of the court the money in dispute. The court may then dismiss the suit as to defendant broker.

A 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 and deposit the fund with the court. 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.

### **Commingling**

An agent who places a client's money in the agent's personal bank account is guilty of commingling and risks attachment of the funds for personal claims against the agent. Except for a check to be held until acceptance, a real estate broker must, within three business days of receipt, place all funds received on behalf of principals in a trust account, neutral escrow depository or into the hands of the principal who is entitled to them. If the broker fails to do so, the broker's license may be subject to disciplinary action by the Commissioner. A salesperson should immediately deliver all deposits into the hands or into the control of salesperson's broker, or as may be instructed by the broker.

### **Agency Disclosure Form**

Sections 2079.13, et seq. of the Civil Code establish an agency disclosure format for sale transactions involving residential property improved with one to four dwelling units. This disclosure format also applies to leases of such residential property for longer than one year and to sale of a mobilehome under authority of a real estate broker's license. A "sale" includes an exchange of the property, or a sale by real property sales contract as defined in Civil Code Section 2985.

The agency disclosure form sets forth 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 a dual agent. The text of the form is set forth in Section 2079.16 of the Civil Code. Sections 2079.13 through 2079.15, inclusive, and 2079.17 through 2079.24, inclusive, must be printed on the back of the form.

The listing broker (or his or her agent, whether salesperson or broker associate) must deliver the form to the seller before entering into a listing agreement. The selling broker (or his or her agent) must provide the form to the seller as soon as practical and before presenting the offer. If the selling broker does not deal face to face with the seller, the form may be delivered by the listing broker. The agency disclosure form may also be delivered to the seller by certified mail. The selling broker must deliver the form to the buyer as soon as practical before the buyer signs the offer to buy. If the offer is not prepared by the selling broker, the form must be delivered to the buyer no later than the next business day following receipt of the offer from the buyer. [Civil Code Section 2079.14 (d)]

(A broker associate is a real estate broker who has entered into a written contract to act as the salesperson/agent of another broker in connection with acts requiring a real estate license and to function under the employing broker's supervision. As used in this chapter, the term "salesperson" includes "broker associate.")

A broker must obtain a receipt from the principal receiving the disclosure. When the disclosure form is delivered by certified mail, no further receipt is required. If a seller or

buyer refuses 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 Section 2079.15)

The disclosures are essentially as follows:

- the duty of utmost care, integrity, honesty and loyalty in dealings with the agent’s principal;
- 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 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.

### **Disclosure and Confirmation of Actual Agency Relationships**

As soon as practicable, a listing agent must disclose to the seller whether the listing agent is acting exclusively as the seller’s agent, or as a dual agent representing both the seller and the buyer.

As soon as practicable, a selling agent must disclose to the buyer and seller whether the agent is acting exclusively as the buyer’s agent, exclusively as the seller’s agent, or as a dual agent representing both the buyer and seller. The term “exclusively” is generally understood to mean the agent acting for the principal in that transaction as contrasted with the dual agency in the same sales contract and does not mean the listing or selling agent does not have other clients. It does not preclude, for example, the listing broker from representing other sellers or the selling agent from representing other buyers.

The disclosed agency relationships must be confirmed in writing, either in the purchase agreement or in separate writings executed or acknowledged by seller, buyer, and agent(s), prior to or coincident with execution of the contract.

These disclosure requirements and the form of the written confirmations are contained in Civil Code Section 2079.17.

### **Statutory Limitations and Definitions**

In addition to establishing disclosure requirements, Civil Code Sections 2079.13, et seq. impose various limitations on the conduct of, and add definitions regarding the performance of, the *agency* role of the real estate broker acting in a sale transaction. Among such limitations and definitions are the following:

1. A listing broker who is also a selling broker is a dual agent and cannot be the agent of the buyer only. (Civil Code Section 2079.18)
2. The source of compensation to a broker does not in and of itself determine who is that broker’s principal. (Civil Code Section 2079.19)
3. A real estate broker functioning as a dual agent may not disclose to the seller that the buyer is willing to pay more than 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. (Civil Section 2079.21)
4. A listing broker may also be the selling agent without necessarily becoming a dual agent. (Civil Code Section 2079.22)

Section 10176(d) of the Business and Professions Code requires that a licensee may act for more than one party to any real estate transaction only with the knowledge or consent of all parties to the transaction.

When applying Section 10176(d), it is prudent for licensees to get written consent and not rely on knowledge of the parties alone.

### ***More on Dual Agency***

Dual agency arises where the listing broker who is the actual agent of the seller becomes also the actual agent, or ostensible or implied agent, of the buyer.

Dual agency also commonly arises when two salespersons associated with the same broker undertake to represent two or more parties to a transaction. The real estate broker is then a dual agent.

Although dual agency is a common practice in California, a real estate broker who represents both parties must act with extreme care.

In any dual agency situation, the broker owes fiduciary duties to both principals. Dual agents face a particular difficulty with the elements of fiduciary duty which involve loyalty and confidentiality. Typical examples arise in connection with the negotiation of price and terms between seller and buyer and negotiation of loan amount and terms between lender and borrower.

The Legislature recognized this conflict when enacting Section 2079.21 of the Civil Code. That section states, in part: "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."

A form of dual agency which has not been specifically addressed in the disclosure statutes is a broker's presentation of offers on behalf of two different buyers. This can easily happen when a broker is showing the same property to two prospective buyers and both buyers want the broker to write an offer on the property. The situation becomes even more complex if buyer A is in contract and buyer B makes a back-up offer. Buyer A's position is almost certainly weakened and buyer A would have reason to claim that the real estate broker breached fiduciary duties and obligations by participating in the offer by buyer B. A broker should not represent two buyers on the same property without the clear, informed and unequivocal consent of both parties.

### **Subagency**

Real property transactions frequently involve cooperation between two brokers. 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.

A critical element in determining relationships between the parties is whether the principal has agreed to allow the listing broker to delegate some portion of his or her authority to another. A listing usually provides that the listing broker may cooperate and share commissions with other brokers to carry out the purpose and scope of the agency.

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. 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.

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 may be imputed to the seller and the seller may be liable to third parties under the legal theory of respondeat superior.

Likewise, when the cooperating broker is the agent of the listing broker, the negligent acts of the cooperating broker may be imputed to the listing broker and the listing broker may be liable to third parties, again under the legal theory of respondeat superior.

(Remember, pursuant to Civil Code Section 2079.19, the payment of compensation does not *necessarily* determine the nature of the agency relationship between the parties.)

### Delegation of Duties

Agents commonly delegate certain of their duties and their responsibilities to others. Unless specifically forbidden by the principal, the general rule is that such delegation is allowed.

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

- purely mechanical acts;
- acts the agent cannot do alone and the subagent can lawfully perform; and
- acts which common practice has established may be delegated or which the principal authorizes to be delegated.

(Civil Code Section 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 performance of the delegee. Although most agency agreements do not require the *personal performance* of the original agent, the original agent will typically remain liable for the acts delegated to others.

### DUTIES OWED TO 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.

Fiduciary duties include: 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, thereby helping the principal make an informed and considered decision to buy, sell, lease, exchange, borrow or lend.

A salesperson owes a duty to the principal equivalent to the duty owed by the real estate broker for whom the salesperson acts.

### **Loyalty and Confidentiality**

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

A broker may not unite his or her role as an *agent* with his or her *personal* objectives in a 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. As a fiduciary, a real estate broker performing as an *agent* is bound by law to exercise, among other duties, the utmost good faith, loyalty and honesty.

### **Fair and Honest Dealing**

A real estate broker who is the agent of a principal owes a duty of fair and honest dealing to the other party to the transaction. This duty includes the obligation to make a complete and full disclosure of all material facts. A real estate broker owes this duty of full disclosure even though the broker is not the agent and fiduciary of the party to whom the disclosures are 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 party on whose behalf the disclosures are being made. Any misrepresentation or material concealment on the part of the agent may afford the other party grounds for rescission or damages.

### **General Disclosure Duties**

In a fiduciary relationship, it is the duty of the agent 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 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 the 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.

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.

### **Reasonable Care and Skill**

An agent has 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 Section 2079.16 requires “a fiduciary duty of utmost care, integrity, honesty and loyalty.” The reasonable care and skill standard applies 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.

Although real estate brokers as agents and fiduciaries are obligated to fully disclose to a principal all material facts which might influence the principal’s decision concerning any real property or real property secured transaction, they should be aware of a California Attorney General’s opinion (Op. 69/263). This Opinion explains that *race, creed or color is not a material fact* and should not be disclosed, even though the furnishing of such information is at the request of the principal.

### Inspection and Disclosures

Listing and selling brokers have an 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.

After the *Easton v. Strassburger* decision, Civil Code Sections 2079, et seq. were enacted to describe this duty of inspection as follows:

1. 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 the property offered for sale and disclose to the 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 a buyer or is a broker who acts in cooperation with such a broker to find a buyer.
2. This duty also applies to leases of such residential property with an option to buy and to real property sale contracts as defined in Civil Code Section 2985.
3. The standard of care owed by a broker 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 real estate license.
4. The inspection to be performed does not include areas that are reasonably and normally inaccessible to such an inspection. If the property is a unit in a planned development, condominium or stock cooperative, the inspection does not include more than the unit offered for sale, if the seller complies with Section 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.
5. 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.

6. 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.

**Transfer Disclosure Statement.** The results of the brokers' inspections will be included on the Real Estate Transfer Disclosure Statement required by Civil Code Section 1102.3.

**Professional liability insurance.** Section 11589.5 of the Insurance Code provides that no insurer who provides professional liability insurance for persons licensed under the Real Estate Law shall exclude from coverage under that policy liability arising from breach of the duty of the licensee arising under Article 2 (starting with Section 2079) of Chapter 3 of Title 6 of Part 4 of Division 3 of the Civil Code. (An insurer may exclude coverage of liability arising out of a dishonest, fraudulent, criminal, or malicious act, error, or omission committed by, at the direction of, or with knowledge of the insured.)

**Buyer's duty.** 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.

### **No Secret Profit or Undisclosed Compensation**

The courts have unequivocally held that an agent *cannot*:

- acquire any secret interests adverse to the principal;
- make a secret personal profit out of the subject of the agency; or
- conceal the agent's interest in the property being conveyed or encumbered.

If an agent is aware of the amount at which a property may be sold and purchases at a lower amount, reselling and pocketing the difference, the agent will be compelled to disgorge the secret profit.

Claiming or receiving a secret profit or any form of undisclosed compensation is cause for discipline under Business and Professions Code Section 10176(g). 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.

### **Obligations of Real Estate Salespersons**

A real estate salesperson is the agent of a broker and is subject to the same duties and obligations arising out of the fiduciary relationship between the broker and the broker's principal.

A salesperson must disclose to the broker's principal all the information the salesperson has which may affect the principal's decision. Failure 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 employing broker. Moreover, a broker will generally be held liable for damages for acts and omissions of the broker's salesperson.

## **DUTIES OWED TO THIRD PARTIES**

### **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 agent's own authority, the agent does not impliedly warrant the authority of the principal (e.g., the principal's authority or capacity to contract).

### **Regarding 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 performance of the contract. If, however, there is a lack of authority on the part of the agent, the agent is liable for performance of the contract as a principal. The agent could also be personally liable for 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.

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.

### **Regarding 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. 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 are constantly making representations to prospects concerning property being offered for sale. A representation may be merely an expression of opinion or "puffing" on the part of the licensee but it may be reasonably understood by a prospective buyer to be a representation of fact and thus a part of the contract if agreement is reached.

Material representations which are false or misleading may result in liability of the real estate broker. The same may be said with respect to failure on the part of the broker to disclose material facts about the property to a prospective buyer. In addition to incurring liability for damages to the buyer, a broker guilty of overt misrepresentations or failure to disclose material facts may be subject to license discipline by the Department of Real Estate.

### **Misrepresentation: Fraud v. Negligence**

Misrepresentation may be either fraudulent or negligent. 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 bad 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.

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 an *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 on the broker's performance of acts for which a real estate license is required, disciplinary action may be taken against the broker based solely on 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 heard 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.

### **Nondisclosures**

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 oftentimes involve 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 inspection of the property. The courts have sometimes referred to such non-disclosure as negative fraud.

### **"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. Persons of limited expertise and sophistication may tend to rely upon such statements and to purchase property as a result of such reliance.

A statement by a licensee that a house was "in perfect shape," while obviously not literally true, has been described by an appellate court as a representation of a material fact.

### **Torts of the Principal**

While an agent is personally liable for torts which the agent commits, regardless of the liability or absence of liability of the principal, the agent cannot be held liable for torts committed by the principal. For example, if the principal supplies the agent with false information concerning the property and the agent passes this information along to a

prospective buyer in reasonable reliance upon its truth, the agent is not liable to the buyer for what amounts to republishing the misrepresentation.

## RIGHTS OF AGENT

### Compensation - Performance Required Under Employment Contract

**Generally.** To be entitled to a commission in a sale transaction a broker must:

- produce a buyer ready, willing and able to purchase upon the terms and at the price stipulated by the seller; or
- secure from a prospective buyer an offer upon terms and conditions which the seller subsequently accepts.

In the first situation, a real estate broker's right to compensation is based upon the written listing. The listing agreement requires that the broker produce an offer by a buyer ready, willing and able to purchase on the seller's listing terms. A ready and willing buyer denotes one who is prepared to enter into a binding contract while an able buyer is one who has the financial ability 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 not dependent upon the amount of work put into finding a buyer and negotiating a "meeting of the minds" of buyer and seller. 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 is the procuring cause and has earned the compensation.

**Lawful condition.** The payment of a commission under a listing contract may be made dependent on 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 payment was contingent upon the happening of a condition that did not occur. The burden is on the broker to establish that he or she has earned a commission. 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.

**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 buyer ready, willing and able to purchase upon the price and terms in the listing. 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 also well settled that a principal cannot discharge an agent pending negotiations by the agent with a prospective buyer, then effect a sale to that buyer without liability to the agent.

**Agreement between brokers.** An agreement between brokers cooperating in the sale of real property for a division of the commission is not 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.

**Right of principal to secure buyer.** Where the listing is an open one, 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 owner. If 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 a 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 as negotiated.** 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 of it, 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 recognizes an implied promise on the part of the owner to pay the usual or customary commission charged in the neighborhood for like services.

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

**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 in the listing. The readiness and willingness of a person to purchase real property may be shown 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 regarded 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. 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.

**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. In order to protect a right to a commission, the broker should attempt to obtain a separate agreement for the payment of a commission even if it is a listing that 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 agreement. Then, a question may arise concerning the seller's obligation to pay a commission if the sale of the property is not consummated. Whether or not 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.

**Both listing agreement and deposit receipt contract.** A broker's right to a commission usually flows from an employment contract/listing. The execution of a 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.

**Sale to broker's prospect after termination of listing.** A 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 buyer and seller after 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 and is entitled to the agreed compensation.

A broker may include a protective clause in a listing agreement. Under this clause, the seller agrees to pay a commission to the broker if the property is sold within a certain time period after expiration of the listing to a person with whom the broker negotiated while the listing was in effect. Ordinarily, a listing contract which includes such a protective clause requires that the broker give to the owner, within a prescribed number of days after expiration of the listing, a list of prospective purchasers with whom the broker has negotiated.

Even if the broker did not negotiate with anyone during the term of the listing, the seller may waive 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, broker may be entitled to a commission.

**Breach of contract v. tort theory.** The obligation to pay compensation to the broker must be in writing. The broker's right to compensation and the amount are usually set forth in the listing agreement. 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 a buyer and describes the compensation the broker is entitled to receive as a result of accomplishing the purpose and scope of the agency.

Statutory and case law have been interpreted to 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.

## TERMINATION OF AGENCY

Ordinarily, an agency may be terminated by the acts of one or both of the parties or by operation of law. An agency is also terminated by the expiration of its term, the accomplishment of the purpose for which the agency was established, the extinction of its subject matter, or the death or incapacity of either principal or agent.

### When Principal May Revoke Agency

Because the relationship between a principal and agent is a personal one, founded on trust and confidence, the principal has an absolute power under the law to revoke the agency at any time.

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 if revocation is without good cause. If the agency was created by a recorded instrument containing a power to convey or execute instruments affecting real property, revocation of the agency is not effective unless it is in writing, acknowledged, and recorded in the same place as the instrument creating the agency.

### **Effect of Termination**

According to Civil Code Section 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 agent's death, incapacity or renunciation. If the agency is in fact terminated in any of the ways enumerated in Section 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.

### **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.

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 compensation pursuant to the terms of the listing agreement. 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 a commission to a 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 may be a basis for license discipline. See Section 10176(f) of the Business and Professions Code.

## **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.

### **Probate Sales**

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 Section 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 Sections 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 may, with court permission, grant an exclusive right to sell the property for a period of not to exceed 90 days. (Probate Code Section 10150)

The broker's compensation and the court confirmation procedure are set forth in Probate Code Sections 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 Sections 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 attempt to establish that the executor or administrator of the estate has exposed the property to the market. (Probate Code Sections 10160, et seq.)

When an offer has been received which the representative has accepted subject to court confirmation, the representative will petition the court to confirm the sale. When the court has set the matter for hearing, any interested person may bid at the time of the hearing. To open the bidding there must be an increase over the bid returned to the court for confirmation which is at least 10% of the first \$10,000 bid and 5% of the bid in excess of \$10,000. Once the bidding has been opened, the court in its discretion may permit the bidding to continue on lesser raises until it declares a bid to be the highest and best obtainable. The sale will then be confirmed by the court to the maker of that bid. (Probate Code Sections 10000, 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.

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, Section 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 Section 10150 of the Probate Code.

It is important that the broker who procures the offer which is accepted by the estate representative and returned to court for confirmation have a written contract with the representative. In the case of an overbid 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 Section 10162.5)

In its order confirming the sale, the court 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 Sections 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* 1980 105 Cal. App. 3d 691)

### **Board of Education Sales**

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.

### **State of California Sales**

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.

## **LICENSEE ACTING FOR OWN ACCOUNT**

A real estate licensee will sometimes act in a real property transaction for his or her own account. Because of professional background and contacts, a licensee is oftentimes more aware than most people of investment and profit opportunities in such transactions. An effort to exploit these opportunities to personal advantage may involve legal or ethical matters to be carefully considered by the licensee.

When acting for his or her own account, a broker or salesperson is obliged to act honestly and fairly, in good faith, and without fraud or deceit. These duties and obligations are expected of all parties to agreements.

In certain fact situations, a broker or salesperson acting as a principal has additional duties to the other party to the transaction. An example is a broker or salesperson acting as a principal in a transaction who is also an arranger of credit pursuant to Civil Code Sections 2956 - 2957. Licensees who are principals in such transactions must prepare and complete a seller financing disclosure statement to be delivered to the other principal.

Oftentimes, complaints to the Department of Real Estate result 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 is explained to the person(s) with whom the licensee is transacting business. The other party to the 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 only as a principal in a transaction, the other party should be aware that dealings with the licensee are at "arms-length" and not that of an *agent* and principal.

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 an *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, 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 an *agent*. An example of such a fact situation occurs when a 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 a real estate broker who undertakes, on behalf of a borrower, to solicit a lender to make a loan. If the broker later decides to make the loan him or herself or with broker-controlled funds, clear disclosure of the broker's changing role should take place.

It is particularly important for a licensee who starts out as an agent in a transaction and then switches status to that of a principal to make a clear and distinct disclosure of the change before the transaction is consummated. It is advisable to create a written record of the disclosure. 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 that the licensee will be acting both as a principal and as an *agent* of the other principal in 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.

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 Section 2079.17 and Business and Professions Code Sections 10176(a) and (d)] Vague or ambiguous disclosures will not be sufficient notice of a change of status by the licensee from *agent* to principal only.

**Option to purchase by the broker as an agent.** A somewhat similar situation arises when a broker who is employed as an *agent* to find a buyer of real property obtains an option to purchase the property 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.”

**Disclosure of conflicts and profits by the broker as an 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 places a 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 principles 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 Section 10176 (g)]

## UNLAWFUL EMPLOYMENT AND COMPENSATION

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 or she 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 Section 10137)

The prohibition against sharing commissions with unlicensed persons applies only to a payment made by a licensee to a nonlicensee as compensation for the performance of acts for which a real estate license is required. Thus, payment of a portion of a commission by a licensee to a principal in the transaction does not constitute a violation of Section 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 Sections 10138, 10139, and 10139.5)

## **BROKER - SALESPERSON RELATIONSHIP**

### **Broker - Salesperson Employment Contract**

Commissioner's Regulation 2726 requires that a real estate broker have a written agreement with each of his or her salespersons, whether licensed as a salesperson or a broker under a broker-salesperson arrangement. An employment contract between broker and salesperson may be instrumental in establishing the relationship between them, but only to the extent that the provisions do not conflict with the relationship as mandated by the Real Estate Law, other statutes, and applicable case law. The details of the association, including supervision, duties and compensation, must be spelled out in the contract and adhered to in practice.

### **Employer - Employee**

An employee is defined in the Labor Code as one who renders personal service to the employer and who performs the service under the direction and control of the employer. An employee works for his or her employer, while an agent not only does this but also acts for and in the place of the principal for the purpose of making agreements and thus bringing the principal into legal relationships with third persons. Thus, a filing clerk in an office or a machinist in a factory would be an ordinary employee. A broker normally would not be classified as an employee. For purposes of the Real Estate Law and the Civil Code, a real estate salesperson is an employee of the real estate broker under whom he or she is licensed. If the broker is a corporation, the salesperson is an agent of the corporation, not of the supervising qualifying broker in his or her individual capacity. (*Walters v. Marler* (1978) 83 Cal.App.3d 1,147 Cal. Rptr. 655)

### **Independent Contractor**

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. 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. An independent contractor may also be an agent of the principal. For instance, a real estate broker is typically an independent contractor acting as an *agent* of the principal for a defined limited purpose.

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 are usually characterized as independent contractors of the broker for purposes of state and federal income tax reporting and sometimes for certain other purposes such as Workers' Compensation Insurance coverage. (See, for example, Unemployment Insurance Code Section 650 and 26 U.S.C. Section 3508.) Accordingly, salespersons 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 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 that the associates are independent contractors and not employees for income tax reporting purposes. However, the real estate broker must distinguish between the implementation of independent contractor status of salespersons for tax reporting, Workman's Compensation, or other labor-related purposes and the broker's duty to supervise those salespersons under the Real Estate Law. Moreover, the independent contractor status does not diminish the broker's responsibilities and civil liabilities for the conduct of the broker's salespersons. (Business and Professions Code Sections 10032, 10132, 10177(h) and 10159.2)

### **Liability**

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 may wish to consider carrying general liability and errors and omission insurance covering their salespersons and office personnel regardless of their contractual and employment relationships with the supervising broker.

### **Workman's Compensation**

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

### **Social Security and Income Taxes**

A similar situation arises under the Federal Insurance Contributions Act and the Internal Revenue Code. A broker may submit to the District Director of Internal Revenue employment agreements and detailed data as to operating methods and obtain a ruling whether the salespersons are considered employees under these laws. 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 nonlicensed activities may wish to review with legal counsel the effect of these activities upon the available exemptions from employer and employee relationships for tax reporting purposes. (26 U.S.C. Section 3508; IRS Rev. Rulings 76-136 and 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 are employees for income tax reporting purposes, the supervising broker may be liable for income taxes due from the salespersons which should have been withheld by the broker and paid to the IRS. Interest and penalties will typically be added. Supervising brokers should obtain the advice of a CPA and/or qualified tax attorney when establishing policies and procedures in this regard.

## Unemployment Insurance

For purposes of maintaining unemployment insurance coverage, the California Unemployment Insurance Act excludes from the definition of employee brokers and salespersons paid solely by commission. (Unemployment Insurance Code Section 650) If the IRS rules in a given fact situation that salespersons are employees of the supervising broker for income tax reporting purposes, EDD is likely to follow the IRS ruling and impose the same relationships.

## Personal Income Tax - Additional Information

In recent years, the IRS has challenged the exemption available to real estate licensees under 26 USC Section 3508 when the activities involved are other than general sales brokerage and related services (mortgage brokerage, mortgage banking, and special project brokering such as new subdivision sales). Real estate licensees may still be 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 the Federal Tax Equity and Fiscal Responsibility Act (TEFRA) and amendment of Section 650 and addition of Section 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: (1) 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 is related directly to sales or other output rather than the number of hours worked; and (3) the real estate services are performed pursuant to a written agreement between the individual and the supervising broker which includes a provision 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 purposes.

Again, it is important to understand that the characterization of independent contractor status for state and federal income tax reporting purposes has no effect upon the supervising (individual or corporate) broker's civil or public liability for the conduct or misconduct of salespersons.

## Commission and Deposit Disputes

The Real Estate Commissioner has no authority regarding commission disputes between licensees or between a licensee and his/her principal.

A commission dispute between (listing and selling) brokers is a civil matter.

A real estate salesperson (or broker acting in the capacity of a salesperson) involved in a commission dispute with his/her broker may contact the Labor Commissioner. In determining jurisdiction, the Labor Commissioner will consider the salesperson's status as either employee or independent contractor. If the salesperson is an independent contractor, the dispute must be settled in a court of competent jurisdiction or through arbitration.

The Real Estate Commissioner has no authority to determine the proper disposition of a deposit in a failed real estate transaction. The Commissioner does not take the place of a court of law and does not give legal advice.

### **CONCLUSION**

The subjects of agency and fiduciary duty are quite complex. Hopefully, the discussion in this chapter has enhanced the reader's knowledge of the duties and obligations owed to their principals by real estate brokers and their salespersons.