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MANDATORY DISCLOSURE: THE KEY TO RESIDENTIAL REAL ESTATE BROKERS' CONFLICTING OBLIGATIONS

The purchase of a home is often the most significant financial investment that the average American makes. The real estate broker commonly guides the prospective home buyer throughout the home-buying process, and in many cases, negotiates and consummates the transfer of the property.¹ Consequently, in making decisions regarding the purchase of a home, buyers often rely on the representations of real estate brokers. Although most real estate brokers recognize the significance of their responsibilities and treat both the buyer and the seller fairly, the laws defining the broker's role in residential real estate transactions may be inconsistent with the understanding of the parties involved. Therefore, for the benefit of all parties to a residential real estate transaction, the broker's duties must be clarified. Clarifying these duties will enable buyers to make informed decisions and help to define the extent of the broker's legal liability.

Most of the broker's duties arise from a listing agreement which contains express promises and conditions. The listing agreement creates an agency relationship between the broker and the seller.² Once the broker-seller agency relationship is created, the law imposes several duties on the broker which remain in force until the property is sold or the listing agreement expires.³ In contrast to the specific duties that the broker owes to the seller, the broker's duties to the buyer remain unclear along with the buyer's perception of those duties. Unlike the broker-seller relationship, the broker-buyer relationship is very informal.⁴ Nonetheless, the typical home buyer is often led to believe that the broker will adequately guide him throughout the home-buying process.⁵ The buyer's reliance upon the broker is fostered by the personal nature of discussions which occur between the respective parties throughout the course of their relationship.

1. F. GALATY, W. ALLAWAY, & R. KYLE, *MODERN REAL ESTATE PRACTICE*, 417 (9th ed. 1982).

2. A. RING & J. DASSO, *REAL ESTATE PRINCIPLES AND PRACTICES* 118 (9th ed. 1981).

3. The primary duties agency law imposes on the broker are utmost good faith, honesty, integrity, and loyalty in his association with the seller. *RESTATEMENT (SECOND) OF AGENCY* §§ 376-77, 379-81, 383, 387-91, 394-95 (1957).

4. The buyer and broker do not enter into any type of formal agreement akin to the broker-seller listing agreement.

5. Owen, *Kickbacks, Specialization, Price Fixing, and Efficiency in Residential Real Estate Markets*, 29 *STAN. L. REV.* 931, 944-45 (1977).

A prospective buyer often selects a real estate broker based upon someone's recommendation. The relationship thus begins on a personal, as well as on a professional basis.⁶ Initially, the broker requests information about the buyer's financial position, housing requirements, and personal tastes. This information is used to develop an inventory of homes suitable to the buyer's particular needs. These discussions reinforce the buyer's belief that the broker is his confidante. As a result, the buyer is often intentionally or inadvertently led to believe that the broker represents his interests.⁷

The broker, consequently, may be viewed as the assumed representative of the buyer.⁸ The buyer, however, is rarely cognizant of the broker's divided loyalty. As a result, buyers often rely on the broker's representations to their detriment.⁹ Conversely, the broker experiences both ethical¹⁰ and legal conflicts¹¹ in performing tasks that the buyer entrusts to him because of the broker's existing agency relationship with the seller.¹² Recent case law expanding the brokers' duties to the buyer has augmented the confusion surrounding the brokers' divided loyalties.

For example, in *Dugan v. Jones*,¹³ the Utah Supreme Court held that a real estate broker owed an affirmative duty to prospective buyers.¹⁴ The court held that a broker may be subjected to liability for negligent misrepresentations made to the buyer. The court stated that such liability is justified when a broker fails to exercise the professional care and competence required in disseminating information beneficial to prospective buyers.¹⁵

6. Even when the broker is selected from an advertisement, the home buyer usually chooses the broker, not the converse.

7. Currier, *Finding the Broker's Place In The Typical Residential Real Estate Transaction*, 33 U. FLA. L. REV. 655, 659 (1981).

8. Interview with Robert Kratovil, Professor, The John Marshall Law School, in Chicago (July 2, 1984).

9. See, e.g., *Bush v. Palermo Realty, Inc.*, 443 So. 2d 104 (Fla. Dist. Ct. App. 1983) (the prospective buyer of the property sued the broker because the broker used information from the buyer to purchase the property for himself); *Buzzard v. Bolger*, 117 Ill. App. 3d 887, 453 N.E.2d 1129 (1983) (buyers of the property were unable to assert an agency relationship with the broker which would have given rise to various fiduciary duties). *Contra O'Brien v. Noble*, 106 Ill. App. 3d 126, 435 N.E.2d 554 (1982) (broker was not liable to the purchaser of property for failing to inform the purchasers of zoning restrictions).

10. NAT'L ASS'N. OF REALTORS, INTERPRETATION OF THE CODE OF ETHICS 42 (7th ed. 1976).

11. For a discussion of recent cases analyzing the broker's legal conflicts, see *infra* notes 13-20 and accompanying text.

12. For a discussion of the broker-seller agency relationship, see *supra* notes 2-4 and accompanying text.

13. 615 P.2d 1239 (Utah 1980).

14. *Id.* A Utah statute governs the licensing of real estate brokers and salesmen and requires "honesty, integrity, truthfulness, reputation, and competency" of each broker and salesmen. *Utah Code Ann.* §§ 61-21 to -23 (1983 Supp.).

15. *Dugan v. Jones*, 615 P.2d 1239, 1249 (Utah 1980) (citing Restatement (Sec-

The *Dugan* decision is representative of a recent trend imposing more stringent duties upon real estate brokers.¹⁶ For example, a recent California decision, *Easton v. Strassburger*,¹⁷ further extended the broker's potential liability to the buyer. In *Easton*, the plaintiffs purchased residential property with major soil problems and a history of earth movements.¹⁸ The brokers failed to request a soil suitability test to inform the buyers of these potential problems. The buyers subsequently sued the real estate brokers for damages resulting from the soil problems.

In *Easton*, the trial court instructed the jury that real estate brokers had a duty to disclose not only known facts which materially affect the value and desirability of the property, but also those facts which through reasonable diligence, the broker should have known.¹⁹ The court determined that the real estate brokers should have been aware of certain "red flags" which indicated soil problems. The court held that the broker's duty of due care in a residential real estate transaction included an affirmative duty to conduct a reasonably competent inspection of the property. This duty also required the broker to disclose to the prospective buyers anything which might affect the value of the property.²⁰

ond) Torts § 552).

16. See, e.g., *Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982) (real estate broker who made material representations to purchasers as to condition of well on unimproved property was liable to purchasers, even though representation was innocently made); *Zichlin v. Dill*, 157 Fla. 96, 25 So. 2d 4 (1946) (a non-principal buyer recovered against a broker who represented that the property could not be purchased for less than \$5,500 when in fact the broker bought it for \$4,500 and resold it to buyer for a \$1,000 profit); *Gouveia v. Citicorp Person-to-Person Financial Center, Inc.*, 101 N.M. 572, 686 P.2d 262 (N.M. Ct. App. 1984) (brokers' status as to prospective purchasers with respect to known or discoverable defects); *Provost v. Miller*, 144 Vt. 67, 473 A.2d 1162 (Vt. 1984) (broker will be found negligent if he passes information to the buyer that he knows or has reason to know may be untrue); *First Church of the Open Bible v. Cline J. Dunton Realty, Inc.*, 19 Wash. App. 275, 574 P.2d 1211 (1978) (the selling broker negligently represented to the prospective buyer that three parcels of property were included in the listing when in fact there was only one); *Gauerke v. Rozga*, 112 Wis. 2d 271, 332 N.W.2d 804 (1983) (real estate broker held strictly liable to purchaser of property for misrepresentations regarding the acreage and amount of road and river frontage); *Hagar v. Mobley*, 638 P.2d 127 (Wyo. 1981) (real estate broker who skimmed over the lease should have known its terms and had a duty to inform the buyers that the length of said lease was less than that represented to the buyers).

17. 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984).

18. *Id.* at 90, 199 Cal. Rptr. at 385.

19. *Id.* at 93, 199 Cal. Rptr. at 386. The court noted that there was a minor slide in 1973 involving about 12 feet of the filled slope and a major slide in 1975 in which the fill dropped about 10 feet in a circular shape approximately 60 feet across. *Id.*

20. *Id.* at 97, 199 Cal. Rptr. at 390. The court did not state whether a broker's obligation to conduct an inspection for defects for the benefit of the buyer applies to the sale of commercial real estate. See generally 1 F. MILLER & J. STARR, CURRENT LAW OF CALIFORNIA REAL ESTATE § 4.18 (Supp. 1983) (a commercial real estate transaction usually involves two brokers); Comment, *Dual Agency in Residential Real Estate Brokerage: Conflict of Interest and Interests in Conflict* 12 GOLDEN GATE U. L. REV. 379, 383 (1982) (a purchaser of commercial real estate is likely to be more exper-

As *Dugan* and *Easton* demonstrate, the broker is torn between two competing interests. Agency law requires the broker to safeguard the interests of the seller, whereas recent case law requires the broker to also consider the interests of the buyer.²¹ As a result, the broker is held accountable to both the buyer and the seller whose interests conflict.²² Brokers are, thus, increasingly subjected to lawsuits by both parties. This dilemma could be resolved if the brokers were required to disclose to prospective buyers his agency relationship with the seller.

Recently, mandatory disclosure has become prevalent in the area of consumer protection to shield consumers from unscrupulous business practices. This form of disclosure developed because of abuses relating to expenses in obtaining consumer loans.²³ Under mandatory disclosure laws, the seller or creditor must disclose pertinent information including statements concerning the consumer's legal rights.²⁴ Mandatory disclosure should also be implemented in the real estate industry. Mandatory disclosure would reveal the constraints agency law imposes upon the broker; namely that the broker is the agent of the seller and not the buyer. Once informed of the broker's existing legal relationship with the seller, the buyer would be able to make an informed decision regarding his alternatives within the transaction.

Under a system of mandatory disclosure, the broker would be required to explain to the buyer that his agency relationship with the seller limits the amount of information which he may disclose to the buyer.²⁵ Having notice of this agency relationship, the buyer could then intelligently choose his course of action in the transaction. The buyer could seek representation from the seller's broker, hire his own broker, or seek the advice of an attorney or building contractor. The buyer could also choose to proceed with the transaction without representation, while cognizant of the selling broker's loyalties in the transaction.

enced and sophisticated in his dealings in real estate and is usually represented by an agent who represents only the buyer's interests).

21. For a list of cases requiring the broker to consider the buyer's interests as well as the sellers, see *supra* note 16.

22. Interview with Robert Kratovil, Professor, The John Marshall Law School, in Chicago (July 24, 1984).

23. See generally Stoppello, *Federal Regulation of Home Mortgage Settlement Costs: RESPA and Its Alternatives*, 63 MINN. L. REV. 367 (1979).

24. See also Davis, *Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts*, 63 VA. L. REV. 841 (1977). See generally Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 WIS. L. REV. 400.

25. Some form of disclosure statement signed by the buyer, acknowledging the fact that the broker is the seller's agent, would probably be necessary to insulate the broker from liability and formally inform the buyer of the broker's legal obligations in the transaction.

.. The problems associated with the broker's divided loyalties to the buyer and seller in a residential real estate transaction can be resolved by requiring the broker to disclose to the buyer the true nature of their relationship. The broker should be required to formally declare to a potential buyer that he is the seller's agent. The buyer would then have notice that the broker could not be relied upon to effectively safeguard the buyer's interests. This would allow the buyer to intelligently decide what information to divulge to the broker based upon a more complete understanding of the broker's duties. Such a requirement would also serve to protect brokers against future lawsuits by buyers who believe that their interests were not properly protected.

The time is ripe to extend the concept of mandatory disclosure into the area of residential real estate transactions. Disclosure would provide the buyer with a clearer understanding of the broker's role, and would also clarify the broker's perceptions as to his own responsibilities. After disclosure, the buyer could seek representation from another party or continue to represent himself. In any event, mandatory disclosure would produce informed buyers capable of making intelligent decisions when purchasing a home through a residential real estate broker.

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