PERFORMANCE ANALYSIS IN BROKER LIABILITY LITIGATION

by Richard J. Rosenthal, CRE

Recognizing the emergence of real estate practitioners as *professionals* and the impact of this change on relationships with clients and customers is a must if we are to understand the analysis of broker liability in today's world. Broker performance is measured against a different set of standards than it was in the past. Brokers were merely perceived as salespeople. Transactions were simple and straightforward. You need only compare the document package created in an ordinary brokerage transaction with the paperwork required two decades ago to sense the demand for technical competence on the real estate professional of today.

How Is Performance Measured In Broker Liability Litigation?

In each litigation assignment, the consulting expert must analyze the matter in order to determine the framework of duties and obligations imposed on the licensee and where they are derived. He must establish the standard of care that a licensee must meet in order to perform each duty or obligation imposed on him in a satisfactory manner. Then, using the evidence, testimony and facts which he was asked to assume, he must formulate an opinion of broker performance for the duties and obligations at issue in the subject dispute.

If one is to assess the potential liability of a defendant broker, it is necessary to be familiar with the ruler used to measure broker performance. Once comfortable with this ruler, the analysis of liability and measurement of performance by the consulting expert becomes only a matter of employing the proper methodology. Let's break down the ruler into three parts, and look at them one at a time.

Determining Broker Duties And Obligations

Broker duties and obligations are derived from four basic sources: 1) The relationship with the client, 2) Statutory and common law, 3) Custom and practice in the industry and 4) Contract obligations. If a broker wishes to be relieved of specific duties or obligations he must affirmatively take action to avoid a principal's reliance on or false expectations regarding his acts. This can be accomplished through disclosure of the broker's intention not to perform or his inability to do so. The principal must discharge the broker from performing those certain specific duties. Silence on the matter may result in the broker being held accountable for a failure.

Duties imposed by the relationship with the client (fiduciary duties)

Whether or not the broker is an agent of the principal is a question of fact. An agency relationship can be deliberately created based on the intent of the

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parties, and can be memorialized as a written agreement (a listing contract) or as an oral agreement (often done between a buyer's broker and a buyer; or a tenant's agent and a lessee). An agency relationship can also be created unintentionally based on the broker's words, acts and deeds ("I can get you the loan you need," or "I will find the perfect property for you."). All it takes is the broker creating an expectation of performance in the mind of a prospective client and you have the makings of an implied and unwitting agency relationship with that principal.

It is critical to remember that when an agency relationship is created accidentally or intentionally, it imposes a fiduciary duty of utmost care, integrity, honesty and loyalty on the broker in all dealings with that client. A fiduciary duty is the highest duty an employee can have to an employer, equal to that of a trustee to his principal. The broker must interpret this duty to mean *that his client's best interests take precedence over his or any other person's interest*, and he must do everything possible to insure the well-being and success of his client in the subject transaction. If the broker chooses to represent more than one principal in any transaction, he will owe this high duty to all clients with whom he creates an agency relationship.

In our analysis, we must be sensitive to what was said and what was done by the broker as he dealt with prospective clients. Most lawsuits involving brokers include a breach of fiduciary duty cause of action, and the breach of fiduciary duty becomes the focus of discovery in assessment of liability. This is especially true where the broker was working with a buyer.[1] Therefore, dealing with prospective buyers require particular care as the unwritten nature of the relationship can often result in unfulfilled buyer expectations. The creation of agency relationships without the specific intent of the broker to do so, happens more often than one might imagine. Each time such a relationship is created, a fiduciary duty to the client is imposed on the broker. In analyzing liability we have consistently found brokers failing to perform their duties because they did not realize they had them in the first place.

Dual agency relationships

On the subject of representation of multiple parties in a single transaction, in many states such as California and Hawaii, brokers have statutory and/or regulatory authority to represent more than one party in a transaction as long as they disclose their intent to do so and gain the informed consent of the parties prior to acting as agent of more than one. Brokers in California have served their clients for decades in this capacity (in hundreds of thousands of transactions) with only a small percentage resulting in disputes. Nevertheless, once a broker becomes a disclosed and authorized dual agent, he must recognize the significant burden that he has undertaken in accepting a fiduciary duty to all parties in the transaction. It is mandatory that he place his principals' interests above all others and recognize that *there will be occasions when the conflicting interests of the parties will preclude his ability to represent them all.* When those occasions occur, the best course of action is for the broker to explain the situation to all principals and withdraw from a dual agency position. The potential for breach of fiduciary duty by the agent makes any other course of action very foolish and an analysis of liability will tend to focus in this area.

Undisclosed and/or unauthorized dual agency (especially one emanating from the Multiple Listing Service unilateral offer of subagency) is, of course, the single greatest threat to the economic and professional well being of a broker. The legal remedies available to a principal for this breach are wide-ranging and severe in their impact on the broker.[2] Today, a course of action exists in many state statutes that, if followed, will prevent an undisclosed or unauthorized dual agency, or at least create a presumption in favor of the broker's proper performance. While the disclosure provisions required by these code sections are generally mandatory only for residential and certain other transactions, many brokers have voluntarily adopted this form of disclosure in all transactions (emerging custom and practice). This voluntary adoption of written disclosure is occurring to document the actions taken by the broker to avoid undisclosed or unauthorized dual agency, without regard to the type of property or engagement involved.

Duties imposed by statutory and common law

Today, the practice of real estate is highly regulated, and real property related disputes have been extensively litigated for decades. The result is a substantial body of case law and an overwhelming array of regulations and statutes.[3] This body of law imposes substantial affirmative duties and obligations on the real estate professional. For liability analysis purposes, we generally classify these duties into three main categories. It is worthy to note that these duties apply to all principals with whom the broker deals, without regard to the broker's status as an agent.

- A duty to diligently exercise reasonable skill and care in the performance of a broker's duties.
- A duty of honest and fair dealing and good faith.
- A duty to disclose all material facts that affect the value or desirability of the subject property, especially that which is not known to or within the diligent attention and observation of the parties, including those facts that would affect the buyer's decision in the subject transaction.

Duties imposed by custom and practice

Definition Custom & Practice: *A group pattern of habitual activity, usually transmitted from one generation to another and is so established that it has the force of law.[4] Principals have the right to expect a broker's performance to conform to the custom and practice in the field, and that he will use reasonable skill and care in doing so.*

Custom and practice may be local, regional, statewide or national. Custom and practice also differ from one real estate discipline to another. As such, a broker must do the homework necessary, to

be competent and capable, especially, when operating out of his normal market area or real estate discipline.

Duties imposed by contract obligations

In accepting employment as the agent of a principal, the broker accepts certain obligations and agrees to perform certain duties. These duties and obligations may be memorialized in an express written contract as with a seller in the listing agreement. They may also be contained in an oral or implied agreement with a seller or buyer, or in some combination of both. It is worthy to note that many brokers are never consciously aware of their contract duties to a client until there is a dispute over an act or omission. Failure to perform a contract duty (breach of contract) can result in the court requiring a party to perform, or in the alternative, to pay damages incurred by the other party due to the breach.

The Analysis

From a broker liability point of view, our analysis would focus on whether the broker appeared to know what was expected and required of him and, if it appears that he accepted an assignment that he was not qualified to perform. In working with a buyer, the broker has an affirmative duty to understand the client's wants, needs and desires in the pending transaction. Moreover, the broker should have documented all mutual points of understanding in order to guard against false expectations and unjustified reliance on the part of the principal. With the proper lines of questioning we can generally determine, during discovery, the state of mind of the parties during the transaction.

Establishing The Standards Of Care

There is no all encompassing "Standard of Care" for a transaction. Rather, for each duty or obligation that is owed to a principal there is an appropriate standard of care. The standards of care operative in any transaction are based on the transaction itself. Moreover, the standard of care for any given duty or obligation is not automatically the same from transaction to transaction. It can and will vary depending on the circumstances. In establishing the standards of care which a licensee's performance must meet in order to satisfactorily execute the duties and obligations to a principal, we must consider what would be required to assure that the client was provided with the information necessary to make an informed decision (based on their knowledge and sophistication; wants, needs and desires; and, the competence and capability of the licensee himself). For example, a broker working with an elderly, unsophisticated person who had never before owned real estate and who desired to invest their nest egg conservatively, would have a standard of care very different than that of a broker working with a sophisticated developer of major properties whose staff would be responsible for all analysis, zoning, financing, conveyancing and negotiations for terms and conditions.

Analyzing Performance

It is critical to any analysis of performance that an evaluation of the licensee's professional competence be made. It is well settled that a licensee is unlikely to diligently exercise reasonable skill and care, if they do not have the requisite level of skills. The errors and omissions encountered in broker liability litigation are generally due to the licensee's lack of competence and capability, not their desire to perform intentional misdeeds. In doing a thorough evaluation of broker liability, whether for plaintiff or defendant, the consulting expert must search for indicators of professional competence in the evidence, testimony and facts alleged by the parties. Obtaining and understanding the significance of information available is of critical importance to positioning the case. A discovery plan must be developed to insure receipt of all information necessary to evaluate the licensee's business practices.

Evaluating the brokers professional competence

In evaluating professional competence, two areas of investigation and review are of great significance. How the licensee went about doing what he did should be documented as the analysis progresses. The presence of a consistent pattern of good business practices and the use of risk management techniques by the licensee will often demonstrate his level of competence and capability, and should also be documented as the analysis progresses.

Business practices

Writing in *Professional Business Practices*, attorney Debra Fink says, "Real estate licensees must learn to develop and maintain business practices which stress professionalism. Basically this requires the licensee to do three things. First, a real estate licensee must recognize key areas in which potential problems arise. Second, the licensee must acquire a broad base and depth of knowledge concerning those areas. And, third, he must commit to staying abreast of the current developments in those areas. Because the real estate industry changes so rapidly, a continuous monitoring of issues must be undertaken in order to be able to uphold good business practices consistently."[5]

A consistent pattern of good business practices is generally indicative of proper performance in the real estate profession and usually indicates an appropriate understanding of the standards to be met. Insightful discovery techniques enable us to explore both the specific performance as well as the normal business practices of brokers participating in the matter at hand.

It is worthy to note that a broker has many ways of staying abreast of changes these days. State and local Realtor associations provide high quality continuing education on broker liability and risk management. In California, the C.A.R. Leader Program examines key issues, changes in the law, standard forms, and techniques to improve professional competence, while the CARNET computer system provides late breaking industry bulletins, legal memoranda, and legislative and technical alerts. And, the Realtor Legal Services Plan assists its members in obtaining legal opinions on any transactional problems that may arise in the course of a

transaction. *A broker's familiarity with resources and techniques available, exposed during discovery, will provide an insight into his professional competence.*

Risk management techniques

Today, real estate professionals in all disciplines incorporate some level of risk management technique into their practices. *Recognizing the use of these techniques by brokers in the performance of their duties, especially where their words, acts and deeds create a presumption of proper performance, is critical to any analysis of liability.* Let's explore then, the profile and performance of a real estate professional operating within the scope of currently recommended risk management techniques.

Assume, if you will, that the licensee is a real estate professional, a broker who is up on all the latest issues, laws and techniques. Let's also assume that he is very sensitive about his agency relationships and works carefully with his clients to be aware of their wants, needs and desires. Knowing their degree of understanding and competence in real estate and financial matters, he determines the level of attention required to perform his duties and obligations in a satisfactory manner. Does this profile indicate a liability-proof broker performing his duties and obligations? Frankly, it only indicates a broker with the proper foundation for a real estate professional's activities. In today's environment it is critical that the broker organize his practice into a consistent pattern of good business practices. Consistency is a key virtue and documentation provides one of the best defenses against broker liability. This approach does not demand a change in what brokers do with their clients, just in the way they organize and document their activities. A broker who has not adopted this approach tends to create risk of liability, not manage and minimize it. Risk management is developed in three parts: risk shifting, risk anticipation and risk control.

Risk shifting

The fine art of shifting risk from the broker to another party is a matter of attitude and attention. There are a number of key ways to begin the process. Errors and omissions and legal defense insurance policies both are methods of shifting the risk of economic loss from the broker to an insurance company for a predetermined number of dollars (the premium). This is the simplest and most pervasive of the risk shifting techniques.

In many states the proper use of a seller's disclosure statement[6] is a method of shifting the risk of non-disclosure of material facts about the subject property from the broker to the seller (especially concerning things of which the seller has knowledge).

The appropriate use of third party experts (such as pest control and home inspectors, civil engineers and architects, attorneys and accountants) and obtaining information from appropriate sources (such as the assessor's office, title companies, the city engineers or the planning department) give the real estate professional a myriad of ways to shift the risk on technical subjects and information away from himself to the appropriate expert, without losing control of the transaction.[7] Throughout this process, the development of a consistent pattern of good business practices will provide the proper framework and detailed documentation for each transaction. Risk shifting loses its impact if each shift is not documented in writing. Generally in real estate, if you don't have it in writing, you don't have it.

If the broker's use of risk shifting techniques can be identified in the evidence and testimony reviewed during analysis, it will provide a basis for the presumption of a number of performance related conclusions such as: the brokers determine their competence and capability to perform services for their clients, and the brokers recommend reliance on appropriate professionals to provide information or advice to their clients. This would be in sharp contrast to evidence and testimony which suggested the broker gave advice and information without a reasonable basis to believe it was true or that no professionals were employed to provide expert advice or information on which the client could rely in making a decision on how to proceed in the transaction. Risk shifting techniques identified during analysis should be documented for use in formulating opinions of performance.

Risk anticipation

This is a technique for standardizing responses to liability producing elements in a broker's normal practice (such as, known material facts in the marketplace and various technical aspects of the real estate discipline practiced). These risks can be managed by anticipating their occurrence and developing standard responses for dealing with them. Utilizing a consistent pattern of good business practices to implement standard responses provides the framework for anticipating risk. Checklists, form disclosures, standard analytical forms and preprepared contingency recitals for purchase contracts are all examples of risk anticipation tools that should be consistently implemented. Confirmation letters which document recommendations, commitments or questions to clients and other parties is another key practice through which a broker creates a presumption of proper professional conduct. Likewise, delivering copies of all transactional documents to the client is a key practice. *We would always check to see if the broker knows which documents the law requires him to deliver to his client.* If not, he may have created a presumption of doubt as to whether he did deliver a copy.

Risk control

Communications with all transactional players on a regular basis is a must. In my opinion, the most important risk shifting phone call a broker can make in the course of a transaction is one in which he says, "I really don't have anything important to report." If a broker made that phone call at least once each week, I believe most client complaints would disappear, especially if the phone calls were documented in a phone log. *If a broker is consistent*

in the aforementioned practices, there is a compelling argument that he knows exactly what he is doing at all times. It becomes very difficult then, for a principal experiencing a case of intermittent alzheimers to claim that the broker did not perform properly if all communications have been consistently documented on a routine basis.

Understanding and recognizing the practice of risk management, or lack thereof, in a broker's performance will lead to effective evaluation of the preliminary liability analysis in a real property dispute.

The Broker's Litigation Mentality

The most startling environmental change for the real estate industry over the last few decades is the increasing incidence of litigation filed against real estate brokers. It is true, but not comforting, that real estate has not been singled out as an industry, but the volume of litigation reflects an attitude held by the general population. In a recent article in the *Los Angeles Times*, a headline proclaimed, "The Land of the Free Is Evolving Into the Home of the Lawsuit". The article went on to say, "there used to be a common retort when one was accused of some infringement or wrong: Sue me! It is not often heard today. The chances are too good that the person challenged will do just that."

Obviously, you can't stop someone from filing a lawsuit if they choose to do so. And, if they do, you can't ignore the complaint or you will lose by default. A broker who has experienced the disruption of litigation knows that even if you win, you really lose. If your law practice includes broker liability defense work, *it is important to understand the psyche of the practitioner as well as the normal structure of the defendant's business operation.* Your guidance in the face of threatened litigation or in advance of an actual dispute is important as is the defense of an actual claim.

From a broker liability perspective, it is critical for the real estate broker to have a plan for handling complaints. Generally, this responsibility falls on the broker's shoulders because he is the agent of all the firm's clients. The sales associate is technically the agent of the designated broker.[8] It is worthy to note that the sales associate providing real estate services to the client is the one with the personal relationship and the first-hand knowledge of the specific facts surrounding the dispute. He is the one at whom any accusations of wrong-doing are normally aimed, yet the complaint is usually directed toward the firm. The receipt of a formal complaint typically results in a predictable emotional response: first anger and indignation, then fear and frustration. And, all of this usually occurs at a time when a cool head and good business perspective is needed most. Any response must be a team effort and must have a team leader. Hopefully, risk control procedures will have alerted the broker to the impending litigation, and he will have already done a preliminary review of the facts and the file. It is highly unlikely that a lawsuit would be filed without preliminary contact and negotiations between the parties. However, there have been many occasions where the sale associate has hidden the dispute and attempts of the client or his attorney to reach an agreement to avoid litigation, leaving the firm to first discover the problem when the suit is filed.

From a broker liability perspective, every real estate professional, prior to any dispute arising, should have selected an attorney who he could rely on if he is sued. Brokers must understand, when faced with a lawsuit, the importance of being represented by an attorney who is competent in litigation matters. All members of the real estate firm who are involved in this dispute must immediately sit down with their attorneys and review the situation. It must be an honest analysis; this is not the time for excuses or emotions. A careful review of the facts often show that real estate professionals have performed up to the standards which are contemplated in the law for their duties and obligations. If, however, an analysis reveals they have made an honest mistake and someone was damaged by their actions, the broker must consider the wisdom of accepting responsibility for his firm's performance and authorize the negotiation of a reasonable settlement.

Bruce Armstrong, a litigating attorney for whom I consult, wrote the following in a successful trial brief: "The essence of the duty of a real estate agent, however, is service to his client. And those who sell their services for the guidance of others in the economic, financial and personal affairs are not liable in the absence of negligence or intentional misconduct. Of course the broker has a duty to the plaintiff to exercise the ordinary skill and care of members of the real estate profession and, upon failure to discharge that duty would be liable to the plaintiff for negligence. But, since the plaintiff accepted the services of the broker because of his special skill as a real estate broker, the plaintiff is entitled to expect only reasonable care, not infallibility. He accepted service not insurance". (Emphasis added.)[9]

Conclusion

Plaintiff's counsel in broker liability litigation generally know how his clients believe they were damaged. Often, however, he does not know if there was a proximate cause for his client's problems. As technology develops and consumerism increases, the complexity of this business will demand a continual increase in the competence of those practicing in the real estate profession. It is easy to accuse a professional of intentional or negligent errors and omissions, and the potential for a broker to be accused of a failure for which he has no responsibility becomes more and more likely. Therefore, an increase in broker liability litigation is inevitable, making the analysis of broker liability and the ability to competently measure broker performance crucial to attorneys practicing in the field.

NOTES

1. The California Civil Code defines a buyer as "one who seeks the services of an agent in more than a *casual, transitory or preliminary* manner, with the objective of entering into a real property transaction" (CA civil code § 2373 et. seq.).
2. In California a principal may be granted: avoidance of compensation to the broker, even if the transaction was successfully completed; recision of the transaction even if a transfer of title has occurred; recovery of damages suffered by the principals, even if the broker is not the proximate cause; and lastly, the regulatory threat of suspension or revocation of the broker's license under CA Business & Professions Code § 10176d.
3. In California, found primarily in the Civil Code, the Business and Professions Code and the Administrative Code [which houses the Real Estate Commissioners regulations.]
4. Random House Dictionary of The English Language, The Unabridged Edition.
5. Fink, Debra. *Professional Practices in Real Estate* (California Association of Realtors, 1989).
6. See Calif. Civil Code § 1102 et. seq.
7. See Calif. Civil Code § 1102.4.
8. In Calif. see Restatement of Agency 2d.
9. *Sweet v Gribaldo, Jones & Assoc.*, 40 CAL. APP. 3de 573, 576 (1974).

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