The Fat Old Bird that Forgot How to Soar

by Douglas C. Kaplan

Preface

Real estate agency is little more than a marketing ploy. It doesn't exist and never has existed. It is the industry's way of playing "Let's Pretend."

Simply put, "agency is a *consensual, fiduciary relation* between two persons, created by law by which one, the principal, has *a right to control the conduct of the agent*, and the agent has *a power to affect the legal relations of the principal.*" [1]

But the *real estate agent* doesn't operate under the control and direction of the principal and is powerless to legally bind him. As one interested in the transaction (no deal, no fee), the *real estate agent* cannot render fiduciary services. Without each of the foregoing ingredients, agency does not and cannot exist.

Like the fruit of the poisoned tree, *real estate agency* has sprouted: *buyer's agency, seller's agency, dual agency, limited agency,* and *designated agency* — all adding tension to the pretension. Export of this quagmire to the Internet (the new real estate marketplace) results in unimaginable confusion and exposure.

Daily, buyers in 50 states deal with sellers and brokers from all over the country, indeed, the world. Listing brokers are acting under every conceivable Agency relationship. Cooperating brokers, buyers, and sellers may live in states that do not recognize the listing broker's Agency relationship. Or, by statute, they define it differently. Or they

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make it illegal. Confusion abounds, disappointment is assured, and liability is inevitable. A simple solution, however, can resolve it all.

EVEN THE MIGHTY

A president of the United States was humbled when he deluded himself into believing that his high office would protect him from disclosing embarrassing personal misconduct.

A company, whose very name conjured the image of the automotive tire industry, faced untold litigation and economic travail when the general public discovered that the company had failed to disclose a known peril generated from the manufacture of its tires.

Tobacco, an industry with major economic and political clout on state and federal levels, was traumatized to the tune of billions of dollars in judgments when the public discovered that corporate executives withheld disclosure of the addictive nature of a harmful substance.

Yet mere ***disclosure*** is not a solution—whether it be of illicit sex in the White House, defective tires that kill, or commonly used harmful, addictive substances. Why? Because disclosure alone solves nothing. It simply exposes the problems.

Conjure the image of a banner in front of the White House depicting the activity in the Oval Office, or a sign on a tire company stating, "y'all take care," or an inscription on cigarette packs suggesting that they may be dangerous to your health. In the following paragraphs, you will see a real estate brokerage industry beset by serious problems that will *not* be resolved by disclosure.

THE REAL ESTATE BROKERAGE INDUSTRY FACES TWO MAJOR CRISES THAT WILL, IF LEFT UNATTENDED, BRING IT TO ITS KNEES:

BROKER (LICENSEE)-CLIENT RELATIONSHIP: THE FIRST CRISIS

AGENCY (SMOKE AND MIRRORS)

It does not take a rocket scientist to understand that an agent who must bring you to the closing table in order to earn a fee cannot be your fiduciary and cannot prefer your interests to his own.[2] Such a proposal is childish and flies in the face of human nature. The agent gets nothing for his efforts unless he walks his principal through a contract to the closing table. The agent is an *interested party* in the transaction.

The industry has been so married to the fiction of agency and fiduciary duty that the fear exists that a divorce will leave the industry in wrack and ruin. In truth, unless the industry levels with the American public, its future is grim.

What is stunning is that enterprising lawyers throughout the country are not already defending sellers in lawsuits simply by asking the agent:

> "As you are an interested party in the transaction, how can you provide fiduciary agency services to the principal?"

Perhaps, real estate agency has sustained itself like the legendary cartoon character, Wile E. Coyote, who runs off the crest of a mountain and lingers comfortably in midair—*that is, until he looks down*! The industry has been so married to the fiction of agency and fiduciary duty that the fear exists that a divorce will leave the industry in wrack and ruin. In truth, unless the industry levels with the American public, its future is grim. Indeed, even this bold caption on the masthead of the real estate contract will do nothing to correct the problem:

> "Beware! Your agent is not your fiduciary and cannot represent you, as your agent has an independent self-interest in this transaction."

EXAMPLES

Recurring examples of real estate agent's conflicts of interest are endless:

A. Within a few days of the expiration of an exclusive listing, the seller's agent produces a buyer for 15 percent under market. Will seller's agent recommend the sale in order to avoid the loss of the commission that inevitably would occur at the termination of his listing? How would that dilemma impact fiduciary obligations?

B. Seller's agent presents seller with two offers. One is from his own customer and one from another agent. Which is he likely to recommend and what effect would that have on his fiduciary obligation?

C. Seller's agent provides seller with a proposed listing price. The lower the listing price, the more likely the sale will result during the listing period. Does this put seller at a disadvantage? What effect does this have on seller's agent's fiduciary obligations?

D. Seller's real estate agent has several similar properties listed. He shows one property. The buyer appears interested and, thus, the agent does not show the other properties. Has the agent breached his fiduciary relationship with the other sellers listing similar properties?

E. Buyers rarely, if ever, pay a commission to a buyer's agent. A buyer's agent usually is paid by sharing seller's listing commission with seller's broker. Incredibly, the more a buyer has to pay for the property, the more a buyer's agent profits for himself. What effect does this have on the buyer's fiduciary obligations?

F. An accepted practice for sellers is to offer a bonus to a buyer's agent who effectuates the sale. Often this bonus is tied to a condition that the buyer purchase the property at listing price by a given time. How can buyer's agent perform a fiduciary obligation to buyer while taking advantage of so tempting a seller's inducement?

Well, what solutions exist? The simplest answer is to have agents compensated for time and services and not compensated based upon whether they produce the deal. Then, the agent has no interest in the transaction because the agent gets paid whether or not a deal generates. Sadly, fee for time and services has never been a reality for real estate brokers. And it never will be. It is time to stop bowing down to idols of complexity, confusion and misdirection, and to earnestly start worshiping at the church of simplicity.[3]

TRANSACTION BROKERAGE (BLOWING AWAY THE SMOKE)

What does work—even over the violent protests of those who look to agency as their "security blanket"—is *transaction brokerage*. This relationship is in the nature of an independent contractor. A transaction broker crafts a transaction between buyer and seller, assists in the details, but does not pretend to represent either party.

In its simplest form, transaction brokerage is a relationship similar to that of the contractor who builds a home for a lot owner. The lot owner agrees with the building contractor, for a stipulated price, to perform a service, to build a house. The contractor is to use its best professional skill and experience in rendering that service. When the job is completed, the contractor is paid for its efforts. Under no circumstances, however, is the building contractor an agent of the lot owner. The contractor simply renders a professional service for a fee and does not pretend to be a fiduciary.

The transaction broker functions in the same way. He/she agrees to render a service—to sell your property or to find you a property—for a stipulated fee. The transaction broker does not pretend to subordinate itself and its interests to those of its client.

Transaction brokers are governed by the ethical requirements of the state licensing statutes and industry standards of ethics. But they don't dangle the unnatural and spurious notion that the licensee is the client's fiduciary and will put the client's interests above their own.

A significant number of states, recognizing the inherent problems of agency and legal exposures for licensees, have adopted transaction brokerage as one of its available brokerage relationships. Indeed, responsible sources in many states, including Florida and Colorado, (both states being at the cutting-edge of transaction brokerage), acknowledge that most of the licensees in their states have found honesty, comfort, and safety without diminution of earnings in the transaction broker relationship.

Transaction brokerage is not a panacea. It will not cure all ills created within the real estate brokerage industry. What it will do is make buyers and sellers more self-reliant and self-vigilant, peeling away the specious, misleading veneer, suggesting that an agent will promote the client's interests over the agent's own interests.[4]

FACING FRUITLESS FICTIONS

Until recently, the real estate brokerage industry has been in the awkward situation of trying to find and identify itself. Structures like *sub-agency* (an imaginative, but severely-flawed fiction) tried to impose an agency relationship between the seller and the broker who found the buyer. The vestiges of sub-agency, where it still exists, are museum pieces.

The industry replaced sub-agency with yet another fiction—cooperation between seller's agent and

buyer's agent. Presumptively, this arrangement was created to justify the buyer's agent's sharing in a seller's agent's commission because, historically, buyers don't pay commissions. (How would a bar association view a successful plaintiff's attorney's sharing his fee with the lawyer for his adversary?)

DUPLICITOUS DUAL AGENCY

Of greater significance is the "**eyes wide shut**" industry attitude *concerning dual agency*. Dual agency occurs when one broker attempts to represent *both* buyer and seller, notwithstanding conflicting fiduciary relationships to each. Rocket scientists aside, integrity compels the conclusion that it is impossible to represent two commercial adversaries at the same time.

The traditional inquiry is, "How can one get the highest price and best terms for the seller, while at the same time getting the lowest price and best terms for the buyer?" That dual agency even exists in many states is testimony to overreaching, and insult to the dignity of honest commerce.

Even more insidious are the structures that seek to hide dual agency under such clone names as designated agency or the hybrid of transaction brokerage that tacks on "limited representation" of parties. Some states have sought to destroy the efficacy and simplicity of transaction brokerage by grafting on repugnant, contradictory powers. This is especially true in Florida where the legislature has granted to the transaction broker the power to offer "limited representation." The word "representation" is a code word for agency. The effect of such action in Florida is to contaminate transaction brokerage by tacking on an agency component, disguising it as a veritable wolf in sheep's clothing.

CONCEAL THE PROBLEM UNDER A MOUNTAIN OF DISCLOSURES

The core of the industry's problem lies in its abuse of the agency relationship, distorted to serve the industry's own uses. Ever wonder why brokerage disclosures are longer and more complex than the contract of sale and purchase? These disclosures describe the multiple kinds of relationships (often multiple forms of agency) effected by legislative changes in definition, e.g., buyer's agency, seller's agency, limited agency, dual agency, and designated agency. The disclosures do nothing but accentuate the confusion. Frequently, licensees cannot explain the disclosures that change after every statutory or regulatory session.

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The public is adrift in a sea of misdirection, a vessel without a rudder, without a chart, without a compass—piloted by a helmsman with a special interest in heading to his own home port.

LEGISLATIVE LETHARGY

Critics have opined that the real estate brokerage industry is incapable of saving itself. State legislatures often are the unwitting puppets of the industry and its lobbyists: They make token, ineffective, and confused efforts at corrections. But they end up with legislation that further confounds the problem—Band-Aid legislation. The public now finds itself with 50 different definitions of agency-dominated relationships that promise (in 50 different ways) *something that never can be*. Many states have *approved double-dealing dual agency*, promising to both sides that which it can deliver to neither side. Some states have enacted dual agency clones, such as designated agency or the hybrid of transaction brokerage that tacks on "limited representation" to clients.

REMOVE THE HEART

While still calling the relationship, *agency*, other states have actually attempted (by statute) to remove fiduciary obligations from the definition of real estate agency, a change that renders *agency* an amoral, mindless, soulless zombie. What ever happened to professionalism?

THE NEW ELECTRONIC ERA: THE SECOND CRISIS

The coming of the new electronic era has made a bad situation insufferable. Much of the property marketed today is offered through Web sites on the Internet. Significant industry plans require the sharing of listings by the year 2002.[5] The industry already has embarked across cyberspace on a voyage lacking a flight plan or destination.

THE AGE OF THE "INTERFRET"

What does a buyer in New Jersey know about the legal relationship he/she is undertaking with a broker in another state when that buyer simply opens a Web site to review the listings? Indeed, this may be the listing of a Web site broker, or of imported and adopted listings of another broker

(functioning on a different contractual basis) or of listings from a broker in a neighboring state (operating under other laws).

A. Does the unsuspecting buyer know in what capacity (i.e. buyer's or seller's agent, dual agent, or transaction broker) the Web site broker is serving and how that affects the buyer?

B. Does the unsuspecting buyer know his/her new legal relationship under the statutory definitions of the Web site state?

C. Does the unsuspecting buyer know what is confidential and what the broker in the other state must disclose?

D. Does the unsuspecting buyer know to whom the Web site broker's pretended fiduciary obligations flow?

Moreover, can a dual agent in a Web site state that authorizes dual agency conduct business with a buyer in another state (such as Florida) where dual agency is unlawful?

More significantly, what are the exposures to the licensees trapped in the conflicts of laws between the states? And how do the state courts sort these conflicts out?

Doubtless, the Internet has dragged the real estate brokerage industry, kicking and screaming, into interstate commerce under the United States Constitution. Therein lies the intensification of its problems and a unique possibility of solution.

TEMPLATE FOR A SOLUTION: THE ELECTRONIC RECORDS & SIGNATURES IN COMMERCE ACT

In January of 2000, the president of the United States signed into federal law an enactment passed by both Houses of Congress providing that a document would not be deemed ineffectual simply because the signature was signed electronically.[6] No one yelled "federal preemption" or "state's rights" because the federal enactment made sense. The new law did not preempt jurisdiction over the substantive contents of the documents. Presumptively, that remains within the province of the several states. It dealt only with the legality of the manner by which the documents and signatures were communicated. That new law was the only way to assure freedom of commerce in a nation impacted by the electronic age.

Earlier, ineffectual efforts had been made to approve electronic signatures by offering, in each state legislature, a uniform act to accomplish this goal. Each legislature has been tempted to modify the act to suit itself. The modifications, if enacted, would have resulted in, after a decade of wrangling, 50 different acts—hardly a solution. The federal government *could and did* resolve the confusion existing throughout the several states with a single uniform act.

THE SIMPLE SOLUTION

The way is clear to slay the many-headed Medusa of agency, together with all of its venomous offspring. The real estate industry can purge itself of the toxins of agency by looking to the Commerce Clause of the United State Constitution and **by creating and supporting a single federal statute making non-fiduciary (transaction brokerage) the uniform default standard for all real estate broker licensee relationships throughout the country.**

The right to license real estate brokers and salespersons, and the enforcement of those privileges, would remain (as it does now) in the state of origin. The state in which an action is venued would continue to enforce the law, with due consideration for conflicts of laws, very much as it does today. The confusion generated by a multiplicity of broker relationships or diversity of their definitions, however, would be eliminated.

With one stroke of the pen of the president of the United States, a vital, honorable, professional real estate brokerage industry can emerge to conquer the business challenges of the 21st century—one pen-stroke that makes volumes of confounding disclosures disappear, and one that will dance across the Internet bringing honesty and candor back to the real estate profession. No other viable alternative exists.

The status quo is no alternative. It is merely an invitation to the muckrakers, to the Federal and State Trade Commissions, and to a legion of trial lawyers to pick on the bones of a **fat old bird that forgot how to soar.**REI

NOTES

1. Professor Warren A. Seavey in *Restatement of Agency, Law of Agency*. The legal requirements of agency are: (1) The relationship must be consensual. That is, both parties must agree to its existence. (2) A fiduciary relationship must exist between the principal and the agent. (3) The agent must function under the control and direction of the principal within the

scope of the agency. (4) The agent must have the ability to affect the legal rights of his principal.

2. Douglas C. Kaplan, Esq., "When It Comes To Agency The Industry Needs To End 'Let's Pretend'" The Real Estate Professional (November/December 1996).
3. Ironically, most industries that profess similar agency brokerage services (e.g., boat brokers, insurance brokers, business brokers) appear to be governed by the cases and state laws of the real estate brokerage industry.
4. In a September 2000, report, the Florida House of Representatives Committee on Real Property & Probate Committee on Business Regulation & Consumer Affairs reported in its conclusion that "the committee members supported an initial presumption of a transaction broker relationship, with the right of the real estate licensee to act as a single agent pursuant to the written authorization of the buyer or seller, as appropriate."
5. The following Statement of Multiple Listing Policy became effective upon approval by the National Association of Realtors Board of Directors on May 22, 2000: "Associations of Realtors and their Multiple Listing Services are encouraged to immediately, and must by January 1, 2002, enable MLS Participants to display on Participants' public Web sites aggregated MLS active listing information through, at Participants' option, either downloading and placing the data on Participants' public access Web sites or by framing such information on the MLS or association public access Web site (if such a site is available) subject to the requirements of state law and regulation."
6. The "Electronic Signatures in Global and National Commerce Act," January 24, 2000.