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Real Estate Agent Liability for Creative Financing Failures

MURRAY S. LEVIN*

I. INTRODUCTION

In recent years, displeased buyers and sellers of real property have sued real estate agents with increasing frequency. Buyers' actions have often involved claims of misrepresentation concerning the condition of the property. Sellers' actions, on the other hand, have often involved claims of breach of fiduciary duty, such as breach of loyalty due to conflict of interest. Many of these same situations have also produced actions by real estate agents against customers for unpaid commissions. This background of growing

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1. The term "real estate agent" as used in this article is meant to include all real estate licensees who may represent a party in a real estate transaction. Brokers and salespersons are thus treated alike. Of course, with respect to a specific liability producing situation, a broker may be liable for the misconduct of a salesperson who is working on behalf of the broker.


5. E.g., Kimmell v. Clark, 21 Ariz. App. 455, 520 P.2d 851 (1974); Jensen v. Peterson,
litigation has set the stage for actions against real estate agents for problems related to the complexities of unconventional real estate transactions that have become so prevalent in the last several years due to higher interest rates. The real estate agent is an especially likely defendant because the agent will often be the only solvent party available as a target for blame when troubles arise in these transactions.

Real estate transactions are structured in a variety of ways to facilitate financing. The record high interest rates for conventional mortgage loans of the last few years have led to a number of innovative alternative forms of financing. As a result, otherwise impossible transactions have frequently proceeded through the use of shared appreciation mortgages, wraparound mortgages, balloon notes, installment contracts for deed, leases with purchase options, and similar techniques. Undoubtedly, with conventional mortgage interest rates as high as seventeen percent, the residential real estate market would have completely collapsed without these unorthodox transactions. Although newly structured, "lower" interest institutional offerings such as the variable or adjustable rate mortgage partly sustained the residential market, the involvement of sellers and other nontraditional parties as financiers was a far more significant factor during the worst of times.  

Although interest rates have declined slowly from these historic highs, real estate sales frequently continue to involve some form of unconventional financing. In the last few years, creative financing techniques have been a frequent subject of discussion in the mass media, and they are now viewed with a degree of acceptance. These techniques are often sophisticated, however, and it would be advisable for the average person to have the close assistance of a competent advisor before becoming a party to such a transaction.


Real estate agents have become actively involved in structuring these creatively financed transactions. In fact, real estate agents have boldly represented in advertisements that, in spite of inflated property prices and high interest rates, they can make home buying affordable again through their expert assistance. The process of facilitating sales thus has become increasingly complex; the real estate agent’s function has expanded far beyond the role of an intermediary who brings buyers and sellers together. The assumption of widening responsibilities, however, brings with it the threat of increased exposure to liability. This article will consider the potential liability of the real estate agent who is actively engaged in structuring unconventional transactions to facilitate property sales.

II. THEORIES OF LIABILITY

There are several legal theories that may serve as a basis for real estate agent liability in transactions involving creative financing. As is often the case with emerging areas of responsibility, plaintiffs are likely to assert multiple legal theories.\(^8\)

A. Contract

A real estate agent’s liability may be based on breach of contract. The real estate agent and client become parties to a contract when they agree that the client shall list the property for sale with the agent. Under the listing contract, the agent undertakes certain express and implied obligations. A breach of any such contractual obligation may serve to establish the liability of the agent. The listing contract will typically consist of a simple form that a trade association or the real estate agent’s firm supplies, and it is therefore not usually viewed as creating unusual obligations for the agent. In fact, the listing contract often will be a totally one-sided expression of the principal’s obligations.\(^9\) If it expressly states the agent’s obligations, it will likely be a very limited statement.\(^10\)

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10. See, e.g., D.B. Burke, Law of Real Estate Brokers § 2.6 Model Listing Agreement, at 50 (1982) (going beyond most listing agreements in this regard). In a three and one-half page “plain English” listing agreement only about one-third of one page is devoted
cause implied terms in a contract often flow from the express terms, the agent's obligations may multiply if a listing reflects a more complex transaction. Thus, if the listing contract describes an unconventional transaction, the real estate agent may have assumed additional responsibilities necessary to facilitate the transaction. For example, if the listing contract contemplates seller financing with a purchase money mortgage, the agent has arguably assumed the responsibility of seeing that an appropriate mortgage instrument is properly prepared and duly recorded. If something were to go wrong, such as the mortgage not being recorded, a strong case could be made that the agent should be liable for the loss that the nonfulfillment of the implied obligation caused. Obviously, there will be considerable debate among litigants over the existence, nature, and breadth of such implied obligations.

B. Agency

The real estate agent is an agent for a principal, which in most cases is the seller and occasionally the buyer. Therefore, liability may be based on a breach of any of the number of duties that agents owe to their principals according to general principles of to the agent's obligations in a paragraph entitled "Broker Warranties":

You, as the broker, will use your best efforts to sell the property and warrant that upon sale you are the sole broker involved, at least so far as you know, in the transaction, and entitled to a commission. You will indemnify me for any and all commissions sought by other brokers in connection with this transaction and defend me in case of litigation over such alleged commissions. Further, you warrant that every prospect presented to me is credit worthy and financially able to purchase the property and to indemnify me for any misrepresentations made by you, not based upon information given by me, about the property, provided that this warranty applies only within and up to the limits of any commission due you for negotiation of this transaction.

Id. at 52.

11. The real estate agent would, of course, be free to enlist the assistance of a lawyer in fulfilling such an obligation. The real estate agent also would be entitled to reimbursement of expenses from his principal. If a lawyer is retained to oversee the transaction, ultimate responsibility for the recording error rests with the lawyer. If the agent handles the transaction without the assistance of a lawyer, then the agent bears the final responsibility for the resulting loss. Cf. Morley v. J. Pagel Realty & Ins., 27 Ariz. App. 62, 550 P.2d 1104 (1976) (real estate agent found liable for failing to inform sellers that purchasers' offer contemplated no security and that a mortgage should be required); Townsend v. Doss, 2 Ark. App. 195, 618 S.W.2d 173 (1981) (real estate agent found liable to seller for purchaser's failure to pay downpayment because agent informed seller that he would be in charge of the entire transaction and that if downpayment was not payed seller could get her house back). For a discussion of these cases, see infra text accompanying notes 52-64. For further discussion regarding the roles of real estate agent and lawyer, see infra text accompanying notes 39-49 and 130-33. See also Currier, Finding the Broker's Place in the Typical Residential Real Estate Transaction, 33 U. FLA. L. REV. 655 (1982).
Because of the considerable breadth of these obligations and the high standards associated with the fiduciary concept, agency theory will probably serve as a frequent basis for real estate agent liability.

Under traditional agency theory, real estate agents involved in creatively financed transactions may be bound to somewhat atypical obligations. Several courts have referred to section 378 of the Restatement (Second) of Agency in identifying a variety of duties that real estate agents owe to their principals. This section provides:

One who, by a gratuitous promise or other conduct which he should realize will cause another reasonably to rely upon the performance of definite acts of service by him as the other's agent, causes the other to refrain from having such acts done by other available means is subject to a duty to use care to perform such service or, while other means are available, to give notice that he will not perform.

The Restatement's rule is essentially a rule of estoppel. When a real estate agent leads a party into an unconventional transaction, the rule of section 378 may serve to establish duties beyond those routinely associated with real estate agents. Unless the agent advises that specified services such as providing counsel, preparing documents, and supervising the closing process, will not be provided, the agent has arguably assumed such obligations. Additionally, if the agent undertakes a function such as document preparation, it must be done competently and in the best interest of the principal.

Agency law imposes upon the agent the fiduciary duty to act...
toward the principal with the utmost good faith and loyalty. As such, the real estate agent faces what in some circumstances can be a perplexing burden of placing the interest of the principal above that of the agent. The great wealth of legal authority in this area addresses matters such as self-dealing or undisclosed dual agency. Undoubtedly, a general sense of ethics and morality has assisted most real estate agents in avoiding problems of this kind. The agent’s role in the unconventional real estate transaction, however, presents a problem of a different character: the agent is involved in producing an “able” buyer. The agent reforms the transaction in such a way as to make that which was unaffordable in conventional terms affordable for the prospective buyer. The transaction requires extra efforts from the agent, and presents new and unusual risks for the principal. The agent’s desire to earn a commission conflicts with the duty to protect and inform the principal. Agents therefore may be inclined to draw inadequate attention to the additional risks associated with the unconventional transaction.

A similar conflict of interest is inherent in all real estate transactions where the agent is paid on a commission basis. For example, in the ordinary real estate transaction, the agent’s eagerness to earn a commission may cause him to influence the principal into accepting a low purchase offer. Although such activity should not be condoned, the subconscious forces at play render it an almost unavoidable fact of life. In this situation, however, the principal is

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The fiduciary duty is potentially broader than a real estate agent’s duty as expressed in a state licensing statute. The court in Carnell v. Watson, 176 Mont. 344, 578 P.2d 308 (1978), stated:

While the Real Estate License Act contains salutory provisions with regard to the conduct of brokers and agents, they are not exhaustive. The duty of a real estate broker or agent to deal fairly with his client ultimately arises from a separate fiduciary relationship between them, and not because of the existence of a licensing act. While a breach of a duty may also be a violation of the licensing act, it may also constitute an independent reason to deny a commission to the broker or agent—perhaps the most effective deterrent of all.

Id. at 350, 578 P.2d at 312.


left to fend for himself with respect to one fairly straightforward and comprehensible factor—price. This determination always will be a matter of personal economics. As long as the agent has not actively persuaded the principal to accept a below market price, the phenomenon would not seem to be so out of character as to be legally neglectful or abusive.\textsuperscript{19}

The unconventional transaction, however, is of a markedly different nature. Because of the unusual attributes and complexity of such a transaction, the principal needs and deserves a great deal more assistance. The typical principal will not have sufficient information to independently evaluate the risks and benefits of the proposed transaction. As a fiduciary, the real estate agent should explain and make full and complete disclosure of all material aspects of the transaction.\textsuperscript{20} This disclosure should include a careful and thorough explanation of all the additional risks associated with the unconventional attributes of the transaction. However, the real estate agent, who has expended extra effort to make the property affordable for the prospective buyer, will not be eager to jeopardize the deal and the commission by alerting the principal to potential problems.\textsuperscript{21}

\begin{itemize}
  \item[19.] Cf. Haymes v. Rogers, 70 Ariz. 257, 219 P.2d 339 (real estate agent under listing contract for $9,500 breached fiduciary duty by telling prospective purchaser that seller would probably accept $8,500), rev'd and remanded on rehearing, 70 Ariz. 408, 222 P.2d 789 (1950) (issue of real estate agent’s bad faith should have been submitted to the jury).
  \item[21.] The recent case of Zee v. Assam, 336 N.W.2d 162 (S.D. 1983), serves as an obvious example of an agent who neglected to adequately advise and counsel a party about the potential risks of a transaction because he was eager to close the deal. When the seller rejected the buyers’ offer by refusing to pay one-half of the title insurance costs, the real estate agent advised the buyers “not to let the ‘title insurance thing blow the deal because it was a good deal.’” Id. at 163. Buyers followed the agent’s advice that “‘title insurance would be a waste of money’” and that buyers should “‘just forget about title insurance.’” Id. The buyers eventually discovered an undisclosed encumbrance on the property and brought an action against the then-bankrupt seller and the real estate agent. The South Dakota Supreme Court affirmed the judgment against the real estate agent on the grounds of negligence and breach of fiduciary duty for the $15,000 that the buyers had to pay to clear the title. See also Timmsen v. Forest E. Olson, Inc., 6 Cal. App. 3d 860, 86 Cal. Rptr. 359 (1970). In Timmsen the court found that the trial court incorrectly awarded defendant’s motion for nonsuit after plaintiff’s opening statement. The opening statement alleged that the real estate agent who presented an unsound offer to an unsophisticated principal violated his fiduciary duty to determine the soundness of the offer and inform the principal, and that the agent hastened the sale at terms unfavorable to his client simply to receive the commission quickly or to prevent the listing contract from expiring. After reviewing these allegations, the appellate court held that the issue of the agent’s liability should have been presented to a jury.
\end{itemize}
Under agency law the agent also owes the principal a duty to exercise reasonable skill and care. In this regard, it has been said that there is a duty to disclose knowledge and material facts concerning the transaction. A difficult question is presented with respect to the degree of skill, care, and knowledge for which the real estate agent will be held accountable. For example, on the one hand, real estate agents are frequently admonished not to give legal advice. On the other hand, there is a growing tendency to characterize the real estate agent as "a highly skilled professional with a great breadth of knowledge of real estate law."

The applicable duty of care or skill of the real estate agent cannot be identified with certainty because there have been few cases addressing this issue, and because the holdings in these cases have been narrowly anchored in the facts of each situation. For the most part, courts have resorted to traditional agency principles with little amplification.

Section 379 of the Restatement (Second) of Agency is a good point of reference for a discussion of the duty of care to which agents usually are held. It reads:

Unless otherwise agreed, a paid agent is subject to a duty to the principal to act with standard care and with the skill which is standard in the locality for the kind of work which he is employed to perform and, in addition, to exercise any special skill that he has.

Although the application of this rule often involves comparisons between parties of the same business or occupation, broader com-


27. See, e.g., Smith v. Fidelity & Colombia Trust Co., 227 Ky. 120, 12 S.W.2d 276 (1928) (duty to employ that degree of skill usually possessed and exercised by others in the same business).
parisons may be justified. As worded, this rule does not focus on the occupation or profession of the agent. Instead, the focus is on the kind of work to be performed. Thus a comparison of the real estate agent's performance to that of a lawyer, accountant, banker, title insurer, financial advisor, or other similar practitioners, may be appropriate depending on the specific services provided and the totality of circumstances. The official comments to section 379 acknowledge that an agent may be required to exercise a higher degree of care or skill than that care or skill that is standard for the occupation in which the agent is employed. Assessing care and skill is not a simple matter. As the official comments indicate, other factors such as the agreement, any special warranties, representations that the agent made, the need for special knowledge, the level of compensation, or the age and experience of the agent, may have an effect on the assessment.

Real estate agents are obviously not required to be complete experts in other fields such as accounting, law, finance, abstracting, surveying, engineering, or insurance. If they undertake functions that these other practitioners normally perform, however, they may have a difficult time defending a flawed performance, given their fiduciary relationship with the buyer or seller.

28. In Hagar v. Mobley, 638 P.2d 127 (Wyo. 1981), the Wyoming Supreme Court, in addressing the issue of professional liability for real estate agents, seems to have left open the possibility of a higher standard:

Realtors, just like doctors, lawyers, engineering consultants, and builders, hold themselves out as professionals; it is their job to know their profession. People rely on and trust them. Failure to comply with either the accepted standards in the field or the standards society is willing to recognize as acceptable, is actionable.

Id. at 138 (footnote omitted).

29. Restatement (Second) of Agency § 379 comment a (1958).

30. Id. comments a-d.

31. Lunden v. Smith, 53 Or. App. 776, 632 P.2d 1344 (1981), is an interesting example of a court struggling through a standard of care and skill analysis. The Lunden suit centered on financial information furnished during negotiations to the prospective buyers of a business. The buyers brought a suit for rescission of the purchase when the financial information was discovered to be erroneous. Although the sellers agreed to rescission before trial, they nevertheless proceeded against the real estate broker, who handled the sale and calculated the erroneous financial information, for restitution of his commission. The purchase agreement was contingent upon the sellers providing income information to the buyers. When sellers informed the broker that the formal financial information concerning the business was in the possession of an out-of-state accountant, the broker inquired whether the profit and loss information could be gathered in some other way. On the sellers' suggestion, the broker constructed statements from the business check register. These "income" statements were transmitted to the buyers, actually showing only the cash flow of the business. When the sellers ultimately received the accountant's statement, it showed a substantially lower profit. This fact, however, was never communicated to the buyers or the broker.
C. Tort

The tort theory of negligence raises the same issue: how to determine the applicable standard of care or level of skill for which a real estate agent will be held accountable. The term "malpractice" is frequently used in connection with the failure of a professional to conform to an acceptable standard of care. In this regard, there is a coincidence among principles of contract, agency, and tort theory. The professional is not an absolute insurer with respect to performance related problems. Instead, the standard used in most malpractice inquiries involves a comparison of the professional's conduct with that of other competent professionals in the same or

The trial court held that the broker was negligent and ordered restitution of the commission. The broker appealed, contending that there was no evidence from which to infer that a reasonably prudent real estate broker in the community would have known that the accounting method was inaccurate and pointed to the fact that none of the witnesses testified that a broker should have expertise in accounting methods. The Oregon Court of Appeals responded by saying that the broker had misunderstood the trial court's findings. According to the appeals court:

The finding is not that [the broker] was required to be an expert in accounting to meet the standard of care for brokers, but that (1) he undertook to participate in the preparation and transmittal of the financial statements to persons for whom he was a fiduciary; and (2) the mistakes in the statements were so obvious that anyone involved in their preparation should have been aware of the problems.

*Id.* at 779-80, 632 P.2d at 1346 (emphasis added). Because the broker prepared and transmitted information that he admitted he did not understand, "[n]o expert testimony was required to show that his conduct failed to meet the applicable standard of care." *Id.* at 781, 632 P.2d at 1347-48. Moreover, according to the court of appeals, the trial court's holding was not that the broker was required to understand accounting methods, but that the broker "violated his duty by engaging voluntarily in an accounting exercise he did not understand." *Id.* at 780, 632 P.2d at 1347. The court of appeals concluded that the vendor should receive restitution of the commission he had paid to the real estate agent because it was the agent's erroneous accounting that caused the rescission of the sale. Although the *Lunden* court analyzed the case under a standard of care or skill analysis, the case could have been analyzed, as the special concurrence noted, under a restoration to the *status quo* analysis. *Id.* at 783, 632 P.2d at 1349.

The real estate agent in *Lunden* argued unsuccessfully that he had ensured that the plaintiffs were independently advised by a banker and an accountant, and that because the experts who provided this independent advice did not perceive the accounting error, he should not have been expected to perceive it. *Id.* at 782, 632 P.2d at 1348. The real estate agent's argument was based on the principle articulated in *Prall v. Gooden*, 226 Or. 554, 360 P.2d 759 (1961) (en banc), that a broker is required to "make his explanation commensurate with the education and understanding of the people he is dealing with, and if he is unable to give competent advice he should allow them to obtain it elsewhere." *Id.* at 561, 360 P.2d at 762. The *Lunden* court observed, however, that the broker's problem arose because he did more than allow the parties to seek independent advice—he participated in preparing the data. According to the court, their defective advice did not cure the agent's failure of responsibility. 53 Or. at 782, 632 P.2d at 1348.
similar locality. Problems arise when this test is applied to the real estate agent situation. The real estate profession is in transition, and the individual professionals display a great diversity of levels of skill. Professionalism and skill levels have increased substantially in recent years because of changing licensing standards and market conditions. Although some real estate agents are qualified to deal with complex and critical aspects of creatively financed transactions, most agents are probably not. The fact that the duties of lawyers and real estate agents overlap in the area of contract preparation and negotiation further complicates the matter. Consequently, it is difficult to identify an appropriate standard. While it may not seem fair to compare the typical real estate agent to a lawyer, it is also not fair to allow a client to suffer because a real estate agent has assumed responsibilities that the agent is not qualified to handle in the best interest of the client.

In addition to establishing a duty of care between the real estate agent and the principal, the tort theory of negligence also establishes the duties to other parties. For example, in the typical transaction in which the agent represents the seller, courts have been increasingly inclined to rule that the real estate agent also owes fairly substantial duties to the buyer. The fact that it is impossible for all acts of the agent to be in the best interest of both the principal and nonprincipal complicates considerations of what duties the agent owes to a nonprincipal such as a buyer.


33. See Ward v. Taggart, 51 Cal. 2d 736, 336 P.2d 534 (1959) (en banc); United Homes, Inc. v. Moss, 154 So. 2d 351 (Fla. 2d DCA 1963); Sawyer Realty Group v. Jarvis Corp., 89 Ill. 2d 379, 432 N.E.2d 849 (1982); Dugan v. Jones, 615 P.2d 1239 (Utah 1980); Hagar v. Mobley, 638 P.2d 127 (Wyo. 1981); see also Sinclair, The Duty of The Broker to Purchasers and Prospective Purchasers of Real Property in Illinois, 69 Ill. B.J. 260 (1981) (The typical real estate transaction involves unsophisticated purchasers; therefore, the broker should be required to make a full disclosure to the buyer to alert him of the conflict presented by a broker's representation of both buyer and seller.); Casenote, Real Estate Brokers' Duties to Prospective Purchasers—Funk v. Tifft, 1976 B.Y.U. L. Rev. 513 (A real estate broker should disclose his interest in the property, as well as any competing bids that he submits on the property, because such a disclosure would be beneficial to both buyer and seller.); Comment, A Reexamination of the Real Estate Broker-Buyer-Seller Relationship, 18 Wayne L. Rev. 1343 (1972) (the public policy and deterrence basis of a fiduciary duty permits more frequent suits by purchasers against real estate agents).
D. Statutes

Real estate agents may also be held liable for violations of licensing statutes. These statutes usually set forth detailed standards specifying when suspension or revocation of a license is appropriate. There is little authority specifically recognizing civil liability of real estate agents based solely on violations of licensing statutes and regulations. In most real estate agent cases, the court's discussion of statutory violations is merged with the discussion of duties under contract, agency, or tort law. It is common for statutes designed to protect the public to play a special role in the context of negligence. In some jurisdictions, the violation is treated


- (A) making a material misrepresentation, or failing to disclose to a potential purchaser any defect known to the broker or salesman;
- (B) making a false promise of a character likely to influence, persuade, or induce any person to enter into a contract or agreement when the licensee could not or did not intend to keep such promise; or
- (C) pursuing a continued and flagrant course of misrepresentation or making of false promises through agents, salesmen, advertising, or otherwise; or
- (D) failing to make clear, to all parties to a transaction, which party he is acting for; or
- (I) soliciting, selling, or offering for sale real property under a scheme or program that constitutes a lottery or deceptive practice; or
- (K) guaranteeing, authorizing, or permitting a person to guarantee that future profits will result from a resale of real property; or
- (P) publishing, or causing to be published, an advertisement including, but not limited to, advertising by newspaper, radio, television, or display which is misleading, or which is likely to deceive the public, or which in any manner tends to create a misleading impression; or
- (U) failing to advise a purchaser in writing before the closing of a transaction that the purchaser should either have the abstract covering the real estate which is the subject of the contract examined by an attorney of the purchaser's own selection, or be furnished with or obtain a policy of title insurance; or
- (V) conduct which constitutes dishonest dealings, bad faith, or untrustworthiness; or
- (W) acting negligently or incompetently in performing an act for which a person is required to hold a real estate license.

The Texas statute also provides for suspension or revocation for engaging in the unauthorized practice of law. *Id.* art. 6573a, § 16; see also Fla. Stat. § 475.25(1)(j) (1983) ("(1) The commission may deny an application for licensure ... if it finds that the licensee ... (j) has rendered an opinion that the title to any property sold is good or merchantable, except when correctly based upon a current opinion of a licensed attorney-at-law, or has failed to advise a prospective purchaser to consult his attorney on the merchantability of the title to obtain title insurance."). Miss. Code Ann. § 73-35-21(n) (Supp. 1983) ("No real estate broker shall practice law or give legal advice directly or indirectly ... [N]or shall he prevent or discourage any party to a real estate transaction from employing the services of an attorney.") In some jurisdictions, misbehavior of an individual member of a firm may affect the licenses held by other members in the firm. *E.g.*, Colo. Rev. Stat. § 12-61-113(2) (1978); Wis. Stat. Ann. § 452.14(4) (West Supp. 1983).

as negligence per se. In other jurisdictions, these violations are treated as merely establishing a presumption, inference, or evidence of negligence. Because of the many different state licensing law statutes and regulations for real estate agents and the varied views among the jurisdictions concerning negligence per se and related concepts, it is not appropriate within this article to proceed with a detailed analysis of those concepts. It is sufficient to note that a serious argument for civil liability could be made with respect to these statutory provisions and creative financing fact situations.

Practice of law statutes also may serve as a basis for real estate agent liability. Real estate agent responsibility in unconventional transactions and the unauthorized practice of law seem inextricably related. The unauthorized practice of law has long been a topic of concern for real estate agents, lawyers, and others focusing on protecting the public. Yet most of the states' laws remain vague on the issue of determining the permissible boundaries of real estate agent activities. Most of the attention given to this issue relates to document preparation. In this respect, there is general agreement that a real estate agent's preparation of contracts,

36. E.g., Noland v. Sears, Roebuck & Co., 207 Kan. 72, 483 P.2d 1029 (1971) (breach of a duty imposed by statutory law or by municipal ordinance constitutes negligence per se and provides the basis of recovery of damages proximately resulting therefrom); Ratliff v. Duke Power Co., 268 N.C. 605, 151 S.E.2d 641 (1966) (violation of statute imposing a duty to protect others is negligence per se unless statute provides otherwise); Phoenix Refining Co. v. Powell, 251 S.W.2d 892 (Tex. Civ. App. 1952) (when violation of criminal statute shown, violator is guilty of negligence as a matter of law).

37. E.g., Young v. Dodson, 239 Ark. 143, 388 S.W.2d 94 (1965); Ellis v. Caprice, 96 N.J. Super. 539, 233 A.2d 654 (App. Div. 1967); Glatt v. Feist, 156 N.W.2d 819 (N.D. 1968). For the basic test to determine whether a court should adopt the requirements of a statute or regulation as the standard of conduct of a reasonable person, see the Restatement (Second) of Torts §§ 286-88 (1965).

38. Liability based on violation of a licensing statute provision would extend to parties other than the principal. See Zichlin v. Dill, 157 Fla. 96, 25 So. 2d 4 (1946).

Generally speaking an agent is responsible only to his principal. This, however, is different. The broker in Florida occupies a status under the law with recognized privileges and responsibilities. The broker belongs to a privileged class and enjoys a monopoly to engage in a lucrative business. . . .

. . . Those dealing with a licensed broker may naturally assume that he possesses the requisites of an honest, ethical man.

Id. at 47-198, 25 So. 2d at 4-15; see also supra note 32 and accompanying text.

39. See generally D.B. Burke, Law of Real Estate Brokers, ch. 8 (1982) (discussing the conflict between attorneys' and brokers' liability for negligence); Shedd, Real Estate Agents and the Unauthorized Practice of Law, 10 Real Est. L.J. 135 (1981) (examining the leading judicial decisions on the issue of real estate agents and the unauthorized practice of law and defining the area where real estate agents may "walk freely" and the area where they should "fear to tread").
deeds, mortgages, or other legal documents, for a transaction in which the agent is not otherwise involved, definitely constitutes the unauthorized practice of law. On the other hand, however, the only document preparation that clearly may be undertaken with impunity is the creation of the listing agreement establishing the agency relationship and the preparation of the simplest of offers and acceptances incident to a normal representation. The treatment of what lies in between varies considerably among the jurisdictions and lacks a comfortable degree of clarity in most of those jurisdictions.

The majority of states have accepted that real estate brokers may fill in the blanks in certain standardized form documents that a lawyer has approved. Some states limit this activity, taking the position that only licensed lawyers may handle deeds, mortgages, and other documents that form the muniments of title. The relatively big blanks that anticipate considerable additional terms in lawyer-approved forms have been the subject of surprisingly little attention. The few cases suggest that a lawyer-approved form contract or offer that includes inserts prepared by a real estate agent who is providing for a creatively financed transaction would probably exceed what the courts have sanctioned in terms of "filling in

40. E.g., Kentucky State Bar Ass'n v. Kelly, 421 S.W.2d 829 (Ky. 1967); Hulse v. Criger, 363 Mo. 26, 247 S.W.2d 855 (1952) (en banc). Representation in court is another fairly certain example of unauthorized practice of law. See, e.g., Heiskell v. Mozie, 82 F.2d 861 (D.C. Cir. 1936) (realtor acting as owner's agent not entitled personally to conduct landlord and tenant proceeding because he was not an attorney at law); Sharp-Boylston Co. v. Haldane, 182 Ga. 893, 187 S.W.2d 855 (1952) (evidence insufficient to show that defendant corporation and its agent were involved in the unauthorized practice of law).

41. See Shedd, supra note 39, at 138; see also Hulse v. Criger, 363 Mo. 26, 247 S.W.2d 855 (1952) (en banc).

42. E.g., Pope County Bar Ass'n v. Suggs, 274 Ark. 250, 624 S.W.2d 828 (1981); Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n, 135 Colo. 398, 312 P.2d 998 (1957) (en banc); In re Matthews, 58 Idaho 772, 79 P.2d 535 (1938); State ex rel. Indiana State Bar Ass'n v. Indiana Real Estate Ass'n, 244 Ind. 214, 191 N.E.2d 711 (1963); Ingham County Bar Ass'n v. Walter Neller Co., 342 Mich. 214, 69 N.W.2d 713 (1955); State ex rel. Reynolds v. Dinger, 14 Wis. 2d 193, 109 N.W.2d 685 (1961).

A unique situation exists in Arizona where the state constitution empowers real estate licensees to draft or fill out and complete, without charge, any and all instruments including, but not limited to, preliminary purchase agreements and earnest money receipts, deeds, mortgages, leases, assignments, releases, contracts for sale of realty, and bills of sale." ARIZ. CONST. art. XXVI, § 1. This constitutional amendment was the product of a popular vote initiated by real estate licensees to overturn State Bar v. Arizona Land Title and Trust Co., 90 Ariz. 76, 366 P.2d 1 (1961) (en banc), a decision that had severely restricted the ability of nonlawyers to prepare real estate documents.

43. E.g., Keyes Co. v. Dade County Bar Ass'n, 46 So. 2d 605 (Fla. 1950) (en banc); Chicago Bar Ass'n v. Quinlan & Tyson, Inc., 34 Ill. 2d 116, 214 N.E.2d 771 (1966).
It is even less clear whether a real estate agent is involved in the unauthorized practice of law when he advises persons regarding their legal rights. In structuring the unconventional transaction there are numerous choices that must be made, each with specific legal consequences. Preparing an appropriate contract would necessarily involve giving legal advice. As a result, one must seriously question whether it is possible for a real estate agent to structure a creatively financed transaction without the assistance of a lawyer and avoid engaging in the unauthorized practice of law.\footnote{44. See, e.g., South Suburban Bar Ass'n, Inc. v. Homestead Realty, Inc., No. 75-CH-4297 (Dec. 9, 1977), summarized in Jones, Homestead Clarifies Quinlan-Tyson Decision and Sets Precedent for Future, 1978 ILL. B.J. 512-13 (blank space does not include the large space left blank on a form contract between the last line of text and the place for the parties signature); State Bar v. Guardian Abstract & Title Co., 91 N.M. 434, 575 P.2d 943 (1978) (Filling in blanks in real estate legal instruments, when forms have been drafted by attorney, and when filling in blanks requires only use of common knowledge regarding information to be inserted, does not constitute the practice of law; but, when filling in blanks affects substantial legal rights and if reasonable protection of such rights requires legal skill and knowledge greater than that of average citizen, then the activity should be performed by a lawyer.); Duncan & Hill Realty, Inc. v. Department of State, 62 A.D.2d 690, 405 N.Y.S.2d 339, (App. Div. 1978) (where detailed terms of purchase money mortgage were inserted in offer by broker, broker was engaged in the unauthorized practice of law); Martineau v. Greaser, 19 Ohio Op. 2d 374, 182 N.E.2d 48 (1962) (real estate agent engaged in unauthorized practice of law when she wrote in contract to purchase form that purchase price was to be financed with $2,000 as a downpayment, this being more than "simple, factual material"); Ralph R. Greer & Co. v. McGinnis, 6 Ohio Misc. 264, 217 N.E.2d 890 (Columbus Mun. Ct. 1965) (various provisions added after "remarks" relating to contingencies and obligations affecting parties, in single page printed form real estate purchase and sale contract drawn by real estate agent went far beyond mere scrivening and constituted the unauthorized practice of law); Washington State Bar Ass'n v. Washington Ass'n of Realtors, 41 Wash. 2d 697, 251 P.2d 619 (1952) (en banc) (preparation of a statutory warranty deed that included an assumption of mortgage clause was unauthorized practice of law); cf. People ex rel. Ill. State Bar Ass'n v. Schafer, 404 Ill. 45, 87 N.E.2d 773 (1949) (en banc). In Schafer, the court stated:

One who merely fills in certain blanks when other pertinent information should be elicited and considered is rendering little service but is acting in a manner calculated to produce trouble. When filling in blanks as directed he may not by that simple act be practicing law, but if he elicits the proper information and considers it and advises and acts thereon he would in all probability be practicing law. In other words, if his service does not amount to the practice of law it is without material value; but if it is of material value it would amount to the practice of law.

\textit{Id.} at 54, 87 N.E.2d at 777-78.\footnote{45. Cf. Wolfenberger v. Madison, 43 Ill. App. 3d 813, 357 N.E.2d 656 (1976) (real estate broker who counseled vendor on tax consequences of various forms of property transfer would most certainly be engaged in activities that constitute the unauthorized practice of law); Duncan & Hill Realty, Inc. v. Department of State, 62 A.D.2d 690, 405 N.Y.S. 2d 339 (App. Div. 1978) (where insertion of terms in contract constitutes the giving of legal advice, the broker or agent must refrain from offering his services therefor). Article 17 of the Code
The threat of criminal prosecution, no doubt, serves to eliminate many potentially abusive activities in the area of the unauthorized practice of law. Also, there is a considerable record of state and local bar associations having policed activities of real estate agents by initiating challenges to certain alleged unauthorized practices. Because the existing authority is divided, however, it

of Ethics of the National Association of Realtors (1974) provides that real estate agents "shall not engage in activities that constitute the unauthorized practice of law and shall recommend that legal counsel be obtained when the interest of any party to the transaction requires it."

46. See, e.g., Arkansas Bar Ass'n v. Block, 230 Ark. 430, 323 S.W.2d 912 (1959); Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n, 135 Colo. 398, 312 P.2d 998 (1957); Chicago Bar Ass'n v. Quinlan & Tyson, Inc., 34 Ill. 2d 116, 214 N.E.2d 771 (1966); State ex rel. Indiana State Bar Ass'n v. Indiana Real Estate Ass'n, 244 Ind. 214, 191 N.E.2d 711 (1963); Ingham County Bar Ass'n v. Walter Neller Co., 342 Mich. 214, 69 N.W.2d 713 (1955).

In some locales realtors and attorneys have resolved their differences extrajudicially. For example, in 1966, the Chicago and Illinois bar associations and the brokerage boards reached an accord. The accord allowed real estate agents to complete preliminary or earnest money contracts customarily used in their locale by filling in only factual and business details in appropriate blanks and to add to or delete from such forms only factual statements and business details that the principals furnished that were necessary to conform to the particular factual situation. The accord, however, prohibited real estate agents from preparing any document necessary to carry out or implement the contract. The Illinois Real Estate Broker-Lawyer Accord, art. 1, reprinted in 32 Unauthorized Practice News 1, 4 (1966); see also Connecticut Realtor-Lawyer Agreement, reprinted in Realtor-Lawyer Principles Adopted, 40 Unauthorized Practice News 177 (1977); Statement of Principles by the Washington Board of Realtors, Inc. and The Bar Association of the District of Columbia, 35 D.C. B.J. Aug.-Sept.-Oct. 1968, at 16.

Recently, the New Jersey Supreme Court approved an agreement between the state bar and realtor associations defining permissible document preparation activities by real estate licensees. New Jersey State Bar Ass'n v. New Jersey Ass'n of Realtor Bds., 93 N.J. 470, 461 A.2d 1112 (1983) (the court upheld the consent judgment, but modified it to conform to the requirements of the plain language law that requires that consumer contracts be expressed in a simple, clear, understandable, and easily readable way). Licensees are permitted to prepare certain residential sales contracts and leases provided that the contract contains prescribed statements, conspicuously at the top of the first page and in detail within the text of the contract, which state that the parties have a right to consult an attorney who can review and cancel the contract by giving notice of disapproval within three business days after delivery of the signed contract by the licensee to the parties. Id. at 475, 461 A.2d at 1115. This novel agreement and the court's opinion are thought provoking. Based on public hearings and trial testimony the superior court chancery, which initially presided over the matter, upheld the accord and stated that the agreement would serve the public interest because it renders contracts for the sale of residential property subject to prompt review by an attorney. 186 N.J. Super 391, 452 A.2d 1323 (1982).

Justice Schreiber of the New Jersey Supreme Court, in a highly critical dissenting opinion, charged that the new rule was against the public interest and went far beyond permitting realtors to fill in blanks in a form by authorizing them to "negotiate and draft the entire contract" and thus "countenances the practice of law by those not qualified as lawyers." 93 N.J. at 483, 461 A.2d at 1120. Justice Schreiber also expressed concern over the attorney cancellation power:

Why the attorney, and not the party, should be given that power is unclear.
is not clear whether persons who have suffered losses in connection

Vesting the attorney . . . with the power of revocation means that when a party changes his mind about a transaction he must engage a lawyer. Thus the protection of unilateral rescission will only be available for those individuals who are willing to pay and can afford to hire an attorney. Moreover, there is merit in the comment of Legal Services of New Jersey, Inc. when it writes: "‘Attorney disapproval’ seems to place the entire burden of decision on the attorney, which would be highly questionable ethically and undesirable as a practical matter. The attorney may think certain provisions are unwise or loose, but for any number of reasons be unwilling to take a rigid stand of disapproval . . . ."

Indeed, the clause is unclear as to whether the right of revocation depends upon the attorney’s reason, if any.

Id. at 485, 461 A.2d at 1121.

According to Justice Schreiber, the new rule is a product of “the economic interests of the realtors and attorneys, rather than societal interests.” Id. Because under the accord the real estate licensees’ contract activities are restricted to residential sales of one to four dwelling units or vacant one-family lots and residential leases of a term of one year or more, real estate agents will be preparing contracts for “mostly low and moderate income individuals who are buying or leasing homes . . . . Only when the financial stakes are likely to be higher must the realtor step aside to be replaced by the attorney.” Id. In Justice Schreiber’s view, “[i]f a line must be drawn within which realtors may practice law, it would seem appropriate that it depend on the subject matter of the advice and the nature of the realtor’s acts, rather than the type of structure to be conveyed.” Id.

In its new creative financing disclosure statute, the California Legislature also used the four family unit distinction. See infra text accompanying notes 99-129. There, in the public interest, the line was drawn in the opposite direction. The California Legislature acted in recognition of the need for special protection for the parties in these smaller transactions. Apparently, it is assumed that the larger transactions typically will involve more sophisticated parties with adequate counsel.

47. See, e.g., Torres v. Fiol, 110 Ill. App. 3d 9, 441 N.E.2d 1300 (1982) (cause of action grounded on nonattorney’s alleged negligent and unauthorized practice of law was cognizable); Rathke v. Lidisky, 59 Ill. App. 3d 560, 375 N.E.2d 871 (1978) (statute prohibiting unauthorized practice of law and punishing violators by contempt does not allow private cause of action); Kronzer v. First Nat’l Bank, 305 Minn. 415, 235 N.W.2d 187 (1975) (although disposing of the case on other grounds, the court set out the criteria for a negligence per se analysis on the basis of a violation of the unauthorized practice of law statute and characterized a damage action based on the statute as an open question); Janssen v. Guaranty Land Title Co., 571 S.W.2d 702 (Mo. Ct. App. 1978) (dismissed statutory claim against title company based on the unauthorized practice of law, noting that traditional claims based on fraud or negligence were available); Hecomovich v. Nielsen, 10 Wash. App. 563, 518 P.2d 1081 (1974) (one who engages in the unauthorized practice of law is liable for the damages caused, and the standard of care applied is the same as the standard applied to those licensed to practice law); Burien Motors, Inc. v. Balch, 9 Wash. App. 573, 513 P.2d 282 (1973) (duty owed by one who engages in the unauthorized practice of law is the same as the duty owed by an attorney). The Washington courts have taken the strongest stand on this issue. In one early case, Mattieligh v. Poe, 57 Wash. 2d 203, 356 P.2d 328 (1960) (en banc), the court seemed to enunciate a standard of strict liability:

The appellant’s proof was that the contract prepared by respondent [broker] was at variance in many particulars with his instructions. When a broker undertakes to practice law, he is liable for negligence. It is immaterial whether the broker’s attempt to prepare a contract, such as had been authorized by his client, failed because of his ignorance, stupidity, incompetence, negligence or fraud.

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with creatively financed real estate transactions will be able to use the unauthorized practice of law as a basis for a private civil action against real estate agents for damages.\[^{48}\] It is equally unclear whether engaging in the unauthorized practice of law will affect the standard of care for which the real estate agent will be held accountable.\[^{49}\]

State consumer protection statutes are an additional basis of liability that may be used against real estate agents for problems arising in creatively financed transactions. Courts often define the scope of these statutes as broad enough to cover real estate contracts. Several recent cases have concerned the real estate agents' duties to disclose under state consumer protection laws.\[^{50}\]

III. THE DEVELOPING CASE LAW AUTHORITY

Notwithstanding the coverage in a number of newspaper reports,\[^{51}\] very few of the actions against real estate agents brought

\[^{48}\] Id. at 204, 356 P.2d at 329 (citation omitted). For a case discussing possible strict liability, see also Wright v. Langdon, 274 Ark. 258, 623 S.W.2d 823 (1981).

\[^{49}\] In addition to serving as a sword for an injured victim, the unauthorized practice of law concept could serve as a shield for a real estate agent. An agent may be able to argue that he could not provide a service because to do so would have constituted the practice of law. Cf. Morley v. J. Pagel Realty & Ins., 27 Ariz. App. 62, 550 P.2d 1104 (1976) (discussed infra in the text accompanying notes 52-59) (where the court was careful to characterize the duty to warn of the need for security as banal advice distinguishable from legal advice constituting the practice of law).

\[^{50}\] One commentator has chided that the prevailing definition of the practice of law is “somewhat contrived in the face of a doctrine that allows . . . personal injury specialists but not real estate brokers to consummate title and closing arrangements.” Rhode, Why the ABA Bothers: A Functional Perspective on Professional Codes, 59 Tex. L. Rev. 689, 705 (1981) (footnote omitted). It must be remembered, however, that the lawyer who is not skilled in the real estate practice but who undertakes complex functions will nonetheless be held to the standard of care of a lawyer who is skilled in the real estate area. It seems reasonable that the same should be true of a real estate agent performing a function that lawyers normally perform. See Olson v. Neale, 116 Ariz. 522, 570 P.2d 209 (1977) (If a real estate agent “can practice law in the area of real property sales, it is reasonable to hold him to a full understanding of the implications and ramifications of the Statute of Frauds.”); Wright v. Langdon, 274 Ark. 258, 263, 623 S.W.2d 823, 826 (1981) (“reason urges that the standard should be no less than that required of a licensed attorney, and conceivably an even higher standard would be appropriate—strict liability, for example, to deter those who might be otherwise tempted to profess a competence they have no right to claim”); see also Real Estate Law Newsletter, Contract and Conveyance Documents—Broker Beware, 11 Colo. L. 2383 (1982); Riggs, Unauthorized Practice and the Public Interest: Arizona’s Recent Constitutional Amendment, 37 S. Cal. L. Rev. 1, 11-13 (1964).


for creative financing failures have progressed to the point of generating appellate court decisions. The few reported judicial opinions display the willingness of some courts to aid the victim of a real estate agent's incompetence or poor advice. The cases discussed in this section arguably point the way toward the imposition of broad liability upon a real estate agent who has caused losses by failing to soundly structure the transaction, to adequately advise the parties or, when appropriate, to make referrals to more qualified advisors.

The two following cases illustrate that, at a minimum, real estate agents should advise their clients that debt should be adequately or properly secured. In Morley v. J. Pagel Realty & Insurance, the agent listed the plaintiffs' home for sale at an asking price of $15,000—$3,000 down and the balance payable pursuant to a fifteen-year, eight percent note. The agent brought plaintiffs an offer for the full asking price but with $2,500 down and the balance payable by a ten-year eight percent note. Upon closing the deal, the buyers executed a $12,500 note. "The form used for the note included the words 'This note is secured by a mortgage on real property,' but these words were crossed out." Shortly thereafter, the buyers deeded the property to a third party for cash, defaulted on the note, and went bankrupt. Plaintiffs sued the real estate firm for damages of $11,900, alleging breach of fiduciary duty and negligence in failing to inform them of the unsecured nature of the buyer's offer, and of the advisability of requiring a mortgage.

The trial court ruled in favor of the real estate firm, reasoning that to require a real estate agent to give advice that a promissory note should be secured by a mortgage would be to require the agent to illegally engage in the practice of law. As a result, the boundaries of the lawyer's exclusive domain—the practice of law—complicated the inquiry of the real estate agent's standard of care.

The Arizona Court of Appeals, drawing on decisions from other states, recited a series of operative rules. First, "a real es-

54. Id.
55. Starkweather v. Shaffer, 262 Or. 198, 497 P.2d 358 (1972) (dictum) (real estate broker must make a full and understandable explanation to his client before having him sign any contract); Prall v. Gooden, 226 Or. 554, 561, 360 P.2d 759, 762 (1961) ("The broker
tate [agent] must make some kind of explanation of the offer he procures for his client.”

Second, “if the offer varies from the terms of the listing, the [agent] must so inform his client.”

Third, an agent acting for “an inexperienced client must employ all his professional ability and knowledge to make sure the client understands the ‘facts’ that will materially affect his desire to sell in accordance with the terms of a purchase offer.”

The court observed that although the average person may not be very familiar with mortgages, the desirability of securing property with a mortgage is common knowledge in the real estate business. The court therefore concluded that by failing to inform the client that the note should be secured, the real estate agent had breached his duty to effect a sale on the best terms possible and to disclose all the relevant information. Rejecting the unauthorized practice of law defense, the Morley court characterized the mere “duty to warn the untutored vendor that he should require some form of security in the contract of sale” as “banal advice” that “creates no danger to the public.”

In Townsend v. Doss, the Arkansas Court of Appeals similarly held a real estate agent liable for failing to safeguard a seller’s interest. Townsend, the listing agent, presented an offer from a buyer who was to assume an existing loan and pay the balance in cash. Although the closing was to occur on September 10, 1979, $7,000 of the “downpayment” was not due until November 20, 1979. A warranty deed granting the property to the buyer was recorded on September 10th, but the $7,000 was never paid. The seller brought an action against both the defaulting buyer and the real estate agent. The trial court found the agent negligent in handling the transaction and granted judgment in favor of the seller.

On appeal the agent argued that he neither breached any con-
tractual obligation nor any regulation of the state real estate commission. He further argued that the trial court's decision should be reversed because there was no expert testimony at trial regarding the standard of care that a real estate agent owes to a customer. The Arkansas Court of Appeals responded:

It is the well-established rule that a real estate broker, who is not a mere middleman, but is employed by a principal to act as agent in a real-estate transaction is under a duty to exercise reasonable care and skill, or that degree of care and skill ordinarily employed by persons of common capacity engaged in the same business, and that a broker is liable to his principal for all consequences directly flowing from his failure to exercise such degree of ordinary care and skill in the handling of the matter entrusted to him.62

The Townsend court rejected the contention that specific evidence of the appropriate standard of care was required. The court was persuaded by the statement in Morley that persons of common capacity in the real estate business are well aware of the need for security, and therefore real estate agents have a duty to inform their customers of this need. In recognizing a duty of care with respect to the security function, section 378 of the Restatement (Second) of Agency also influenced the court.63

Narrowing in on the specific facts of the case, the Townsend court observed that there was evidence in the record to show that the real estate agent was aware of the prior financial problems of the buyer; that the seller was concerned about the buyer's history and the security for the balance of the downpayment; that the seller expressed these concerns to the agent; that the agent discouraged her from becoming personally involved in the details of the transaction and assured her that if the balance was not paid she could get her house back; and that the agent "made absolutely no effort to secure (by mortgage or otherwise) the balance due . . . ."64 The court therefore affirmed the judgment for $7,000 against the real estate agent on the basis of his negligence, commenting that the agent's assurances that the seller could get her house back in the event of a default buttressed the finding of

63. See supra text accompanying note 14.
64. 618 S.W.2d at 175. The agent's only explanation for his failure was that he somehow believed that the savings and loan that held the first mortgage "was going to hold the deed rather than record it until a substantial sum had been paid on the amount due." Id. The court found no evidence of such an escrow arrangement. Id.
negligence.

Morley and Townsend thus stand as basic authority for imposing liability upon a real estate agent who fails to competently counsel a customer regarding the financing of a real estate transaction. Both cases, however, concerned relatively simple transactions, and the courts were required to address only the fundamental error of an agent's failure to advise a customer to acquire security for the unpaid portion of the sale price. It is certainly no great burden to ask real estate agents to show this rather minimal regard for the well being of their principals.

The case of Colley v. Tipton serves as another recent example of a court imposing liability on a real estate agent in the context of a seller financed transaction. In Colley, the defendant, a real estate agent, failed to provide for interest on all the balances that were to be paid over time. The listing agreement had specified that eight percent interest would be due on any balance of the purchase price that the sellers carried. In May 1979, the sellers' real estate agent drafted an offer for prospective buyers in the form of a proposed real estate contract. The offer provided for a sale of the listed farm property at $171,000, with $10,000 to be paid at the signing of the contract and $4,500 to be paid on December 31, 1979. An additional $35,000 was to be paid on September 1, 1980. The balance was "to be carried by seller for a period of 20 years at 8% interest (sic) . . . . First payment to be made annually (sic) on December 31, 1981." The buyers were to receive possession on June 1, 1979 and a warranty deed on September 1, 1980, when the $35,000 was to be paid.

After the buyers signed this offer, the real estate agent presented it to the sellers. According to the sellers, they did not read the offer because the husband "did not have his glasses, and because they believed that they would probably not understand it anyway." The real estate agent disputed this, claiming that the sellers did read it and that the agent had explained the payment terms to them. The agent admitted, however, that nothing was said about interest from June 1, 1979 to September 1, 1980 on the balance due after the $10,000 downpayment. Sometime after the sellers accepted the offer, they called the agent to inquire whether they would receive interest from June 1, 1979. The agent replied:

65. 657 S.W.2d 268 (Mo. Ct. App. 1983).
66. Id. at 270.
67. Id.
The buyers subsequently took the position that the contract did not require them to pay interest during that period. In the action against the real estate agent that ultimately followed, the jury awarded the sellers almost $24,000 in damages for lost interest. On appeal, the Missouri Court of Appeals upheld the jury’s verdict.

There are a number of other decisions in which real estate agents have lost commissions or been similarly held liable for losses due to errors committed in structuring or overseeing transactions. Although many of these cases have involved conventional transactions, the reasoning behind most of these rulings also applies to more complicated unconventional contexts. For example, failure to investigate suspected title problems; the character, suitability, and financial responsibility of prospective parties; and the suitability of the property, have led to judgments against real estate agents. Naturally, failure to disclose known problems is also actionable. Real estate agents also have been found liable for fail-

68. Id.

69. See id. at 273.

70. One confusing aspect of the case law concerning real estate agent responsibilities is the general lack of distinction between actions over real estate commissions and actions involving broader issues of damages. The courts routinely apply authority from one context to the other without comment. Although some of these applications are theoretically sound, many seem questionable.

71. E.g., Wilson v. Hisey, 147 Cal. App. 2d 433, 305 P.2d 686 (1957) (failure of broker to recommend that lessee obtain a title search and misrepresentation that there was only one encumbrance of a certain amount against the property constituted negligence); Mayflower Mortgage Co. v. Brown, 530 P.2d 1298 (Colo. 1975) (broker failed to make record search and therefore did not discover existing second lien); Zee v. Assam, 336 N.W.2d 162 (S.D. 1983) (negligence and breach of fiduciary duty in informing purchaser that title insurance was not necessary); Hinrichs v. Brady, 23 S.D. 250, 121 N.W. 777 (1909) (broker failed to examine note and therefore did not warn buyer that note had been paid in full and further failed to advise that a tax lien encumbered the property).

72. E.g., Fitzgerald v. Edelen, 623 P.2d 418 (Colo. App. 1980) (real estate agent breached duty of care by not ascertaining that corporation was “solid”); Shatz Realty Co. v. King, 225 Ky. 846, 10 S.W.2d 456 (1928) (real estate agent is under a duty to make a reasonable inquiry and investigation to determine whether a prospective tenant is a suitable person); Bute v. Williams, 162 S.W. 989 (Tex. Civ. App. 1914) (agent who recklessly and inaccurately informed principal that prospective purchaser was a person of wealth and financial responsibility, thereby inducing principal to accept notes from purchaser that proved to be worthless, was not entitled to a commission for services, even though the misinformed statements about financial worth were not made with intent to deceive).

73. E.g., Ford v. Cournale, 36 Cal. App. 3d 172, 111 Cal. Rptr. 334 (1973) (real estate broker had a duty to investigate whether a property would produce sufficient income to meet expenses).

74. E.g., Cooper v. Jevne, 56 Cal. App. 3d 860, 128 Cal. Rptr. 724 (1976) (“negative fraud” and “misrepresentation by false opinion” with respect to buyer); Prall v. Corum, 403
ing to explain adequately the nature of a contract, to prepare properly papers relating to a transaction, and to see that the closing is carried out properly. There are relatively few decisions per-

So. 2d 991 (Fla. 2d DCA 1981) (broker's failure to disclose that he was the source of buyer's downpayment was a material breach of fiduciary duty); Hare v. Bauer, 223 Minn. 285, 26 N.W.2d 359 (1947) (The agent concealed the fact that he advanced the earnest money payment from his own funds, and that the prospective purchaser was unable to go through with the sale due to financial difficulties brought on by prolonged illness.).

75. E.g., Leigh v. Loyd, 74 Ariz. 84, 244 P.2d 356 (1952) (seller's broker held liable for damages for intentionally remaining silent while his client signed certain legal instruments under a serious misapprehension of their true nature); Monty v. Peterson, 85 Wash. 2d 956, 540 P.2d 1377 (1976) (broker failed to adequately emphasize importance of private restrictive covenants).

In Reese v. Harper, 8 Utah 2d 119, 329 P.2d 410 (1958), the Utah Supreme Court denied a real estate agent his commission for not making sufficiently clear to the principal who was to pay off an existing mortgage and other encumbrances. The agent had taken a $45,000 listing on the seller's farm. The agent presented a contract that showed an offered purchase price of $30,000 and stated that the property would be sold free of all encumbrances. The seller misunderstood that he would receive $30,000 net, with the buyer paying off approximately $15,000 worth of encumbrances. The agent did not explain the nature of the offer to the seller. In the action for the commission, the agent argued that he was under no "duty to coddle and 'spoonfeed'" the seller because the seller had ample opportunity to read the papers and he signed them voluntarily. The court responded:

The above contention is sound as between people dealing with each other under usual circumstances. But the relationship of real estate agent and client makes the situation quite different. The agent is issued a license and permitted to hold himself out to the public as qualified by training and experience to render a specialized service in the field of real estate transactions. There rests upon him the responsibility of honestly and fairly representing the interests of those who engage his services, and upon failing to do so his license may be revoked. Accordingly, persons who entrust their business to such agents are entitled to repose some degree of confidence that they will be loyal to such trust and that they will, with reasonable diligence and in good faith, represent the interests of their clients. Unless the law demands this standard, instead of being the badge of competence and integrity it is supposed to be, the license would serve only as a foil to lure the unsuspecting public . . . to be duped by people more skilled and experienced in such affairs than are they, when they would be better off taking care of such business for themselves.

Id. at 122, 329 P.2d at 412.

76. E.g., Kimball Bridge Rd. v. Everest Realty Corp., 141 Ga. App. 835, 234 S.E.2d 673 (1977) (inadequate property description in sales contract; seller was not contributorily negligent as a matter of law for failing to consult an attorney); Wisnieski v. Harms, 188 Neb. 721, 199 N.W.2d 405 (1972) (broker cannot recover compensation for services if negligent in drawing a contract of sale for his principal); Mattie Leigh v. Poe, 57 Wash. 2d 203, 356 P.2d 328 (1960) (contract that agent prepared was at variance with the instructions seller gave him); Shaw v. Briggie, 193 Wash. 595, 76 P.2d 1011 (1938) (deed failed to provide for assumption of notes).

77. E.g., Lester v. Marshall, 143 Colo. 189, 352 P.2d 786 (1960) (broker failed to pay off deed of trust from funds paid to broker for that and other purposes); White v. Brock, 41 Colo. App. 156, 584 P.2d 1224 (1978) (closing papers not in conformity with sales contract); Stewart v. Muse, 62 Ind. 385 (1878) (failure to record mortgage); Doane v. Knoxville Inv. Corp., 159 Tenn. 76, 16 S.W.2d 186 (1929) (real estate agent liable for damages resulting
taining to each of these examples of misconduct. Collectively, however, these decisions depict a growing territory of legal responsibility for real estate agents. The decisions lay the groundwork for claims of real estate agent liability predicated upon failure to counsel the seller and buyer about risks associated with unconventional transactions and failure to ensure that certain fundamental safeguards are provided.

In contrast to the ordinary real estate transaction, the creatively financed transaction will typically present the real estate agent with a broader range of matters to be investigated and disclosed, a greater number of papers to be prepared and explained, and a far more complex closing to supervise. In short, there will be many more potential pitfalls for the agent to overcome. The recent decisions that follow illustrate the expanding purview of real estate agent responsibility.

In *Hurney v. Locke,* the plaintiffs sued a real estate agent and a broker for failing to adequately advise them about certain regulations under a state mortgage subsidy program. In 1978 the Hurneys purchased a home in Flandreau, South Dakota, with financing arranged through the Western Bank of Sioux Falls. The financing was through the Federal Housing Authority (FHA) and the South Dakota Housing and Development Authority (SDHDA), and it carried a subsidized interest rate of seven and a half percent per year on the unpaid balance. In November of that same year, the Hurneys decided to sell their home and move to Sioux Falls. Buck, a licensed real estate agent for the Locke Agency, called the Hurneys and asked to represent them in the sale. The Hurneys agreed because their own efforts were unsuccessful, and shortly thereafter the agent presented a prospective buyer and offer to them. Although the sellers rejected this offer, in subsequent negotiations conducted through the agent, the buyers agreed to pay more if they could assume the SDHDA mortgage. Locke, the agency broker, brought the buyers to Western Bank to discuss financing and later arranged to hold the closing at Western Bank.
A crucial element in the Hurney sale transaction was a limitation on SDHDA loans that would apply to the Hurneys if the buyers assumed their SDHDA loan. On October 6, 1978, SDHDA sent a memorandum to all participating lending institutions in South Dakota reminding them of the importance of determining whether a loan applicant had held an SDHDA loan in the past. If there had been such a loan and the new purchasers assumed it, the applicant could not apply for another SDHDA loan. The applicant might apply for a new loan, however, if the previous loan had been satisfied or if a substitution of mortgagor was approved. Breidenbach, a Western Bank employee, stated that he had informed the broker at least twice of the risks to the Hurneys in permitting the assumption, including when the broker first brought the buyers to Western Bank to discuss financing. The broker admitted he had been informed of the problem, but only a few days prior to the scheduled closing. The sale closing occurred in Breidenbach's office at Western Bank with the Hurneys and the broker in attendance. Neither Breidenbach nor the broker informed the Hurneys of the SDHDA memorandum on mortgage assumptions.

Subsequently, the Hurneys found a home that they wanted to buy in Sioux Falls. When they applied at Western Bank for financing, they were told for the first time of their ineligibility for another SDHDA loan. Because they were unable to obtain an SDHDA loan, they resorted to conventional financing, which required a larger down-payment and a higher interest rate on the unpaid balance. The Hurneys sued the real estate agent and the broker for the cost differential between SDHDA financing and the conventional financing they actually obtained. Additionally, the Hurneys sought exemplary damages for the intentional and fraudulent failure to inform them of the SDHDA loan limitation. The real estate agent and the broker impleaded Breidenbach and Western Bank as third-party defendants. The trial court granted summary judgment in favor of all defendants. The trial court's decision regarding the agent and the broker was based on a ruling that they were merely "middlemen," apparently owing a less substantial duty to their customer.

The South Dakota Supreme Court reversed on appeal, holding that the trial court's use of the middleman distinction was erroneous. The supreme court explained that this distinction was only useful when the issue was a real estate agent's right to collect com-
missions from both parties to a real estate transaction. Here the issue was whether the agent and the broker had breached a duty to inform their customers of the risk in permitting assumption of their mortgage. The court wrote:

A real estate agent is a licensed professional holding himself out as trained and experienced to render a specialized service in real estate transactions. Clients rely on the agent's expertise and expect the agent to act in their best interests. For these reasons, the relationship between real estate agent or broker and the principal is confidential and fiduciary. Locke and Buck owe appellants a duty of utmost good faith, integrity and loyalty.

Unless otherwise agreed, Locke and Buck owe their principals, like appellants, a duty to use reasonable efforts to fully, fairly and timely disclose information to their principals within their knowledge, which is or may be material to the subject matter of their agency.

The court further explained that the scope of a real estate agent's duty is limited in several respects: it depends on the agent's knowledge of the information allegedly withheld, on the task entrusted to the agent, the agreement of the parties, their previous relations, and the facts of the situation. The real estate agent and the broker argued that they owed no duty regarding financing details. They also argued that the bank was duty bound to inform the seller because it acted as the seller's agent for the purpose of financing. The court observed, however, that the broker had determined that the mortgage was assumable, had advised of the counter-offer that included the mortgage assumption, and was present at the closing. The court thus remanded the case for a determination of the issues of fact concerning the scope of the agent's duty.

The Hurney case is somewhat limited as authority for real estate agent liability for creative financing failures. First, the court did not go so far as to rule as a matter of law that real estate agents always assume responsibility for safeguarding against problems related to the financial complexities of transactions. Al-

80. See id. at 768 (citing Langford v. Issenhuth, 28 S.D. 451, 134 N.W. 889 (1912)).
81. Hurney, 308 N.W.2d at 768 (footnote omitted).
82. Id. at 769. For an example of circumstances negating the duty to inform, see Bel-
though the court's observations about the broker's and the agent's activities suggest an inclination toward holding them responsible in this case, the court ultimately turned the question back to the trial court for a factual determination. Thus, the issue of responsibility was not resolved on the basis of status alone. The factors of "knowledge," "task," "agreement," "previous relations," and "facts of the situation," which the court listed in regard to a determination of the scope of a real estate agent's duty, suggest that the court is seeking a measure of intent and reasonable expectations based on the totality of the relationship. Second, it is unclear from a reading of the case report to what extent actual knowledge was a necessary ingredient to the cause of action. A fiduciary duty to disclose known material information is not novel. When a real estate agent takes an active role in structuring financing, the agent will surely be required to fully inform the principal of known material information. One should further consider, however, the extent to which an agent's fiduciary duties may extend beyond that which is actually known. The *Hurney* court leaves the impression that the agent and the broker would probably not have been liable if they had not been specifically notified of the SDHDA loan limitation.

In addition to the duty of good faith or loyalty, an agent owes a duty of due care and skill. As a result, matters that are not known should also present a potential threat of liability. Mere ignorance of operative laws and pertinent facts will surely not serve as an automatic defense for the real estate agent involved in structuring an unconventional transaction.

In *Peirce v. Horn*,83 the California Court of Appeals for the First District addressed the issue of a real estate agent's duty of good faith and care in the context of arranging loans for a customer. Peirce, a seventy-seven year-old widow, who owned her residence and several rental properties, was having financial trouble. She sought the assistance of Hom, a licensed real estate broker with an office near her residence, whom she had known on a non-business basis for several years. She asked Hom to arrange a loan on one of her properties. He arranged a loan secured by a second deed of trust, charging her a fee. A couple of months later, responding to a similar request, Hom arranged another loan for Peirce on identical terms securing another property. During the

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83. 126 Cal. App. 3d 193, 178 Cal. Rptr. 553 (1981) (The case was initially reported in the advance sheets, but by order of the Supreme Court of California dated January 27, 1982, the Reporter of Decisions was directed without explanation to delete the opinion.).
next year, without Hom's assistance, Peirce borrowed money from several other parties, some of these debts being secured by other of her properties. Eventually, Peirce was unable to keep up with her loan payments and all of the lenders foreclosed. She then filed an action against Horn for certain statutory violations and breach of fiduciary duty.

The statutory claim in Peirce concerned the broker's fee and the balloon payment. Horn's fee clearly exceeded a statutory⁸⁴ ten percent limitation by a few percentage points. Additionally, the payment schedule for the loans clearly failed to conform with another operative statute. California law provided that in an installment loan of less than three years duration "[n]o installment including the final installment shall be greater than twice the amount of the smallest installment."⁸⁵ The loans Horn arranged were payable in twenty-three monthly installments of fifty dollars and a final installment of $1,900. Nevertheless, the trial court found in favor of the real estate agent because, according to the court, the loans were not usurious or oppressive or in willful violation of the statutes.

In its opinion, which was subsequently withdrawn from the official California reporter, the Court of Appeals rephrased the inquiry regarding the commission overcharge. The court noted that the statute provided for a treble excess recovery unless the excess is the result of a bona fide error.⁸⁶ The court concluded that the evidence failed to support the finding of a bona fide error; it showed simply that Horn was "ignorant or mistaken as to the law."⁸⁷ The court also differed regarding the balloon payment. According to the court, there was a clear statutory violation, and an appropriate remedy could be fashioned.

The evidence regarding whether the broker had breached his fiduciary duties was somewhat contradictory. At the trial Horn had testified that he had explained to Peirce the nature of her obligations and that she had no objections or questions. Peirce contradicted this testimony by testifying that the terms of the loans had never been fully explained, but that she simply placed her trust in Horn. Evidence further showed that Horn believed Peirce intended to use the loan proceeds to pay bills; he did not know of her other indebtedness, nor did he inquire of her ability to repay. The trial

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⁸⁴. CALIF. BUS. & PROF. CODE § 10242(b)(2) (West 1964).
⁸⁵. Id. § 10244.
⁸⁶. Id. § 10246.
⁸⁷. Peirce, 178 Cal. Rptr. at 556.
court determined that Horn had used reasonable care in advising Peirce, had not fraudulently or negligently misrepresented the terms of the loans to her, and had not breached the duty of a fiduciary or trustee. 88

On appeal, Peirce argued that Horn had breached his fiduciary duty in two respects: first, by violating the statutes and, second, by failing to inquire about her ability to repay and to advise her about more prudent means of raising money on her property. Horn replied that “he ‘was not [her] financial advisor’” and that the evidence did not show “in what manner [he] was negligent or careless, or that he was incompetent, or acted in bad faith.” 89

The court of appeals viewed the matter quite differently than the trial court. Because there was a fiduciary relationship, Horn owed Peirce “the duty of acting with the highest good faith and care.” 90 The court further noted that Peirce’s age, infirmities, and the confidence she reposed in him would also support the finding of a confidential relation. 91 Although the lack of a causal connection between the statutory violations and the loss of her properties troubled the Peirce court, Peirce found a sympathetic ear regarding the agent’s failure to inquire about her ability to repay and the agent’s failure to render appropriate advice. The court wrote:

[The real estate licensee] is a professional agent who holds himself out to the public as having particular skills and knowledge in the real estate field. When he undertakes to perform the services of his agency he assumes an obligation to exercise greater care and skill than is within the capacity of the ordinary citizen . . . . [T]his increasingly expanding burden of professionalism . . . is being imposed upon the licensee by the courts . . . . In addition, the legislative changes to the Real Estate Law which increased the degree of knowledge of real estate law and legal principles required of the real estate licensee add measurably to the scope of the licensee’s professional obligations toward all of the principals to the transaction. . . . 92 A mortgage [loan] broker is an agent procured by the borrower to obtain a loan. As a real estate licensee he holds himself out as an expert on matters pertaining to real estate loans, and his duty as agent is to use

88. Id. at 554-55.
89. Id. at 557.
90. Id. at 556.
91. Id. This status, though possibly of some effect, does not seem critical to the court’s handling of the issues.
92. Id. at 558 (quoting 1 MILLER & STARR, CURRENT LAW OF CALIFORNIA REAL ESTATE, pt. 2, § 4.19, at 59-60 (1975)).
this expertise to his principal's advantage. After all, the borrower is paying a substantial fee for his service. 93

Appellant paid respondent over $800 in commissions. For her money she was entitled to more than his finding a lender. . . . She was also entitled to expert advice.

Respondent was not capable of rendering sound advice because he had no knowledge of appellant's financial condition. He did not know, but he should have at least inquired into appellant's circumstances as to whether she could reasonably be expected to be able to repay the loan. The lenders were secure, but [Hom's] duty—the duty of highest good faith and care—was to protect appellant. . . . His failure to make inquiry and to give sound advice was a breach of the duty of a fiduciary or trustee. 94

The court commented in a footnote that the degree of protection required was a function of the principal's "experience and ability to understand and evaluate real estate financing transactions." 95

The court thus concluded that the real estate agent had breached his fiduciary duty and that his acts were a "substantial factor" in bringing about Peirce's loss of those properties securing the debts arranged by the agent. 96

Although the unreported Peirce v. Hom opinion cannot be cited as precedent, it presents a thought provoking illustration of the expanding duties of real estate agents who become involved in structuring financing. In holding the agent to the highest degree of professional care the court has placed the agent in a position of financial advisor. One might be inclined to think that the special nature of this agency limits the holding. Peirce did not hire Hom to perform the traditional selling function; she hired him to arrange a loan. The court's language and analysis seems equally applicable, however, to the more traditional arrangement. The responsibilities of the agent are clearly not expressed in terms of a separate class of agent, as mortgage broker. To the contrary, the mortgage broker's skill and duty are described in terms of a real estate licensee. As a real estate licensee he holds himself out as an expert on matters pertaining to real estate loans. The court stated that the principal paid a substantial fee and was entitled to more than just the finding of a lender. There is no reason to distinguish

94. Id.
95. Id. at 558 n.8.
96. Id. at 558.
this fee and the associated service from the typical real estate commission and service. Although a finder's fee can be earned by simply bringing forth a ready, willing, and able lender or buyer, typical real estate clients expect, and in recent times are being increasingly led to expect that they will be guided through a complicated and unfamiliar transaction. In the creatively financed sale, application of the court of appeals' reasoning would seem to be particularly justified because it is only through the real estate agent's efforts and activities that the "ready and willing" buyer becomes "able." This activity is thus an integral part of earning the commission.

The breadth of the advice that a real estate agent may be expected to offer regarding the complexities of the creatively financed transaction is well illustrated in a recent California case, Umet Trust v. Santa Monica Medical Inv. Co.97 Umet Trust involved a real estate licensee functioning as a loan broker. Nevertheless, there is nothing in the Umet Trust court's opinion to suggest that the reasoning would be any different in the context of a sale of property. Furthermore, though the case involves a commercial transaction, this should not serve as a limiting factor. If anything, the real estate agent would owe a greater duty to explain and protect from risk a noncommercial client than a commercial client.

Umet Trust involved a loan structured in the form of a sale-leaseback. When the borrower-tenant failed to make rent payments the lender-landlord terminated the lease and demanded possession. In the suit that followed, the trial court completely reformed the transaction into an equitable mortgage. The trial court also found that the defendant real estate firm had committed numerous breaches of fiduciary duty to their client, the borrower.

The court of appeals flatly rejected the real estate firm's assertion that it did not owe a fiduciary duty to the borrower:

[G]eneral principles of agency . . . combine with statutory duties created by the Real Estate Law . . . to impose upon mortgage loan brokers an obligation to make a full and accurate disclosure of the terms of a loan to borrowers and to act always in the utmost good faith toward their principals. 'The law imposes on a real estate agent "the same obligation of undivided service and loyalty that it imposes on a trustee in favor of his beneficiary. . . . A real estate licensee is' charged with the duty of ful-

lest disclosure of all material facts concerning the transaction that might affect the principal's decision.\textsuperscript{98}

The court of appeals further explained that the trial court's findings revealed overwhelmingly that the real estate firm had breached this fiduciary duty:

[The real estate firm] failed to advise its clients that their interest in the property, as lessee, could be terminated upon abbreviated notice; failed to advise its clients that the statutory right of redemption existing in loan agreements does not exist in sale-leaseback transactions; failed to disclose that the anti-deficiency provisions which statutorily exist in traditional loans secured by interests in real property do not exist in sale-leaseback transactions; and failed to advise . . . that the final transaction documents contained provisions which could be interpreted as granting to [the "lender"] an immediate future interest in the building. [The real estate firm] further affirmatively misrepresented that the sale-leaseback financing gave . . . the same flexibility as a conventional loan, and would accomplish the same result.\textsuperscript{99}

The \textit{Umet Trust} case opinion offers a better illustration than any other of the character of a fair and full explanation of the nature and risks of such an unconventional transaction.

Because of the effect of the judicial reformation on the transaction and California rules of law regarding damages, the borrower was awarded only nominal damages of one dollar against the real estate firm for its breach of the fiduciary duty. Thus, on the specific facts of this case, this real estate agent's liability turned out to be financially insignificant. In principle, however, the case should serve as a major warning to real estate agents. The holding and the identified instances of misconduct illustrate that real estate agents who are actively involved in structuring creatively financed transactions owe a substantial duty to counsel their clients about unconventional attributes and warn them of any unusual risks.\textsuperscript{100}

\section*{IV. A Statutory Approach to the Problem}

The creative financing phenomenon has been associated most

\textsuperscript{98} \textit{Umet Trust}, 140 Cal. App. 3d at 872-73, 189 Cal. Rptr. at 927-28 (quoting Wyatt v. Union Mortgage Co., 24 Cal. 3d 773, 782, 157 Cal. Rptr. 392, 397, 598 P.2d 45, 50 (1979)).

\textsuperscript{99} \textit{Umet Trust}, 140 Cal. App. 3d at 873, 189 Cal. Rptr. at 927-28.

\textsuperscript{100} Also noteworthy was the court's rejection of the real estate firm's argument that retention by its client of a separate attorney who assisted in the closing of the "loan transaction" served as a superseding cause of the client's injury. \textit{Id.} at 873, 189 Cal. Rptr. at 928.
frequently with the state of California. Creative financing in large part fueled the quadrupling of housing prices in California between 1975 and 1982. One group of researchers recently asserted that the approximately thirty-four billion dollars of balloon payments in California that will become due between 1983 and 1986 presents a serious cause for public concern. It is asserted that few borrowers will be able to repay the balloon payments from savings or current income and that, if these loans cannot be refinanced, they will go into default. The potential default crisis could be of enormous proportions. The problem is exacerbated because many of the seller-lenders themselves immediately purchased homes similarly financed. They are dependent on the money owed them as creditors to meet their own obligations as debtors. Thus, a small number of defaults could easily start a chain reaction. California lawmakers are well aware of this situation and, although they have not tackled the problem that these past transactions have raised, they have taken definite steps to help insure that state residents are not unwitting victims in the future.

In 1983, the California Legislature enacted the first disclosure statute for the purpose of alerting buyers and sellers to the special risks of certain transactions involving creative financing. The statute requires that several enumerated disclosures and warnings be given to both buyer and seller when a purchase includes an extension of credit by the seller. These requirements pertain to transactions "for the purchase of a dwelling for not more than four families in which there is an arranger of credit . . . ." An "arranger of credit" is defined as

[a] person, other than a party to the credit transaction . . . who is involved in developing or negotiating credit terms, participates in the completion of the credit documents, and directly or indirectly receives compensation for arrangement of the credit or from any transaction or transfer of the real property which is facilitated by that extension of credit.


103. "Purchase" is broadly defined to include acquisition of equitable title or a lease with a purchase option if there is intent to transfer equitable title. Id. § 2957(d).

104. Id. § 2956.

105. Id. § 2957(a)(1).
"Arranger of credit" does not include an attorney representing one of the parties or a person acting as an escrow; it does include a real estate licensee or an attorney acting as a party to the transaction.

Quite clearly, the typical real estate agent will serve as an "arranger of credit" in a transaction involving seller financing. Not only will the real estate agent likely be involved in developing or negotiating the credit terms, but the agent will also participate in completing the credit documents that are defined to include "a contract of sale if the contract spells out terms upon which a vendor agrees to provide financing for a purchaser."

The "arranger of credit" is required to make the written disclosures to both the buyer and the seller. Information is to be provided to the buyer by "the arranger of credit and the vendor (with respect to information within the knowledge of the vendor)." Information is to be provided to the seller by "the arranger of credit and the purchaser (with respect to information within the knowledge of the purchaser)." If the transaction involves "more than one arranger of credit and one of those arrangers has obtained the offer by the purchaser to purchase the property, that arranger shall make the disclosure, unless the parties designate another person in writing." As a result, a real estate agent will most likely bear this burden. If only one real estate agent is involved, typically seller's agent, then the real estate agent's obligation to the buyer would exceed the bounds of the traditional fiduciary duty because the seller's agent would not necessarily be a fiduciary to the buyer. Nevertheless, in recent years courts have tended to impose certain fiduciary-like duties upon real estate licensees with respect to buyers under the rationale that buyers are members of the general public. If the transaction involves two real estate agents, as is often the case, especially when there are strong multiple listing services, then it would seem that the disclosure burden would fall on the "buyer's agent" unless otherwise agreed.

Several of the statutory requirements are obviously for the benefit of the buyer while others are for the seller. Several of the

106. Id. § 2957(a)(1) and (3).
107. Id. § 2957(a)(2).
108. Id. § 2957(c).
109. Id. § 2956(a).
110. Id. § 2956(b).
111. Id.
112. See supra note 32.
disclosures are quite routine—for example, describing the terms of
the promissory note or providing a copy.\textsuperscript{113} The more noteworthy
requirements are those specifically concerning the attributes of the
creatively financed transaction. Details must be provided about
senior incumbrances,\textsuperscript{114} the credit-worthiness of the purchaser,\textsuperscript{115}
and whether the purchaser is to receive any cash from the proceeds
of the transaction.\textsuperscript{116} Specific warnings must be given that “if refi-
nancing would be required as a result of lack of full amortization
. . . such refinancing might be difficult or impossible in the con-
ventional mortgage marketplace,”\textsuperscript{117} and that California law “may
limit any recovery by the vendor to the net proceeds of the sale of
the security property in the event of foreclosure.”\textsuperscript{118} If negative
amortization is possible, it must be clearly disclosed and its poten-
tial effect explained.\textsuperscript{119} Balloon payment amounts and due dates
must be disclosed with an accompanying statement “that there is
no assurance that new financing or loan extension will be available
. . . .”\textsuperscript{120} The act also imposes special notice requirements regard-
ing the balloon payment and mandates that all balloon notes shall
include a statement that the “note is subject to section 2966 of the
Civil Code, which provides that the holder . . . shall give written
notice to the trustor, or his successor in interest, of prescribed in-
formation at least 60 and not more than 150 days before any bal-
loon payment is due.”\textsuperscript{121} With wraparound financing, a number of
disclosures must be made regarding the responsibilities for various
components of the transaction and a warning must be given that
the parties “may wish to agree to have a neutral third party design-
nated”\textsuperscript{122} to handle funds.

Finally, the act calls for a number of practical reminders or
suggestions that the parties take appropriate action regarding loss
payee clauses in property insurance policies,\textsuperscript{123} requests for notice
of default,\textsuperscript{124} title insurance policies,\textsuperscript{125} monitoring the payment of

\begin{footnotesize}
\begin{itemize}
\item[114.] Id. § 2963(c).
\item[115.] Id. § 2963(i).
\item[116.] Id. § 2963(o).
\item[117.] Id. § 2963(d).
\item[118.] Id. § 2963(i).
\item[119.] Id. § 2963(e).
\item[120.] Id. § 2963(g).
\item[121.] Id. § 2966(d).
\item[122.] Id. § 2963(h).
\item[123.] Id. § 2963(j).
\item[124.] Id. § 2963(k).
\item[125.] Id. § 2963(l).
\end{itemize}
\end{footnotesize}
property taxes,\textsuperscript{126} and recording of security documents.\textsuperscript{127}

Noncompliance with these requirements does not serve to invalidate the transaction documents. Any person, however, who willfully violates any provision shall be liable for the actual damages that are proximately caused. The statute elaborates that a person will not be liable if the violation is not intended and results from "a bona fide error notwithstanding the maintenance of procedures reasonably adopted to avoid any such error."\textsuperscript{128}

Consequently, this new statute serves as clear authority in California for finding real estate agents liable because of their failure to adequately inform buyers and sellers about the details and risks of transactions including seller financing. The statute will benefit the public because it serves to encourage real estate agents to disclose several inobvious risks. It is unlikely that the typical parties to a residential transaction will comprehend the more complex disclosures, but they will probably be more inclined to seek legal counsel.\textsuperscript{129} Although this statute is intended to benefit the public, it will also conceivably serve to benefit real estate agents. To the extent that this statute establishes an exclusive claim or remedy with respect to an agent's duty to inform about seller financing, the statute serves to clarify greatly what an agent must do to avoid liability.\textsuperscript{130} Compliance with the statute should go a long way toward establishing a defense to a claim based on an alleged failure to adequately counsel about the details of a seller financed transaction.\textsuperscript{131}

Furthermore, the "willfulness" requirement and

\textsuperscript{126} Id. § 2963(m).
\textsuperscript{127} Id. § 2963(n).
\textsuperscript{128} Id. § 2965.
\textsuperscript{129} One commentator has critically observed:

"Disclosure will most likely occur after a contract of sale has already been executed and, although the contract remains contingent on buyer's approval of the disclosures, the momentum of the transaction at that stage may minimize the impact of the disclosures. . . . [I]n the hands of an eager real estate agent, the disclosure . . . will be no substitute for the more dispassionate analysis of an attorney."


\textsuperscript{130} Some doubt must remain for now about the exclusivity of this claim or remedy. Section 2964 of the California Civil Code provides that the disclosure requirements do "not limit or abridge any obligation for disclosure created by any other provision of law or which may exist in order to avoid fraud, misrepresentation, or deceit in the transaction." CAL. CIV. CODE § 2964 (West Supp. 1983). Because the subject of an agent's duty to advise and inform about creative financing has received little judicial attention thus far, California courts are likely to be hesitant to place additional burdens upon real estate agents with respect to advising about seller financing in light of this detailed statute.

\textsuperscript{131} The California State Realtors' Association supported passage of this new legisla-
the "bona fide error" defense ostensibly raise serious doubts about liability predicated on negligence. The wording, however, does seem to contemplate liability in the event that real estate agents fail to maintain reasonable procedures to avoid noncompliance with the statute.

V. Conclusion

The high interest rates of the last several years have caused real estate transactions to be structured in a variety of unconventional forms. Real estate agents often play an active role in this process. Although many of these transactions will probably prove worthwhile, the comments and reports of several observers suggest that a substantial number of these transactions are poorly conceived and poorly structured. These same observers also note that the parties are often inadequately advised. Real estate agents will surely be blamed for failures that can be linked to the formative stages of these transactions.

State statutes and traditional contract, agency, and tort law rules impose a number of duties on real estate agents. These duties may vary considerably depending on the specific facts and circumstances of a case. The precise nature and extent of the duty that a real estate agent, who plays an active role in structuring a creatively financed transaction, owes has received little judicial scrutiny thus far, and therefore will be a matter of considerable debate. Moreover, because of the multiplicity of applicable legal theories, the sparseness of relevant appellate decisions, and the complex and often situation-specific character of the creatively financed transaction, it is not possible to definitively outline the liability producing circumstances.

It is fairly obvious, however, that the threat of liability for a real estate agent will increase substantially when the agent plays a role in structuring a creatively financed transaction. There is simply a greater likelihood that more will go wrong in these transactions because they require more complex documentation, present greater risks for the parties and generally require more sophisticated and complete representation. For example, standard contract, mortgage, or conveyance documents will typically need significant modification or will be so unsuited to the transaction that

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tion. One commentator has suggested that this support was due to the great awareness of California realtors of their potential liability in creative financing situations. Kanner, supra note 129, at 194.
tailor-made documents will be necessary. Damaging flaws or weaknesses in documents will be fairly obvious in retrospect, and courts will probably not be sympathetic to the real estate agent who has performed activities bordering on or clearly constituting the unauthorized practice of law. Also, an explanation of the unusual attributes and risks associated with a creatively financed transaction will be required in dealing with all but the most sophisticated parties. The unique California disclosure statute and the few cases discussed in this article illustrate the considerable scope of this explanation. Moreover, there is a serious fundamental question whether a real estate agent or a lawyer should perform these functions. Real estate agents are being caught in a squeeze: while there is growing pressure for real estate agents to provide parties to a transaction with substantial advice and counsel about legal matters, the concept of the unauthorized practice of law remains as a counterforce. Silence on these matters would be against the best interests of the principal and therefore improper. Thus the real estate agent should supply a competent explanation or make an appropriate referral. This referral should often be to a lawyer.

If a referral is to be truly beneficial it should occur very early in the transaction. In many locales, the formation of real estate contracts involves a two stage process. First, the parties sign a "short form contract" that reflects an agreement with respect to price. Typically unbeknownst to the parties, the enforceability of these agreements is debatable because of possibly inadequate treatment of material terms. Such a shortcoming seems likely

132. Related authority indicates that the duty of the agent varies depending on the sophistication of the parties. See, e.g., Mallory v. Watt, 100 Idaho 119, 594 P.2d 629 (1979) (agent's explanation must be commensurate with the education and understanding of the principal; because client was sophisticated, agent was not liable).

133. There is apparent risk in continuing to oversee a transaction even though legal counsel is involved when that counsel was not retained at the agent's insistence and the agent has clearly relinquished responsibilities. See supra notes 30 & 86.

134. One commentator has recommended that real estate agents include a statement in all contracts that "[a]ll parties are advised to seek legal, tax, and other counsel to consider the implications of this agreement. Said advisors should be sought and consulted prior to the execution of this agreement." M. Levine, Realtor's Liability 136 (1979). Whether a party's failure to seek this advice will serve to relieve the real estate agent of liability for problems that may arise would seem to depend on the totality of circumstances. If such a statement is to serve to protect the agent it must be conspicuous. Furthermore, the agent's conduct must not be inconsistent. In the creatively financed transaction, extra urging may be necessary for an agent to be able to use a defense such as election, comparative negligence, or assumption of risk. Cf. Kimball Bridge Rd. v. Everest Realty Corp., 141 Ga. App. 835, 234 S.E.2d 673 (1977) (seller was not contributorily negligent as a matter of law in failing to consult an attorney for assistance in drafting sales contract).
when a creatively financed arrangement is briefly mentioned rather than outlined in detail. Alternatively, if a creatively financed transaction is contemplated but not mentioned, a party may be bound to a wholly unsuitable obligation if the creative financing cannot be subsequently arranged. Lawyers often disapprove of the use of "short form contracts" because of the uncertain status of the transaction. Real estate agents favor the use of the "short form contract" because it is an efficient mechanism for completing negotiations with respect to the critical factor of price. The "short form contract" contemplates the second step—entering into a "long form contract." This occurs usually within a few days after the parties execute the "short form contract." The "long form contract" should contain all of the details of the transaction. In a real estate transaction, especially one that is unconventional, the document that serves to create a binding obligation should be a blueprint for the entire transaction. In the two-step process just described, it is often unclear precisely when a binding obligation arises. The party's benefit is maximized only if the lawyer's representation commences prior to the actual formation of a valid and enforceable contract.

Because the lawyer is viewed as a potential spoiler, however, real estate agents are often reluctant to involve lawyers in the formative stages of a transaction. Furthermore, because of the

135. In New Jersey State Bar Ass'n v. New Jersey Ass'n of Realtor Bds., 93 N.J. 470, 484, 461 A.2d 1112, 1120 (1983) (Schreiber, J., dissenting), Justice Schreiber observed in dissent that it is "easy to assure the lay person that an attorney is not needed and that the seller or buyer should avoid an unnecessary cost. Indeed, the realtor will frequently arrange for the financing, advising the purchaser that the lending institution's attorney will protect his interest." This is a fairly widely accepted view. See also M. Levine, REALTOR'S LIABILITY 137 (1979) (discussing how many real estate agents have been influenced by books such, as Robert Ringer's Winning Through Intimidation, which alerts that attorneys and others often destroy a transaction). In Prall v. Gooden, 226 Or. 554, 360 P.2d 759 (1961), clients testified about their real estate agent:

He explained that it was a very good deal the way he had figured it out for us, he had taken a lot of time, had had a great deal of experience and had made so many arrangements for people . . . that he could really see through things where people who hadn't had that much experience couldn't . . . And he told us it was a honey of a deal for us, that we were making a huge mistake if we didn't go ahead and sign these papers.

[We] were rather reluctant to sign them and asked him if we couldn't show those to an attorney—that we would like to have an attorney look them over. And he explained that that wasn't necessary, . . . and that it would just be to our expense to call an attorney on it, . . . and that it was foolish to even go to an attorney with the papers.

[In] fact, these papers the ordinary attorney wouldn't understand.

Id. at 762. This conversation concerned a complicated exchange of several properties that
routineness of many real estate transactions, the desirability of having legal counsel has unfortunately become obscured. For example, buyers, sellers, and real estate agents have come to place too much significance and reliance on the coincidence of interests between themselves and an involved institutional lender. It is often erroneously assumed that if the lender's lawyer has no objections then everything must be reasonably in order. A false sense of security thus develops. Because of the complexity and unconventional character of the creatively financed transaction, a lawyer's attention is all the more desirable. Ironically, because creatively financed transactions often do not directly involve an institutional lender, they are more likely than conventional transactions to completely escape the review of a lawyer. The growing number of actions against real estate agents concerning problems related to complexities of creatively financed transactions may change this. Nothing better serves to heighten awareness of responsibility than news of the substantial liability of one's peers. Knowledge of the growing risk of professional liability for real estate agents should restrain those forces that cause real estate agents to advance complex transactions in the face of client ignorance or despite other inadvisable circumstances. Real estate agents must come to accept that if they are unable to furnish unbiased and competent advice regarding the risks of a proposed creatively financed transaction, or are unable to otherwise provide capable assistance in soundly structuring the transaction, they should insist that the parties consult with someone who can.

The legislatures and courts are recognizing that the role of the real estate agent is undergoing a major change. In recent years most states have imposed more demanding requirements for obtaining and maintaining real estate licenses. The increased emphasis on education, combined with the promotion of more complex and varied services of real estate agents, has led the public to expect more from real estate agents than mere salesmanship. The repeated judicial references to professional expertise and fiduciary duty suggests that courts often will favor naive clients over real

the agent had arranged. The clients, who had signed the agreement under a mistaken impression that they would receive needed cash, eventually found out that there was no likelihood of receiving any appreciable amount of cash and decided not to proceed with the transactions. The court found that there was a breach of fiduciary duty by the agent and stated that "[t]his reluctance to give the defendants a few hours in which to consult an attorney indicates whose interests were uppermost in the [real estate agent's] mind when he obtained his clients' signatures." Id.
estate licensees. Given the increased sense of professionalism, the expansion of services, and the heightened concern in our society for consumer protection, one can expect the courts to hold real estate agents to very high standards of loyalty, skill, and care—standards that courts eventually may equate with those imposed on a lawyer or other professionals performing the same service. Any real estate agent who structures a creatively financed transaction without making appropriate referrals invites this treatment.