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POTENTIAL LIABILITY FOR MISREPRESENTATIONS IN RESIDENTIAL REAL ESTATE TRANSACTIONS: LET THE BROKER BEWARE

I. Introduction

Real estate brokers¹ are prime targets of litigation² by dissatisfied

1. For purposes of this Note, the terms "real estate broker" or "broker" include persons representing the seller in the sale of residential property, including real estate salespersons, sales agents, real estate agents, listing brokers, selling brokers and realtors. For a discussion of each of these positions, *see generally* R. KRATOVIL & R. WERNER, REAL ESTATE LAW 90-102 (8th ed. 1983) [hereinafter KRATOVIL & WERNER]. New York Real Property Law article 12-A, § 440(1) sets forth the definition of a real estate broker as follows: "[B]roker means any person, firm or corporation, who, for another and for a fee, commission or other valuable consideration, lists for sale, sells, at an auction or otherwise, exchanges, buys or rents, or offers or attempts to negotiate a sale, at an auction or otherwise, exchange, purchase or rental of an estate or interest in real estate" N.Y. REAL. PROP. LAW § 440 (McKinney Supp. 1987).

Brokers earn fees or commissions by bringing purchasers and sellers together—in essence serving as a catalyst in sales transactions. *See* Ryan v. Walker, 35 Cal. App. 116, 169 P. 417 (1917). For a general discussion of a real estate broker's role in a typical transaction, *see infra* notes 31-48 and accompanying text.

2. The number of lawsuits filed against real estate brokers has increased dramatically in recent years due to significant increases in the number of brokers, the high visibility of the broker in a transaction and the general perception of brokers as "deep pockets." *See* F. FISHER, BROKER BEWARE: SELLING REAL ESTATE WITHIN THE LAW ix (1981) [hereinafter FISHER]; *see also* N.Y.L.J., Dec. 16, 1986, at 1, col. 4 (discussing expansion of tort liability for real estate brokers).

Many jurisdictions have recently addressed the issue of real estate broker liability in a misrepresentation action based on a broker's failure to inform a prospective purchaser of defects in residential real estate. These jurisdictions include Alabama, *see* Dexter v. Baker, 382 So. 2d 552 (Ala. 1980); Alaska, *see* Bevins v. Ballard 655 P.2d 757 (Alaska 1982); Arkansas, *see* Strout Realty, Inc. v. Burghoff, 19 Ark. App. 176, 718 S.W.2d 469 (1986); California, *see* Easton v. Strassburger, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984); Colorado, *see* Caldwell v. Armstrong, 642 P.2d 47 (Colo. Ct. App. 1981); Delaware, *see* Lock v. Schreppler, 426 A.2d 856 (Del. Super. Ct. 1981); District of Columbia, *see* Berman v. Watergate West, Inc., 391 A.2d 1351 (D.C. 1978); Florida, *see* Ellis v. Flink, 374 So. 2d 4 (Fla. 1979); Georgia, *see* U-Haul Co. v. Dillard Paper Co., 169 Ga. App. 280, 312 S.E.2d 618 (1983); Hawaii, *see* Shaffer v. Earl Thacker Co., 716 P.2d 163 (Haw. Ct. App. 1986); Illinois, *see* Munjal v. Baird & Warner, Inc., 138 Ill. App. 3d 172, 485 N.E.2d 855 (1985); Iowa, *see* Menzel v. Morse, 362 N.W.2d 465 (Iowa

purchasers³ of residential real estate.⁴ A purchaser who discovers a physical defect⁵ in the property purchased after title has

1985); Kansas, *see* Johnson v. Geer Real Estate Co., 239 Kan. 324, 720 P.2d 660 (1986); Louisiana, *see* Joseph v. Austin, 420 So. 2d 1181 (La. Ct. App. 1982), *cert. denied*, 427 So. 2d 870 (La. 1983); Maine, *see* Emerson v. Ham, 411 A.2d 687 (Me. 1980); Massachusetts, *see* Nei v. Burley, 388 Mass. 307, 446 N.E.2d 674 (1983); Michigan, *see* Hammond v. Matthes, 109 Mich. App. 352, 311 N.W.2d 357 (1981); Minnesota, *see* Baker v. Surman, 361 N.W.2d 108 (Minn. Ct. App. 1985); Missouri, *see* Maples v. Porath, 638 S.W.2d 337 (Mo. Ct. App. 1982); Montana, *see* Hoefler v. Wilckens, 684 P.2d 468 (Mont. 1984); Nebraska, *see* Suzuki v. Gateway Realty, 207 Neb. 562, 299 N.W.2d 762 (1980); New Hampshire, *see* Duby v. Apple Town Realty, Inc., 120 N.H. 438, 417 A.2d 1 (1980); New Mexico, *see* Gouveia v. Citicorp Person-to-Person Fin. Center, Inc., 101 N.M. 572, 686 P.2d 262 (1984); Ohio, *see* Sanfillipo v. Rarden, 24 Ohio App. 3d 164, 493 N.E.2d 991 (1985); Pennsylvania, *see* Long v. Brownstone Real Estate Co., 355 Pa. Super. 268, 484 A.2d 126 (1984); South Carolina, *see* May v. Hopkinson, 289 S.C. 549, 347 S.E.2d 508 (1986); Tennessee, *see* Hughey v. Rainwater Partners, 661 S.W.2d 690 (Tenn. Ct. App. 1983); Texas, *see* Cameron v. Terrell & Garrett, Inc., 618 S.W.2d 535 (Tex. 1981); Utah, *see* Dugan v. Jones, 615 P.2d 1239 (Utah 1980); Vermont, *see* Provost v. Miller, 144 Vt. 67, 473 A.2d 1162 (1984); Washington, *see* Hoffman v. Connall, 43 Wash. App. 532, 718 P.2d 814 (1986), *rev'd*, 108 Wash. 2d 69, 736 P.2d 242 (1987); West Virginia, *see* Lengyel v. Lint, 280 S.E.2d 66 (W. Va. 1981); Wisconsin, *see* Gauerke v. Rozga, 112 Wis. 2d 271, 332 N.W.2d 804 (1983); and Wyoming, *see* Walter v. Moore, 700 P.2d 1219 (Wyo. 1985).

3. Commentators have characterized purchasers of residential real estate as naive or uninformed. *See generally* Note, *Dual Agency in Residential Real Estate Brokerage: Conflicts of Interest and Interests in Conflict*, 12 GOLDEN GATE U.L. REV. 379, 380-81 (1982) (residential real estate purchasers described as "the unsophisticated segment of the real estate market").

4. As used in this Note, "residential real estate" includes one-family residences and multi-family residences comprised of up to six units. This Note makes no distinction among city, suburban or rural residences. While larger multi-family properties are also residential in nature, they are characterized as commercial real estate because of their higher property value and greater transactional complexity. *See* A. ARNOLD & J. KUSNET, *THE ARNOLD ENCYCLOPEDIA OF REAL ESTATE* 692 (1978) [hereinafter ARNOLD & KUSNET].

For the purposes of this Note, residential real estate refers to used housing as opposed to new construction. New housing construction has been characterized as a "product" introduced into the stream of commerce and is therefore subject to a products liability analysis. For a discussion of the application of products liability to real estate brokers in the sale of new housing, *see* Note, *Products Liability Applies to the Sale of Housing and Extends to All Parties Who Are an Integral Part of the Overall Production and Marketing Enterprise, Including Realtors*. Berman v. Watergate West, Inc., 391 A.2d 1351 (D.C. 1978), 28 CATH. U.L. REV. 887 (1979) [hereinafter *Products Liability*]. *See infra* note 81 and accompanying text.

5. The term "physical defect" encompasses a wide variety of problems that can occur with residential property, including but not limited to (1) structural problems, *compare* Josephs v. Austin, 420 So. 2d 1181 (La. Ct. App. 1982), *cert. denied*, 427 So. 2d 870 (La. 1983) (real estate broker's knowledge of house and its history, and subsequent failure to communicate to buyers information concerning crack in foundation constituted breach of duty sufficient to subject him to liability

closed⁶ may attempt to recover his losses from the real estate broker who handled the transaction.⁷ Traditionally, a real estate broker was protected from such litigation by the legal theory of caveat emptor—"let the buyer beware."⁸ Courts and commentators, how-

in negligent misrepresentation) *with* *De Soto v. Ellis*, 393 So. 2d 847 (La. Ct. App. 1981) (broker not liable for fraud or negligence although real estate company for which broker worked had notation in its files concerning defects in foundation); (2) flooding, *see Baker v. Surman*, 361 N.W.2d 108 (Minn. Ct. App. 1985) (directed verdict for real estate broker who saw property only once even though house later proved to have leaky basement); (3) sewer and septic tank problems, *see Lyons v. Christ Episcopal Church*, 71 Ill. App. 3d 257, 389 N.E.2d 623 (1979) (real estate broker's actions as conduit in passing on seller's inaccurate information in regard to connection to city sewerage system did not afford basis on which recovery could be had against broker); (4) termites, *see May v. Hopkinson*, 289 S.C. 549, 347 S.E.2d 508 (1986) (broker liable in fraud action for termite damage); (5) boundaries, *see Shaffer v. Earl Thacker Co.*, 716 P.2d 163 (Haw. Ct. App. 1986) (real estate broker representing seller of residential real property liable to buyer in innocent misrepresentation action for reciting inaccurate information about property boundaries and lack of encroachments); and (6) water supply, *see Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982) (buyer who relied on material misrepresentation concerning home's water supply had cause of action against real estate broker who communicated misrepresentation even though representation was innocently made).

6. The seller transfers the deed (title to the property) to the purchaser at the closing. *See Residential Real Estate Transactions: The Lawyer's Proper Role—Services—Compensation*, 14 REAL PROP. PROB. & TRUST J. 581, 590 (1979) (Report of the Special Committee on Residential Real Estate Transactions of the American Bar Association) [hereinafter *Special Committee*]. The parties also make all required payments and conclude all formal aspects to the transaction at that time. *See id.* At the closing, the purchaser acquires a possessory interest in the property and title is closed. *See M. FRIEDMAN, CONTRACTS AND CONVEYANCES OF REAL PROPERTY* § 5.1, at 627-640 (4th ed. 1984) [hereinafter *FRIEDMAN*].

7. *See, e.g., Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982); *Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984); *Shaffer v. Earl Thacker Co.*, 716 P.2d 163 (Haw. Ct. App. 1986). Although the seller is frequently a defendant in an action by the purchaser, with the broker and the seller both bearing liability in proportion to his fault, the broker may be responsible for the entire judgment. *See generally* W. PROSSER, D. DOBBS, R. KEETON & D. OWEN, *PROSSER AND KEATON ON THE LAW OF TORTS* § 52, at 322-55 (5th ed. 1984) (discussion of joint tortfeasors) [hereinafter *PROSSER & KEETON*]. Many jurisdictions have adopted the rule of joint and several liability, under which each individual defendant is liable for the entire amount of the judgment, regardless of fault. *See id.* Once the individual pays more than his proportionate share of the judgment, he may seek contribution from the other defendant(s). *See id.* When the seller is insolvent, however, the solvent broker will be responsible for the entire judgment. *See id.* § 52, at 345-55.

8. In full, the Latin maxim reads "*Caveat Emptor, qui ignorare non debuit quod jus alienum emit*," meaning let a purchaser, who ought not be ignorant of the amount and nature of the interest which he is about to buy, exercise proper caution. H. BROOME, *LEGAL MAXIMS* 590 (7th ed. 1900). For a discussion of the origin and history of the doctrine of caveat emptor, *see* Hamilton, *The Ancient Maxim Caveat Emptor*, 40 YALE L.J. 1133 (1931).

ever, have criticized caveat emptor as inapplicable to contemporary society⁹ and its acceptance as a defense in real property transactions has been substantially eroded.¹⁰

As courts moved away from the strict application of caveat emptor in real estate transactions, dissatisfied purchasers brought actions in tort for misrepresentation against real estate brokers.¹¹ Initially, courts considered only those actions premised on a theory of intentional misrepresentation¹² in suits against a real estate broker. Subsequently, some courts¹³ permitted purchasers to base their actions on negligent misrepresentation.¹⁴ A minority of courts¹⁵ later recognized the tort of innocent misrepresentation in the real estate broker liability context.¹⁶

To prevail in any misrepresentation action, a purchaser must prove the elements of each tort—including proof that a real estate broker

9. See *Cousineau v. Walker*, 613 P.2d 608, 614-16 (Alaska 1980). See generally FRIEDMAN, *supra* note 6, § 1.2(n), at 37-71; Bearman, *Caveat Emptor in Sales of Realty—Recent Assaults Upon the Rule*, 14 VAND. L. REV. 541 (1961).

10. For a discussion of the reduced application of caveat emptor in real property transactions, see Jacobson, *Broker's Liability for Sale of Defective Homes: The Decline of Caveat Emptor*, 52 L.A. B.J. 346 (1977). As one court stated, the rule of caveat emptor has no application to dealings between a broker and a party to the exchange of realty because the relation is based on utmost confidence and good faith. See *Lent-Agnew Realty Co. v. Trebert*, 212 A.D. 460, 462, 208 N.Y.S. 598, 599 (4th Dep't 1925).

11. The dissatisfied purchaser was forced to use a tort action against his seller because the purchase and sale of real estate carries no warranties other than title. For a discussion of liability under a warranty theory, see Freyfogle, *Real Estate Sales and the New Implied Warranty of Lawful Use*, 71 CORNELL L. REV. 1 (1985) [hereinafter Freyfogle]. When the seller has already invested the proceeds in another house, a purchaser will attempt to recover against the broker who is either insured or whose assets are more liquid. See generally FISHER, *supra* note 2.

This Note is concerned only with misrepresentations by real estate brokers that cause purchasers to suffer pecuniary loss. Because courts have always been more reluctant to impose liability for this kind of loss than to impose liability for direct physical injury or property damage, special rules have evolved governing misrepresentations that result in only pecuniary losses to the real estate purchaser. See generally Prosser, *Misrepresentation and Third Persons*, 19 VAND. L. REV. 231 (1966) [hereinafter Prosser].

12. See *infra* notes 58-63 and accompanying text.

13. See, e.g., *Gouveia v. Citicorp Person-to-Person Fin. Center, Inc.*, 101 N.M. 572, 686 P.2d 262 (1984) (recognizing cause of action for negligent misrepresentation against broker if broker fails to exercise reasonable care).

14. See *infra* notes 65-73 and accompanying text.

15. See, e.g., *Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982) (liability for innocent misrepresentation extends to real estate broker when buyer relied on material misrepresentation).

16. See *infra* notes 76-84 and accompanying text.

owes him some duty.¹⁷ A purchaser may have difficulty proving that a broker owes him a duty to refrain from making an affirmative misrepresentation or to disclose the existence of a defect.¹⁸ The courts, however, by broadening the basis¹⁹ of a broker's duty to a prospective purchaser have eased the purchaser's burden of proof.²⁰ For example, some courts have found that a broker owes a duty to a purchaser only when the broker and purchaser have created an agent-principal relationship.²¹ Other courts have found that a broker owes a duty to a purchaser when public policy,²² statutory language,²³ ethical codes,²⁴ or malpractice case law²⁵ dictate that such a duty should exist. Courts have thus lessened the purchaser's burden of proof in some instances. The purchaser's proof of a broker's duty has, however, to a great extent, depended on the court's interpretation of the basis upon which a broker owes a duty to a prospective purchaser.²⁶

Courts have also differed over the scope of the duty a broker owes a purchaser.²⁷ For example, while some courts have held that a broker does not have the duty to investigate the truth of a seller's

17. See *infra* notes 58, 65 and 77 and accompanying text for a discussion of the elements of intentional, negligent and innocent misrepresentation.

18. See *infra* notes 86-89 and accompanying text.

19. See *infra* notes 21-26 and accompanying text.

20. See *infra* notes 90-154 and accompanying text.

21. See *Lerk v. McCabe*, 349 Ill. 348, 182 N.E. 388 (1932) (holding that broker owes duty to purchaser based on agency relationship). For a discussion of agency as a basis for a real estate broker's duty to a purchaser, see *infra* notes 90-104 and accompanying text.

22. See *Hagar v. Mobley*, 638 P.2d 127 (Wyo. 1981) (holding that real estate broker's duty is, to certain extent, determined by public policy). For a discussion of public policy as a basis for a real estate broker's duty to a purchaser, see *infra* notes 105-13 and accompanying text.

23. See *Young v. Joyce*, 351 A.2d 857 (Del. Super. Ct. 1975) (holding that real estate broker owes duty to purchaser based on state consumer protection statute). For a discussion of state statutes used as a basis for a real estate broker's duty to a purchaser, see *infra* notes 114-29 and accompanying text.

24. See *Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984) (basing broker's duty in part on National Association of Realtor's Code of Ethics). For a discussion of ethical codes as a basis for a real estate broker's duty to a purchaser, see *infra* notes 130-44 and accompanying text.

25. See *Menzel v. Morse*, 362 N.W.2d 465 (Iowa 1985) (purchaser brought malpractice action against broker). For a discussion of malpractice as a basis for a real estate broker's duty to a purchaser, see *infra* notes 145-53 and accompanying text.

26. See *supra* notes 21-25 and accompanying text.

27. See *infra* notes 157-65 and accompanying text.

representation,²⁸ other courts have held that a broker has an affirmative duty to inspect the property and disclose any defects discovered.²⁹ In sum, current case law is divided on the issues of: (1) the level of culpability required to find broker liability; (2) the basis of a real estate broker's duty to a prospective purchaser; and (3) the scope of any duty a broker owes to a prospective purchaser.³⁰

This Note examines these three areas of current controversy and recommends state legislation that will clarify the law. As background, Part II examines the role of the real estate broker in a typical residential transaction. Part III surveys tortious misrepresentation in the context of real estate broker liability and the source and scope of the duty owed by a real estate broker to a prospective purchaser of residential real estate. Part IV analyzes the policy considerations for imposing broker liability for misrepresentation and concludes that courts should not impose broker liability for innocent misrepresentation, nor should courts impose an affirmative duty of inspection and disclosure upon real estate brokers. Finally, this Note recommends that state legislatures take some action to prevent the transfer of defective real estate and thus protect home-buyers, without imposing liability on an innocent broker.

II. A Real Estate Broker's Role in a Typical Residential Real Estate Transaction

Many courts have examined the broker's role in the real estate transaction to determine the broker's liability for misrepresentation.³¹ Although a broker's primary role is that of a sales agent,³² a broker

28. See, e.g., *Strout Realty, Inc. v. Burghoff*, 19 Ark. App. 176, 718 S.W.2d 469 (1986) (broker not liable for constructive or legal fraud when representation to purchaser was only good faith repetition of statement authorized by seller).

29. See *Gouveia v. Citicorp Person-to-Person Fin. Center, Inc.*, 101 N.M. 572, 686 P.2d 262 (1984) (broker may have duty to disclose defects that inspection would reveal); cf. *De Soto v. Ellis*, 393 So. 2d 847 (La. Ct. App. 1981) (court refused to determine precise scope of duties owed by broker to purchaser).

30. Because they are result-oriented, courts increasingly further the trend towards greater broker liability for misrepresentations made to prospective purchasers. See, e.g., *Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982) (because of nature of broker-purchaser relationship, liability for innocent misrepresentation merited); *Gauerke v. Rozga*, 112 Wis. 2d 271, 332 N.W.2d 804 (1983) (public policy may dictate placement of loss on innocent broker).

31. See, e.g., *Munjal v. Baird & Warner, Inc.*, 138 Ill. App. 3d 172, 485 N.E.2d 855 (1985) (examining relationship between purchaser and real estate broker); *Walter v. Moore*, 700 P.2d 1219 (Wyo. 1985) (describing role of broker in ordinary transaction).

32. See KRATOVIL & WERNER, *supra* note 1, at 93.

may perform a variety of other functions in a transaction.³³ A brief description of a typical residential real estate transaction follows.

Once a seller decides to sell residential real estate through a broker, the seller generally³⁴ enters into a written agreement³⁵ with the broker. The broker³⁶ then shows the property to prospective purchasers and

33. See B. HENZEY & R. FRIEDMAN, *REAL ESTATE LAW* 341 (1984) (describing function of broker in residential real estate transaction) [hereinafter HENZEY & FRIEDMAN].

34. Real estate purchase procedures vary greatly across the country. See *Special Committee*, *supra* note 6, at 583.

35. Although a typical statute of frauds requires a contract to be in writing and signed by the party to be charged if the contract cannot be fulfilled within one year of the date it is signed, the majority of states has no writing requirement in its statute of frauds regarding an employment contract between a real estate broker and his principal. See, e.g., ALA. CODE § 8-9-2 (1984); ARK. STAT. ANN. § 38-101 (1962); COLO. REV. STAT. § 38-10-112 (1982); CONN. GEN. STAT. ANN. § 52-550 (West Supp. 1987); DEL. CODE ANN. tit. 6, § 2714 (1975); D.C. CODE ANN. § 28-3502 (1981); FLA. STAT. ANN. § 725.01 (West Supp. 1987); GA. CODE ANN. § 13-5-30 (1982); ILL. ANN. STAT. ch. 59 paras. 1, 2 (Smith-Hurd 1972 & Supp. 1987); IOWA CODE ANN. § 622.32 (West 1950); KAN. STAT. ANN. § 33-106 (1986); ME. REV. STAT. ANN. tit. 33, § 51 (West 1978); MD. REAL PROP. CODE ANN. §§ 5-101 to 5-108 (1981); MINN. STAT. ANN. § 513.04 (West 1947); MISS. CODE ANN. § 15-3-1 (1972); MO. ANN. STAT. § 432.010 (Vernon 1949); NEV. REV. STAT. § 111.220 (1986); N.H. REV. STAT. ANN. § 506:1-2 (1983); N.Y. GEN. OBLIG. LAW § 5-701 (McKinney 1983 & Supp. 1987); N.C. GEN. STAT. §§ 22-1, 22-2 (1986); N.D. CENT. CODE § 9-06-04 (1987); OHIO REV. CODE ANN. § 1335.05 (Page 1979); OKLA. STAT. ANN. tit. 15, § 136 (West 1983); PA. STAT. ANN. tit. 33, §§ 1-8 (Purdon 1967); S.C. CODE ANN. § 32-3-10 (Law. Co-op. 1977); S.D. CODIFIED LAWS ANN. § 53-8-2 (1980 & Supp. 1987); TENN. CODE ANN. § 29-2-101 (1980); VT. STAT. ANN. tit. 12, § 181 (1973 & Supp. 1987); W. VA. CODE § 55-1-1 (1981); WYO. STAT. § 1-23-105 (Supp. 1987).

A number of states, however, provide within their statutes of frauds that a broker's contract must be in writing and signed by the party to be charged. See, e.g., ALASKA STAT. § 09.25.010 (1983); ARIZ. REV. STAT. ANN. § 44-101 (1967); CAL. CIV. CODE § 1624[d] (West 1985 & Supp. 1987); HAW. REV. STAT. § 656-1 (1985); IDAHO CODE § 9-508 (1979); IND. CODE ANN. § 32-2-2-1 (Burns 1980); KY. REV. STAT. ANN. § 371.010[8] (Michie/Bobbs-Merrill 1972 & Supp. 1986); MASS. GEN. LAWS ANN. ch. 259, § 7 (West Supp. 1987); MICH. COMP. LAWS ANN. § 566.132 (West Supp. 1987); MONT. CODE ANN. § 28-2-903[e] (1986); NEB. REV. STAT. § 36-107 (1984); N.J. STAT. ANN. § 25:1-9 (West 1940); OR. REV. STAT. § 41.580[7] (1985); R.I. GEN. LAWS § 9-1-4[6] (1985); UTAH CODE ANN. § 25-5-4[5] (1987); VA. CODE ANN. § 11-2(6a) (1985); WASH. REV. CODE ANN. § 19.36.010[5] (West 1978); WIS. STAT. ANN. § 240.10 (West 1987).

The better practice for both the seller and the broker is to reduce their agreement to writing. This writing should contain the following information: (1) the names of the parties; (2) a description of the property; (3) the amount of the commission and the conditions precedent to its accrual; (4) any specific provision addressing the nature of the listing, such as an exclusive right to sell; and (5) the duration of the agreement. See generally P. ROHAN, B. GOLDSTEIN & C. BOBIS, *10 REAL ESTATE BROKERAGE LAW AND PRACTICE* § 2.03 (1986).

36. A broker will usually obtain a right to market the seller's home through

receives offers on behalf of the seller.³⁷ When the broker finds a potential purchaser, negotiations between the seller and purchaser begin, with the broker acting as an intermediary.³⁸ After the seller accepts the purchaser's offer, the parties to the transaction subscribe a sales contract.³⁹ Upon the execution of the contract, the purchaser generally attempts to secure financing⁴⁰ through a lending institution.⁴¹ Once the purchaser obtains financing, the parties set a closing date⁴²

a multiple listing service agreement, which gives a "listing broker" an exclusive right to sell for three to six months. See N.Y. Times, Mar. 8, 1987, § 8 (Real Estate), at 1, col. 1. The listing broker is the broker who obtained the listing from the seller and has actually contracted with the seller. See generally HENZEY & FRIEDMAN, *supra* note 33, at 329-35. A selling broker, by contrast, is the broker who obtains the offer to buy from the purchaser. See *id.* The selling broker and the listing broker can be the same person. See *id.* When two brokers are involved, any commission is split proportionately according to custom in the area or by the terms of the multiple listing agreement. See *id.*

37. The broker, as the seller's agent, solicits offers from a purchaser and then reports that offer to the seller. See HENZEY & FRIEDMAN, *supra* note 33, at 335-36. Unlike a "pure" agency relationship, in which the agent has the power to negotiate and bind his principal to a contract, the seller, not the broker, accepts or rejects the offer made by the prospective purchaser. See *id.*

38. See *Henderson v. Hassur*, 225 Kan. 678, 594 P.2d 650 (1979) (broker carries on negotiations as intermediary between seller and purchaser).

39. A basic residential sales contract sets forth the identity of the parties, describes the property to be sold, recites the promise to sell and buy, lists the purchase price and the method by which it is payable and sets a closing date. See FRIEDMAN, *supra* note 6, § 1.2(b), at 5-6.

It is prudent for both the seller and the purchaser to engage the services of a knowledgeable real estate attorney before entering any real estate transaction. See *Special Committee*, *supra* note 6, at 581 (American Bar Association recognizes that it is essential for parties to be represented by their own attorneys in order to protect their interests). The attorney's participation in the transaction may include counseling as to (1) the selection of the property; (2) the manner in which the purchaser should take title; and (3) the terms of the transaction. See *id.* at 584-90. The attorney may also prepare documents, advise purchasers of the consequences of the transaction, analyze financing arrangements and explain land use restrictions. See *id.*

40. In 1982, the overwhelming majority of American families paid for its homes with borrowed money. See *Mortgage and Housing Update*, REAL EST. Q., 3-4 (Summer 1983).

41. For a detailed discussion of institutional financing, see Eskridge, *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transactions*, 70 VA. L. REV. 1083 (1984) [hereinafter *Eskridge*].

42. A closing date is set to appoint a time and place for the delivery of the deed and the payment of the purchase price, and for adjustment of expenses incident to the transfer of the ownership interest. See generally HENZEY & FRIEDMAN, *supra* note 33, at 229-38. By establishing a date and place for the closing, the parties know in advance when they must complete their obligations under the contract.

and assemble the necessary documents⁴³ to complete the transaction.

At any time during these events, a broker may assist in the valuation of the property,⁴⁴ serve as an escrow agent,⁴⁵ or procure papers essential to the transaction.⁴⁶ Thus, a broker has a highly visible role in most residential real estate transactions. Because of this visibility, if a purchaser discovers a serious, previously undisclosed defect⁴⁷ in the property after closing, the purchaser is likely to file suit against the broker.⁴⁸

III. A Purchaser's Suit Against a Broker

A purchaser may sue a real estate broker under several theories of liability.⁴⁹ To prevail in any action, however, the purchaser must prove the prima facie elements of the action.⁵⁰ One of the most nebulous elements in an action in misrepresentation is that of duty.⁵¹

For a discussion of purchasers' and sellers' performance obligations, see *id.* at 229-37.

43. The purchaser should obtain the following documents prior to closing: (1) a title report (which informs the purchaser of the limitations, if any, that impair title); (2) title insurance (which protects the purchaser against loss incurred because of defective title); (3) a survey (to ascertain whether the legal description of the land conforms to the lines marked on the property); and (4) a termite inspection. See *Special Committee, supra* note 6, at 587-89. In a typical transaction, the lender will require presentation of these documents at the closing in order to protect his security interest in the property. See *id.* at 587-89.

44. See HENZEY & FRIEDMAN, *supra* note 33, at 341 (brokers may act as professional appraisers).

45. See *id.* (brokers receive and disburse funds through their escrow accounts).

46. See *id.* (brokers may apportion taxes, obtain payoff figures for existing mortgages from lenders and assemble documents).

47. See *supra* note 5.

48. See *supra* note 2 and accompanying text. Even when the broker is not originally named in the purchaser's action, the broker may become a party to the suit because the seller may plead him. See generally J. FRIEDENTHAL, M. KANE & A. MILLER, CIVIL PROCEDURE § 6.8, at 357-60 (1985).

49. A broker may be sued for fraud, breach of fiduciary duty, negligence or misrepresentation. See generally PROSSER & KEETON, *supra* note 7, § 106, at 736-40 (discussing misrepresentation and nondisclosure). Because most actions are based on a real estate broker's misrepresentation or nondisclosure of facts pertaining to a particular transaction in question, these causes of action can generally be characterized as tortious misrepresentation. See *id.* (party may be liable for words or acts that create false impression through active misrepresentation or passive misleading). For a discussion of a possible contract action against a real estate broker under an implied warranty theory, see Freyfogle, *supra* note 11. The most common cause of action against a real estate broker lies in tort; such action is the subject of this Note.

50. See PROSSER & KEETON, *supra* note 7, § 37-38, at 235-42.

51. See *Josephs v. Austin*, 420 So. 2d 1181, 1185 (La. Ct. App. 1982) ("courts have historically struggled with the nature and source of real estate broker and agents' duties"), *cert. denied*, 427 So. 2d 870 (La. 1983).

Courts have struggled to define the basis of the duty a broker owes to the purchaser and the scope of that duty.⁵² The discussion below examines: (1) the tort of misrepresentation in the real estate broker liability context;⁵³ (2) the basis of the broker's duty to the purchaser;⁵⁴ and (3) the scope of the broker's duty.⁵⁵

A. Tortious Misrepresentation

A residential real estate purchaser who suffers pecuniary loss after purchasing defective real estate⁵⁶ usually brings an action against a broker in tort for intentional, negligent, or innocent misrepresentation.⁵⁷ Because courts fail to apply these tort theories consistently in the real estate broker liability context, a brief discussion of the history and merits of each form of misrepresentation follows.

1. Intentional Misrepresentation

The nine elements of the tort of intentional misrepresentation in the real estate broker liability context are: (1) that a representation was made; (2) that the representation was false; (3) that the representation was material to the purchaser's transaction; (4) that the broker made the representation and knew it to be false or did not know it to be true; (5) that the broker intended the purchaser to rely on it; (6) that the purchaser did not know that it was false; (7) that the purchaser relied on its truth; (8) that the purchaser was reasonable in his reliance; and (9) that the purchaser's reliance proximately caused him injury.⁵⁸ Historically, this cause of action was available to the purchaser only when a broker had made an affirmative misrepresentation⁵⁹—it was not available in the case of

52. See *id.* at 1185 (" 'precise duties of a real estate broker must be determined by an examination of the nature of the task the real estate agent undertakes to perform' ") (quoting *Latter & Blum, Inc. v. Richmond*, 388 So. 2d 368, 372 (La. 1980)).

53. See *infra* notes 57-84 and accompanying text.

54. See *infra* notes 85-156 and accompanying text.

55. See *infra* notes 157-65 and accompanying text.

56. See *supra* note 5.

57. See *infra* notes 58-84 and accompanying text.

58. See *Carrel v. Lux*, 101 Ariz. 430, 434, 420 P.2d 564, 568 (1966); see also RESTATEMENT (SECOND) OF TORTS § 526, at 59 (1977) (listing conditions under which particular representation is fraudulent).

59. See PROSSER & KEETON, *supra* note 7, § 106, at 737 (nondisclosure not actionable); see also Note, *Imposing Tort Liability on Real Estate Brokers Selling Defective Housing*, 99 HARV. L. REV. 1861, 1862-66 (1986) (outlining doctrinal bases courts have used to impose broker liability) [hereinafter *Imposing Tort Liability*].

an intentional nondisclosure.⁶⁰ Eventually, however, courts broadened the scope of this cause of action to include any intentional misrepresentation regardless of whether the misrepresentation was an affirmative statement or an omission.⁶¹

It is true that no contemporary court would question a broker's liability when the broker has made an actual misrepresentation of a material fact concerning the property.⁶² Nevertheless, the purchaser is often unable to bear the burden of proof necessary to prevail in such an action.⁶³ Thus, when the purchaser cannot prove intentional misrepresentation, he may bring an action for negligent misrepresentation or innocent misrepresentation—depending on which form of action the court will recognize in a suit for misrepresentation against a real estate broker.⁶⁴

2. Negligent Misrepresentation

The elements of the tort of negligent misrepresentation are: (1) the broker owed a duty to the purchaser; (2) the broker breached that duty; (3) harm resulted as a breach of that duty; and (4) the broker's misrepresentation or nondisclosure was the proximate cause of the harm.⁶⁵

Historically, in the absence of some fiduciary relationship⁶⁶ between the parties, courts refused to find that a remedy existed for a negligent misrepresentation⁶⁷ made in any transaction when the defendant had asserted the representation in good faith and the only resulting harm

60. See Freyfogle, *supra* note 11, at 6-7.

61. See Note, Johnson v. Davis: *New Liability for Fraudulent Nondisclosure in Real Property Transactions*, 11 *Nova L.J.* 145, 145-50 (1987); see also Lingsch v. Savage, 213 Cal. App. 2d 729, 29 Cal. Rptr. 201 (1963) (broker liable for "negative fraud" when he fails to disclose material facts).

62. See, e.g., May v. Hopkinson, 289 S.C. 549, 347 S.E.2d 508 (1986) (broker who intentionally misrepresented existence of termites in property held liable).

63. See *Imposing Tort Liability*, *supra* note 59, at 1863 (purchaser has difficulty proving that broker made certain representations, knowingly lied and intended that purchaser rely on statements).

64. As a matter of common sense, a purchaser will bring the form of action that implicates the lowest burden of proof, provided that the court recognizes that form of action.

65. See PROSSER & KEETON, *supra* note 7, § 30, at 164; see also *id.* §§ 107, 108, at 740.

66. See *infra* notes 105-12 and accompanying text for a discussion of a fiduciary relationship and its inherent obligations.

67. A broker negligently misrepresents when he makes the representation without exercising reasonable care to ascertain its truth, makes it carelessly as to manner of expression or makes it without the skill and competence required of the profession. See Prosser, *supra* note 11, at 234.

was pecuniary loss.⁶⁸ Gradually, courts expanded the application of negligent misrepresentation to include any case in which a "special relation" existed between the parties.⁶⁹ Many courts now recognize the tort of negligent misrepresentation for both affirmative statements⁷⁰ and for nondisclosures⁷¹ in the real estate broker liability context.⁷² Thus, a real estate broker may be liable for negligent misrepresentation when he fails to use reasonable care in ascertaining the truth of the representation, even if he honestly believes it to be true.⁷³

3. *Innocent Misrepresentation*

If the purchaser is unable to meet the burden of proof for the tort of intentional misrepresentation⁷⁴ or negligent misrepresentation,⁷⁵ he may try to premise his action against the broker on innocent misrepresentation.⁷⁶ The elements of the tort of innocent misrep-

68. See generally Goodhart, *Liability for Negligent Misstatements*, 78 LAW Q. REV. 107, 111-13 (1962).

69. See *Hedley Byrne & Co. v. Heller & Partners*, [1964] A.C. 465 (bank that made negligent misrepresentation causing pecuniary loss to customer had duty to exercise reasonable care in making representation); RESTATEMENT (SECOND) OF TORTS § 522 (1984).

70. See, e.g., *First Church of the Open Bible v. Cline J. Dunton Realty, Inc.*, 19 Wash. App. 275, 574 P.2d 1211 (1978) (broker liable for negligent misrepresentation of boundary line of property offered for sale).

71. See, e.g., *Lingsch v. Savage*, 213 Cal. App. 2d 729, 29 Cal. Rptr. 201 (1963) (broker liable for nondisclosure of defects in property).

72. The courts have been willing to allow recovery for negligent misrepresentation when the defendant made his statements in the course of his business or profession, and he had a pecuniary interest in the transaction. See, e.g., *Amato v. Rathbun Realty, Inc.*, 98 N.M. 231, 647 P.2d 433 (1982). The *Amato* court relied on § 552 of the Restatement (Second) of Torts to hold that a broker's duty is not limited to failure to convey information within his actual knowledge. See *id.* at 232, 647 P.2d at 434.

73. See *Lyons v. Christ Episcopal Church*, 71 Ill. App. 3d 257, 260, 389 N.E.2d 623, 625 (1979) ("rule we follow would permit a finding of fault only in situations where the real estate agent knew or should have known that the representation might be false"); *Hoffman v. Connall*, 108 Wash. 2d 69, 77, 736 P.2d 242, 246 (1987) (if broker willfully or negligently conveys false information about real estate to buyer, broker is liable therefore); accord *Amato*, 98 N.M. at 232-33, 647 P.2d at 434-35 (recognizing cause of action against broker who fails to exercise reasonable care or competence in obtaining or communicating information).

74. See *supra* note 58 and accompanying text.

75. See *supra* note 65 and accompanying text.

76. Section 552C(1) of the Restatement (Second) of Torts defines the tort of innocent misrepresentation as follows:

One who, in a sale, rental or exchange transaction with another, makes a misrepresentation of material fact for the purpose of inducing another to act or to refrain from acting in reliance upon it, is subject to liability

resentation are: (1) the broker made a misrepresentation of material fact for the purpose of inducing the purchaser to act in reliance upon it; and (2) the purchaser suffered pecuniary loss as a result of his justifiable reliance.⁷⁷

Only a minority of courts⁷⁸ has recognized the tort of innocent misrepresentation in the real estate broker liability context.⁷⁹ Nevertheless, this form of action is effective because the purchaser need only prove that he justifiably relied on a misrepresentation of material

to the other for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation, even though it is not made fraudulently or negligently.

.RESTATEMENT (SECOND) OF TORTS § 552C(1) (1977). The Restatement (Second) leaves open the question whether such a cause of action may be brought against real estate brokers. *See id.* § 552C(1) comment g.

77. *See supra* note 76.

78. The following jurisdictions recognize a cause of action by a purchaser of property against a real estate broker for the latter's innocent misrepresentation or nondisclosure of property defects: Alaska, *see* *Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982); District of Columbia, *see* *Spargnapani v. Wright*, 110 A.2d 82 (D.C. 1954); Illinois, *see* *Buzzard v. Bolger*, 117 Ill. App. 3d 887, 453 N.E.2d 1129 (1983); Minnesota, *see* *Berryman v. Riegert*, 286 Minn. 270, 175 N.W.2d 438 (1970); South Carolina, *see* *Lawlor v. Scheper*, 232 S.C. 94, 101 S.E.2d 269 (1957); Texas, *see* *Polk Terrace, Inc. v. Harper*, 386 S.W.2d 588 (Texas Ct. App. 1965); Utah, *see* *Dugan v. Jones*, 615 P.2d 1239 (Utah 1980); Wisconsin, *see* *Guaerke v. Rozga*, 112 Wis. 2d 271, 332 N.W.2d 804 (1983).

79. Some courts and commentators have lauded the application of innocent misrepresentation to residential real estate transactions. For example, the *Bevins* court held that "[a]s between a broker who communicated the misrepresentation, and the purchaser whose only fault was to rely on the broker . . . it [is] preferable that the broker bear any loss caused by misrepresentation." *Bevins*, 655 P.2d at 763; *see also* Note, *Realtor Liability for Innocent Misrepresentation and Undiscovered Defects: Balancing the Equities Between Broker and Buyer*, 20 VAL. U.L. REV. 255, 267 (1986) (justifiable buyer reliance and purchaser expectations of broker-buyer relationship stated as reasons for imposition of innocent misrepresentation liability) [hereinafter *Balancing the Equities*].

In contrast, other courts and commentators have sharply criticized the finding of liability for innocent misrepresentation in the broker-purchaser relationship. *See* *Hoffman v. Connall*, 108 Wash. 2d 69, 75-78, 736 P.2d 242, 245-246 (1987) ("[w]e perceive no persuasive reason to hold real estate brokers to a higher standard of care than other professionals must satisfy. . . . Real estate agents and brokers are not liable for innocently and nonnegligently conveying a seller's misrepresentation to a buyer"); *see also* *Bevins*, 655 P.2d at 764 (Connor, J., dissenting). The dissent in *Bevins* equated recognition of a cause of action for innocent misrepresentation to imposition of strict liability and stated, "[t]here is no reason to make the broker the 'insurer' of the seller's representation." *Id.*; *accord* *Prigge v. South Seventh Realty*, 97 Nev. 640, 640, 637 P.2d 1222, 1223 (1981) (court refused to find liability based on innocent misrepresentation); Note, *Easton v. Strassburger: Judicial Imposition of a Duty to Inspect on California Real Estate Brokers*, 18 LOY. L.A.L. REV. 809, 818 (1985) (arguing that broker should not be required to disclose defects to purchaser because broker has fiduciary duty to act solely in interest of seller).

fact made by the real estate broker.⁸⁰ Under this theory of liability, a broker's knowledge that a representation is false or his intention that a purchaser rely on the representation is irrelevant.⁸¹ Thus, the purchaser need not prove the broker's subjective intent.⁸² Furthermore, even if the broker believed that the representation was true, based on statements made by the seller,⁸³ the broker may be liable if the representation was in fact false.⁸⁴

B. The Element of Duty

It is settled that in an action for intentional misrepresentation,⁸⁵ a broker has a duty to refrain from fraudulently inducing a prospective purchaser to enter into a transaction.⁸⁶ In an action for negligent misrepresentation⁸⁷ or innocent misrepresentation,⁸⁸ however, the basis and scope of a duty owed to a prospective purchaser

80. See *supra* notes 76-77 and accompanying text. For an excellent discussion of innocent misrepresentation in the real estate broker liability context, see *Balancing the Equities*, *supra* note 79.

81. See *supra* notes 76-79 and accompanying text. This form of action closely resembles a products liability action under § 402A of the Restatement (Second) of Torts:

- (1) One who sells any product in a defective condition unreasonably dangerous to the user or consumer or to his property is subject to liability for physical harm thereby caused to the ultimate user or consumer, or to his property, if (a) the seller is engaged in the business of selling the product, and (b) it is expected to and does reach the user or consumer without substantial change in the condition in which it is sold. (2) The rule stated in Subsection (1) applies although (a) the seller has *exercised all possible care* in the preparation and sale of his product, and (b) the user or consumer has not bought the product from or entered into any contractual relation with the seller.

RESTATEMENT (SECOND) OF TORTS § 402A (emphasis added).

One court has used this products liability approach to impose broker liability for misrepresentation of defective real estate. See *Berman v. Watergate West, Inc.*, 391 A.2d 1351 (D.C. 1978). It is important to emphasize, however, that in *Berman* the broker was actually a subsidiary of the building's seller. See *id.* Thus, the holding may be limited to cases in which the broker and seller are essentially one entity. The *Berman* decision has been criticized as an overextension of the law of products liability. See *Products Liability*, *supra* note 4.

82. See *supra* note 81 and accompanying text.

83. Or even if the broker believed that the representation was true based on independent investigation. See *infra* note 84.

84. See *Gauerke*, 112 Wis. 2d at 281, 332 N.W.2d at 809 (in some situations, innocent broker, rather than innocent purchaser, should bear loss).

85. See *supra* notes 58-63 and accompanying text.

86. See PROSSER & KEETON, *supra* note 7, § 107, at 740-45.

87. See *supra* notes 65-73 and accompanying text.

88. See *supra* notes 76-84 and accompanying text.

by the broker is much less clear.⁸⁹ The discussion below sets forth the theories under which a broker may have a duty to a prospective purchaser.

1. Agency

According to general principles of agency law, a real estate broker acting as agent for the seller has a duty to faithfully and honestly represent the seller. The broker, however, owes no duties to third parties.⁹⁰ Thus, a purchaser traditionally could not rely on agency as a basis for establishing duty in an action for misrepresentation. The broker could claim that, absent an employment relationship,⁹¹ no agency was created; hence the broker owed no duty to the purchaser.⁹²

89. See *Josephs v. Austin*, 420 So. 2d 1181, 1185 (La. Ct. App. 1982), (“courts have historically struggled with the nature and source of real estate broker . . . duties”), *cert. denied*, 427 So. 2d 870 (La. 1983).

90. See RESTATEMENT (SECOND) OF AGENCY § 347(2) (1958). Furthermore, according to general agency principles, an agent is permitted to repeat information from his principal without fear of liability should the information prove untrue, unless the agent knows or has reason to know of its falsity. See *id.* § 348 comment b (1979).

91. Employment is one method of creating agency. See generally H. REUSCHLEIN & W. GREGORY, HANDBOOK ON THE LAW OF AGENCY AND PARTNERSHIPS § 12, at 31 (1979) [hereinafter REUSCHLEIN & GREGORY]. The parties create an agency relationship only when one person intends for another to act on his behalf and the other person consents to represent him. See *id.* Thus, consent of both parties is required to create an agency relationship. See *id.* An agency relationship normally arises when a seller enters a multiple listing agreement with a real estate broker. See *supra* note 36; see also *Marra v. Katz*, 74 Misc. 2d 1010, 1012-13, 347 N.Y.S.2d 143, 146-47 (Sup. Ct. Westchester County 1973) (multiple listing services assume cooperating broker is subagent of listing broker, thus, the agent of the seller). Unlike the seller, who usually enters a written listing agreement with the real estate broker, the purchaser generally has no such writing defining the duties of the parties to one another.

92. According to agency principles, a real estate broker is not liable to a purchaser for a misrepresentation in a real estate transaction when the broker states that the representation is derived from the principal (seller), and the facts from which the representations are made are not such as would be peculiarly within the broker's knowledge. See REUSCHLEIN & GREGORY, *supra* note 91, § 118, at 182 (when agent discloses existence and identity of principal to third party, agent has no liability).

It is, of course, possible for the purchaser to enter an agency relationship with a real estate broker in which the purchaser is the principal. When this occurs, the broker has the duty to act with utmost good faith and loyalty in the interest of his principal—the purchaser. See *id.* §§ 68-69, at 122-24. This obligation of good faith and loyalty would include an obligation to disclose defects known to or reasonably ascertainable by the broker. See *id.*

Recently, however, some courts have begun to infer dual-agency⁹³ in the broker-purchaser-seller relationship.⁹⁴ In a dual-agency context, the broker is the express agent⁹⁵ for the seller and the implied agent⁹⁶ for the purchaser. Dual-agency status creates several problems for the real estate broker.⁹⁷ The broker has a duty of good faith and loyalty⁹⁸ to both parties—each of whose interest is adverse to the other's.⁹⁹ Furthermore, the legal fiction of implied dual-agency¹⁰⁰ is contrary to the principles of agency,¹⁰¹ which require

93. The broker, when acting as a middleman in effecting the sale or exchange of property, acts in a certain sense as the agent of both parties to the transaction. *See* *Walter v. Moore*, 700 P.2d 1219, 1224 (Wyo. 1985) ("broker is held to owe a duty to both the seller who employs him and the buyer to whom real estate is sold").

94. *See id.*, *see also* *Lerk v. McCabe*, 349 Ill. 348, 182 N.E. 388 (1932).

95. An agency relationship is expressly created by a multiple listing agreement, *see supra* note 56, or by express agreement of the parties. *See supra* note 91.

96. A court may infer an agency relationship by the course of conduct between the parties. *See supra* note 93.

97. The broker in an implied dual-agency relationship may be unable to ascertain his obligations to both of his principals. *See infra* notes 98-99 and accompanying text. The extent to which a broker may disclose defective property conditions while preserving his duty as agent for both principals is unclear. *See id.* While several writers have addressed the problem of dual-agency in the broker-purchaser context, none has set forth an effective solution to the problems it creates. *See, e.g.*, Note, *Theories of Real Estate Broker Liability: Arizona's Emerging Malpractice Doctrine*, 20 ARIZ. L. REV. 757 (1978) [hereinafter *Arizona's Emerging Malpractice Doctrine*]; Note, *Real Estate Broker's Duties to Prospective Purchasers—Funk v. Tift*, 1976 B.Y.U. L. REV. 513; Note, *A Re-examination of the Broker-Buyer-Seller Relationship*, 18 WAYNE L. REV. 1343 (1972) [hereinafter *Broker-Buyer-Seller Relationship*]. As one commentator stated, "[t]his [confusion] is to be expected, since the law of agency is predicated on the fundamental principle that an agent can represent only one set of interests." Sinclair, *The Duty of the Broker to Purchasers and Prospective Purchasers of Real Property in Illinois*, 69 ILL. B.J. 260, 264 (1981).

98. *See* REUSCHLEIN & GREGORY, *supra* note 91, §§ 68-69, at 122-24.

99. The seller is interested in obtaining the highest possible purchase price and the purchaser, in negotiating the lowest acceptable purchase price. Courts have held that a person employing a broker to sell property is entitled to recover from the broker both the commission that he himself has paid and that paid by the buyer, when the broker has taken a commission from the purchaser. *See* *Wechsler v. Bowman*, 285 N.Y. 284, 34 N.E.2d 322 (1941).

100. *See supra* notes 93-99 and accompanying text.

101. An agent may not represent any interests adverse to those of his principal in transactions that involve the subject matter of his agency without the principal's full knowledge and consent. *See* REUSCHLEIN & GREGORY, *supra* note 91, § 68, at 122. Furthermore, the agent may rely on the principal's representations unless he knows or should know that the principal's representations are untrue. *See id.* § 125, at 195; *see also* *Prigge v. South Seventh Realty*, 97 Nev. 640, 640, 637 P.2d 1222, 1223 (1981) (broker not liable for innocent misrepresentation because he properly relied on statements of seller).

the full knowledge and consent of both parties in order for the broker to act as a dual-agent in a transaction.¹⁰² Recognizing the problems inherent in this dual-agency status,¹⁰³ other courts have focused on different bases for holding that a broker owes a duty to the purchaser.¹⁰⁴

2. Public Policy

Implied in any agency-principal relationship are the duties of a fiduciary—loyalty, good faith, care, and disclosure.¹⁰⁵ Some courts,¹⁰⁶ however, find a fiduciary duty even when no agency relationship exists between the parties.¹⁰⁷ To support findings that a broker owes a fiduciary duty to a purchaser, some courts rely on public policy considerations¹⁰⁸ coupled with the real estate broker's role in a typical real estate transaction.¹⁰⁹

One example of a court finding a fiduciary duty in these circumstances is the Illinois appellate court's decision in *Sawyer Realty*

102. See RESTATEMENT (SECOND) OF AGENCY §§ 313, 391-392 (1958).

103. See *supra* notes 97-102 and accompanying text.

104. See *infra* notes 105-53 and accompanying text.

105. See *Walter v. Moore*, 700 P.2d 1219 (Wyo. 1985); REUSCHLEIN & GREGORY, *supra* note 91, §§ 68-69, at 122-24.

106. See, e.g., *Hughey v. Rainwater Partners*, 661 S.W.2d 690, 691 (Tenn. Ct. App. 1983) (“[w]here a broker acts as an intermediary between a seller and purchaser . . . broker is under a duty to deal fairly and honestly with both parties”); *accord Gouveia v. Citicorp Person-to-Person Fin. Center, Inc.*, 101 N.M. 572, 686 P.2d 262 (1984) (broker's duties based upon status as a fiduciary).

107. A fiduciary relationship is created when one party places great trust and confidence in another due to the latter's representation of superior knowledge and skill. See J. POMEROY, EQUITY AND JURISPRUDENCE §§ 902, 956, at 550, 789 (5th ed. 1941). For a detailed discussion of the fiduciary nature of the real estate broker-purchaser relationship, see *Broker-Buyer-Seller Relationship*, *supra* note 97.

108. See, e.g., *Hagar v. Mobley*, 638 P.2d 127 (Wyo. 1981) (real estate broker's duty is to an extent determined by public policy). The *Hagar* court explained its holding in the following manner:

The underlying rationale of [a real estate broker's] duty to a buyer who is not his client is that he is . . . in a unique position to verify critical information given him by the seller. His duty is to take reasonable steps to avoid disseminating to the buyer false information. . . . The broker is required to employ a reasonable degree of effort and professional expertise to confirm or refute information from the seller which he knows, or should know, is pivotal to the transaction from the buyer's perspective.

Id. at 137-38 (citing *Tennant v. Lawton*, 26 Wash. App. 701, 706, 615 P.2d 1305, 1309-10 (1980) (citations omitted). The *Hagar* court further stated that “[r]ealtors, 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.” *Hagar*, 638 P.2d at 138.

109. See *supra* notes 31-48 and accompanying text.

*Group, Inc. v. Jarvis Corp.*¹¹⁰ The *Sawyer* court held that since real estate brokers occupy a position of trust with respect to prospective purchasers with whom they are negotiating, they have a duty to exercise good faith in their dealings with such purchasers, even in the absence of an agency relationship.¹¹¹ Thus, some courts do not hesitate to hold that a real estate broker owes a duty to a purchaser on the basis of public policy considerations.¹¹² Other courts, however, rely on statutes to find that a broker owes a duty to a prospective purchaser.¹¹³

3. Statutory Duty

Several courts have used a statutory basis¹¹⁴ to hold that a real estate broker owes a duty to a prospective purchaser.¹¹⁵ A state may, under its general police power,¹¹⁶ regulate the business of real estate brokers,¹¹⁷ including the imposition of licensing requirements.¹¹⁸ Courts

110. 89 Ill. 2d 379, 432 N.E.2d 849 (1982).

111. *See id.* at 386, 432 N.E.2d at 852; *see also* *Josephs v. Austin*, 420 So. 2d 1181 (La. Ct. App. 1982) (when broker negotiates for both vendor and vendee, broker must relay accurate information because both parties rely on his knowledge and expertise), *cert. denied*, 427 So. 2d 870 (La. 1983).

112. *See, e.g., Sawyer Realty Group, Inc. v. Jarvis Corp.*, 89 Ill. 2d 379, 432 N.E.2d 849 (1982); *Josephs v. Austin*, 420 So. 2d 1181 (La. Ct. App. 1982), *cert. denied*, 427 So. 2d 870 (La. 1982); *Hagar v. Mobley*, 638 P.2d 127 (Wyo. 1981).

113. *See infra* notes 114-28 and accompanying text.

114. The broker's duty arises from state real estate broker licensing acts or state consumer protection acts. *See infra* notes 115-27 and accompanying text.

115. *See, e.g., Earle, McMillan & Niemeyer, Inc. v. Dekle*, 418 So. 2d 97 (Ala. 1982) (real estate brokers subject to professional standards under state licensing code); *Johnson v. Geer Real Estate Co.*, 239 Kan. 324, 720 P.2d 660 (1986) (action for damages against Kansas real estate broker may be predicated on negligent violation of state broker licensing act); *McRae v. Bolstad*, 32 Wash. App. 173, 646 P.2d 771 (1982) (primary purpose of real estate broker licensing acts is to promote minimum standard of conduct for those engaged in the business), *aff'd*, 101 Wash. 2d 161, 676 P.2d 496 (1984).

116. *See Groetzinger v. Forest Hills Terrace Corp.*, 123 Misc. 274, 205 N.Y.S. 125 (Sup. Ct. Westchester County 1924) (validity of real estate broker licensing statute as lawful exercise of police power sustained).

117. *See Roman v. Lobe*, 243 N.Y. 51, 152 N.E. 461 (1926) (legislature acts within law when it establishes system for licensing real estate brokers).

118. For the brokerage licensing laws of each state, see ALA. CODE § 34-27-1 to 38 (1985); ALASKA STAT. § 08.88.161 to 261 (1982); ARIZ. REV. STAT. ANN. § 32-2121 to 2133 (1986); ARK. STAT. ANN. § 71-1301 to 1306 (1979); CAL. BUS. & PROF. CODE §§ 10000-30, 10150 to 10165 (West 1964 & Supp. 1987); COLO. REV. STAT. § 12-61-101 to 110 (1978 & Supp. 1987); CONN. GEN. STAT. ANN. § 20-311 to 314 (West 1969 & Supp. 1987); DEL. CODE ANN. tit. 24, § 2907-11 (Supp. 1984); D.C. CODE ANN. § 45-1921 to 1951 (1981); FLA. STAT. ANN. § 475.001 to 475.486 (West 1981); GA. CODE ANN. § 43-40-7 to 32 (1984); HAW.

have found that the primary purpose of real estate broker licensing acts is to protect the general welfare of the public¹¹⁹ and to promote a minimum standard of conduct for those engaged in the business of real estate in the capacity of a broker.¹²⁰ Because state licensing statutes sometimes fail to provide specifically for a private cause of action,¹²¹ some courts will not consider these acts as a basis for holding that a real estate broker owes a duty to a prospective purchaser.¹²²

REV. STAT. § 467-1 to 30 (1985); IDAHO CODE § 54-2022 to 2053 (1979 & Supp. 1985); ILL. ANN. STAT. ch. 111, paras. 5701 to 5743 (Smith-Hurd 1984 & Supp. 1987); IND. CODE ANN. § 25-34.1-3-2 to 3-4.1 (Burns Supp. 1986); IOWA CODE ANN. § 117.1 to 117.30 (West 1984); KAN. STAT. ANN. §§ 58-3035 to 3075 (1983); KY. REV. STAT. ANN. §§ 324.010 to 324.990 (Michie/Bobbs-Merrill 1983 & Supp. 1986); LA. REV. STAT. ANN. §§ 37:1431 to 1459 (West Supp. 1985); ME. REV. STAT. ANN. tit. 32, §§ 4001 to 4119 (Supp. 1984); MD. BUS. OCC. CODE ANN. art. 56, §§ 212-232A (1983 & Supp. 1984); MASS. ANN. LAWS ch. 112, § 87SS-TT (Law. Co-op. 1975 & Supp. 1987); MICH. STAT. ANN. § 18.425 (Callaghan Supp. 1985); MINN. STAT. ANN. §§ 82.17 to .34 (West 1986); MISS. CODE ANN. §§ 73-35-1 to 35-35 (1972 & Supp. 1987); MO. REV. STAT. §§ 339.010 to .170 (1959); MONT. CODE ANN. §§ 37-51-102 to 512 (1985); NEB. REV. STAT. §§ 81-885.01 to .46 (1986); NEV. REV. STAT. §§ 645.230 to .840 (1986 & Supp. 1987); N.H. REV. STAT. ANN. §§ 331-A:1 to A:8 (1984); N.J. STAT. ANN. §§ 45:15-1 to 15-16 (West 1978 & Supp. 1987); N.M. STAT. ANN. §§ 61-29-2 to 27 (1978); N.Y. REAL PROP. LAW §§ 440 to 442 (McKinney Supp. 1987); N.C. GEN. STAT. §§ 93A-1 to 38 (1985); N.D. CENT. CODE §§ 43-23-05 to 14.1 (1978 & Supp. 1987); OHIO REV. CODE ANN. §§ 4735.01 to .99 (Page Supp. 1986); OKLA. STAT. ANN. tit. 59, §§ 858-101 to 401 (West Supp. 1987); OR. REV. STAT. §§ 696.007 to .990 (Supp. 1983); PA. STAT. ANN. tit. 63, §§ 455.101 to .608 (Purdon Supp. 1987); R.I. GEN. LAWS §§ 5-20.5-2 to .19 (1976 & Supp. 1985); S.C. CODE ANN. §§ 40-57-10 to 240 (Law. Co-op. Supp. 1984); S.D. CODIFIED LAWS ANN. §§ 36-21-1 to 73 (1986 & Supp. 1987); TENN. CODE ANN. § 62-13-301 to 320 (1986); TEX. REV. CIV. STAT. ANN. art. 6573a, §§ 1-20 (Vernon Supp. 1987); UTAH CODE ANN. § 61-2-1 to 23 (1986 & Supp. 1987); VT. STAT. ANN. tit. 26, §§ 2291-2299 (1975 & Supp. 1986); VA. CODE ANN. §§ 54-740 to 749 (Supp. 1987); WASH. REV. CODE ANN. § 18.85.090, .100 to .150, .161 to .271 (1978 & Supp. 1987); W. VA. CODE §§ 47-12-1 to 23 (1986); WIS. STAT. ANN. §§ 452.01 to .22 (West 1974 & Supp. 1986); WYO. STAT. §§ 33-28-101 to 122 (Supp. 1987).

119. See *Johnson v. Geer Real Estate Co.*, 239 Kan. 324, 330, 720 P.2d 660, 665 (1986) ("purpose of the [real estate broker licensing] act is clearly to require high standards of conduct by real estate brokers licensed in this state, and to protect the members of the public who deal with real estate brokers").

120. See *2 Park Ave. Assocs. v. Cross & Brown Co.*, 36 N.Y.2d 286, 289, 327 N.E.2d 632; 633, 367 N.Y.S.2d 476, 478 (1975) (purpose of New York brokerage licensing statute is to assure standards of competency, honesty and professionalism).

121. See GA. CODE ANN. § 43-40-7 to 32 (1984).

122. See *Campagna v. Sara Hudson Realty Co.*, 137 Ga. App. 451, 224 S.E.2d 102 (1976). The *Campagna* court held that the section of the real estate broker licensing statute "relating to establishment and maintenance of a real estate recovery fund" does not create a private cause of action. *Id.* at 452, 224 S.E.2d at 102. *Contra Johnson v. Geer Real Estate Co.*, 239 Kan. 324, 720 P.2d 660 (1986)

Other courts have relied upon state consumer protection statutes as the basis for a broker's duty to a prospective purchaser.¹²³ Some courts rely on the underlying policy of consumer protection statutes to find a basis for a broker's duty, even though the statute may fail to provide a private cause of action¹²⁴ in real property transactions.¹²⁵ Thus, the existence of a statutory duty running from a broker to a purchaser will often depend on the language of an individual state's consumer protection statute¹²⁶ or broker licensing statute¹²⁷ and the manner in which the courts interpret them.¹²⁸ When courts cannot reasonably interpret existing statutory language to impose a duty on a broker, courts have justified a broker's duty to a prospective purchaser on other grounds.¹²⁹

4. Ethical Codes

Courts have also used real estate broker's associations' ethical codes¹³⁰ to find that a broker owes a duty to a prospective pur-

(because prerequisite for making claim against real estate recovery fund is final judgment in lawsuit in which cause of action is based upon violation of real estate broker's license act, licensing act may be the basis of such suits).

123. See, e.g., ALASKA STAT. § 11.46.710(a)(1) (1983) (person commits crime of deceptive business practices if he makes false statement in connection with promotion of sale of property); ILL. ANN. STAT. ch. 121 ½, paras. 267-72, 311 to -17 (Smith-Hurd Supp. 1987) (action lies against broker for misrepresentations under consumer acts); TEX. BUS. & COM. CODE ANN. §§ 17.41 -.63 (Vernon Supp. 1985) (imposing liability on sellers and their real estate brokers for misstatements regardless of scienter, and for knowing nondisclosures of facts); see also *Straus v. Latter & Blum, Inc.*, 431 So. 2d 9 (La. Ct. App.) (broker liable for nondisclosure under state deceptive trade practices act if defect known to him), *cert. denied*, 438 So. 2d 572 (La. 1983); *Mongeau v. Boutelle*, 10 Mass. App. Ct. 246, 407 N.E.2d 352 (1980) (broker's failure to disclose material fact that could influence buyer actionable under state deceptive trade practices act); *McRae v. Bolstead*, 32 Wash. App. 173, 646 P.2d 771 (1982) (broker has duty under state consumer protection act to disclose matters known to him), *aff'd*, 101 Wash. 2d 161, 676 P.2d 496 (1984).

124. A statute may not explicitly provide for a private cause of action in real property transactions. See, e.g., ARK. STAT. ANN. § 70-921 (1979).

125. See *Young v. Joyce*, 351 A.2d 857 (Del. 1975) (finding real estate broker liability based on state consumer protection statute forbidding concealment, suppression or omission of any material fact with intent that others rely).

126. See *supra* note 123.

127. See *supra* note 118.

128. See *supra* notes 119-25 and accompanying text.

129. See *infra* notes 130-53 and accompanying text.

130. See, e.g., *Hoey v. San Antonio Real Estate Bd.*, 297 S.W.2d 214 (Tex. Ct. App. 1956). The National Association of Realtors, a voluntary association composed of real estate boards throughout the United States, promulgates a Code of Ethics for its members. See FISHER, *supra* note 2, app. A. Local real estate brokerage associations may have their own codes of ethics to which members are expected to adhere.

chaser.¹³¹ *Easton v. Strassburger* presents a striking example of a court's use of an ethical code as a basis for a broker's duty in an action for misrepresentation.¹³² The *Easton* court held that a real estate broker had a duty to inspect for defects and to disclose them to a prospective purchaser.¹³³ The *Easton* court relied in part on the National Association of Realtor's Code of Ethics,¹³⁴ but also focused on policy reasons¹³⁵ for imposing such a duty upon a broker, stating that the "primary purposes [of imposing a duty] are to protect the buyer from the unethical broker and seller and to insure that the buyer is provided sufficient accurate information to make an informed decision whether to purchase."¹³⁶

Similarly, the Iowa Supreme Court in *Menzel v. Morse*,¹³⁷ relied on the National Association of Realtor's Code of Ethics¹³⁸ as a basis for its holding that a broker owed a duty to a prospective purchaser.¹³⁹ The *Menzel* court stated that "courts have turned to published ethical standards and practices of real estate brokers to determine the requisite skill and knowledge, and *acceptable practices*, of members in good standing in that occupation."¹⁴⁰

Article 9 of the National Association of Realtor's Code of Ethics, states that a real estate broker must "avoid exaggeration, misrepresentation, or concealment of pertinent facts [and] has an affirmative obligation to *discover* adverse factors that a reasonably competent and diligent investigation would disclose."¹⁴¹ Thus, if a court uses this Code of Ethics as a basis for finding that a broker owes a duty to a prospective purchaser, it may impose a greater duty of care than that which would be required under an action for intentional or negligent misrepresentation.¹⁴² Rather than merely having the duty to use reasonable care to refrain from making a material

131. See, e.g., *Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984); *Menzel v. Morse*, 362 N.W.2d 465 (Iowa 1985); *Hoey v. San Antonio Real Estate Bd.*, 297 S.W.2d 214 (Tex. Ct. App. 1956).

132. 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984).

133. See *id.* at 99-100, 199 Cal. Rptr. at 388-89.

134. See *id.* at 101-03, 199 Cal. Rptr. at 389-90.

135. See *id.* at 99-102, 199 Cal. Rptr. at 388-90.

136. *Id.* at 99, 199 Cal. Rptr. at 388.

137. 362 N.W.2d 465 (Iowa 1985).

138. See *supra* note 130.

139. *Menzel*, 362 N.W.2d 472 (Iowa 1985) (violation by broker of code of ethics provides evidence of negligence in malpractice action).

140. *Id.* at 472 (emphasis added).

141. FISHER, *supra* note 2, app. A., art. 9 (emphasis added).

142. In an action for negligent misrepresentation, the plaintiff must prove that the broker failed to exercise reasonable care. See *supra* note 73.

misrepresentation of fact¹⁴³ to a prospective purchaser, a broker may have a duty to inspect for and to disclose the existence of any defect located on the property in question.¹⁴⁴

5. *Malpractice*

A malpractice theory¹⁴⁵ may also be used by courts as a basis for finding that a broker owes a duty to a prospective purchaser. Because of an amendment to the Arizona State Constitution,¹⁴⁶ for example, it is possible that an Arizona purchaser may bring an action against a broker for malpractice. Arizona's constitutional amendment granted brokers a limited right to engage in the practice of law.¹⁴⁷ Because real estate brokers now have a limited right to prepare legal documents in real estate transactions,¹⁴⁸ they are subject to certain duties with respect to these transactions. For example, a recent Arizona case, *Morely v. J. Pagel Realty & Insurance*,¹⁴⁹ discussed a broker's duties to a purchaser and stated that without regard to whether a relationship exists between the parties, brokers have a duty to explain the implications of documents they prepare.¹⁵⁰ The *Morely* court determined that "[f]ailure to do so may constitute real estate malpractice."¹⁵¹ Although the *Morely* court specifically limited its holding

143. "A material fact is one 'to which a reasonable man might be expected to attach importance in making his choice of action.'" *Cousineau v. Walker*, 613 P.2d 608, 613 (Alaska 1980) (quoting W. PROSSER, *LAW OF TORTS* § 108, at 719 (4th ed. 1971)).

144. See *Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984) (duty to inspect for and disclose defects); see also *Hoey v. San Antonio Real Estate Bd.*, 297 S.W.2d 214 (Tex. Ct. App. 1956) (by voluntarily joining association of real estate brokers, broker agrees to certain limitations upon his activities and is bound by its code of ethics).

145. See *Menzel v. Morse*, 362 N.W.2d 465 (Iowa 1985) (appeal from district court judgment denying purchaser damages in malpractice action against broker).

146. See ARIZ. CONST. art. 26, § 1 (1984).

147. Article 26, § 1 of the Arizona Constitution provides:

Any person holding a valid license as a real estate broker or a real estate salesman regularly issued by the Arizona State Real Estate Department when acting in such capacity as broker or salesman for the parties, or agent for one of the parties to a sale, exchange, or trade, or the renting and leasing of property, shall have the right to draft or fill out and complete, without charge, any and all instruments incident thereto 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.

Id.

148. See *supra* note 147.

149. 27 Ariz. App. 62, 550 P.2d 1104 (1976).

150. See *id.* at 65-66, 550 P.2d at 1107-08.

151. *Id.* at 66, 550 P.2d at 1108.

to the broker's client (the seller),¹⁵² at least one commentator has advocated its application to a prospective purchaser.¹⁵³

Thus, as the previous sections have outlined, courts have relied on several theories to find that a real estate broker owes a duty to a prospective purchaser.¹⁵⁴ Because the courts have asserted disparate theories as the basis of a broker's duty to a prospective purchaser, a broker may be unsure of his obligations to the parties to the transaction.¹⁵⁵ Similarly, even when the broker is aware that he owes a duty to a purchaser, he may be unsure of what that duty entails—whether it is a duty to refrain from making an affirmative misrepresentation, a duty to disclose all facts that he knows or should have known, or a duty to inspect the property and disclose any problems.¹⁵⁶

C. The Scope of Duty Owed to a Prospective Purchaser

In short, the standards courts have developed for determining the scope of the broker's duty are not clearly defined.¹⁵⁷ The standards are unclear because courts in different jurisdictions have reached different conclusions as to the scope of the broker's duty. For example, a California court recently held that a real estate broker has an affirmative duty to investigate the property and to disclose to a prospective purchaser any defects discovered.¹⁵⁸ By contrast, in *Provost v. Miller*,¹⁵⁹ a Vermont court reached the opposite conclusion, holding that “[r]eal estate brokers and agents are marketing agents, not structural engineers or contractors” who “have no duty to verify independently representations made by a seller unless they are aware of facts that ‘tend to indicate that such [representations are] false.’”¹⁶⁰ An Ohio court¹⁶¹ went even further when it held that caveat emptor still applies to circumstances in which the property has no latent defects and any conditions in question are open to observation.¹⁶² These cases illustrate that courts have failed to achieve a uniform

152. *Id.* at 65, 550 P.2d at 1107.

153. See generally *Arizona's Emerging Malpractice Doctrine*, *supra* note 97.

154. See *supra* notes 90-153 and accompanying text.

155. See *supra* notes 92, 123, 142, 144 and accompanying text.

156. See *id.*

157. See *infra* notes 158-65 and accompanying text.

158. See *Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984).

159. 144 Vt. 67, 473 A.2d 1162 (1984).

160. *Id.* at 69-70, 473 A.2d at 1164 (quoting *Lyons v. Christ Episcopal Church*, 71 Ill. App. 3d 257, 259-60, 389 N.E.2d 623, 625 (1979)).

161. See *Sanfillipo v. Rarden*, 24 Ohio App. 3d 164, 493 N.E.2d 991 (1985).

162. See *id.* at 167, 493 N.E.2d at 995.

standard for defining the scope of a broker's duty. Accordingly, the majority of jurisdictions set forth the scope of duty owed to the prospective purchaser on a case-by-case basis.¹⁶³ As a result, even if a real estate broker is aware that he owes a duty¹⁶⁴ to a prospective purchaser, unless the broker has read the most recent case law in his state, he will be unable to ascertain the full extent of his obligations to either the seller or the purchaser in a given transaction.¹⁶⁵

IV. A Critical Analysis of the Imposition of Broker Liability

A recent Federal Trade Commission study found that "[o]ver the years, brokers have carried on the business of brokerage by dealing with both parties without much concern about the technical legal requirements of agency law and fiduciary relationships."¹⁶⁶ Courts that recognize a cause of action for innocent or negligent misrepresentation¹⁶⁷ against a real estate broker have incorporated similar statements into their opinions.¹⁶⁸ For example, one opinion noted:

Real estate brokers and their agents hold themselves out to the public as having specialized knowledge with regard to housing, housing conditions and related matters. The public is entitled to and does rely on the expertise of real estate brokers in the purchase and sale of its homes. Therefore, there is a duty on the part of real estate brokers to be accurate and knowledgeable concerning the product they are in the business of selling—that is, homes and other types of real estate.¹⁶⁹

These courts are following a trend that imposes broker liability for misrepresentation or nondisclosure on a result-oriented basis.¹⁷⁰ After

163. See generally *supra* notes 157-62 and accompanying text.

164. See *supra* notes 157-63 and accompanying text.

165. See *id.*

166. See *Eskridge, supra* note 41, at 1196 n.345 (citing 1 FTC Los Angeles Regional Office, *The Residential Real Estate Brokerage Industry* 8, 346 (Dec. 1983)).

167. See *supra* notes 70-72, 78 and accompanying text.

168. See, e.g., *Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982) (policy favoring liability is based on recognition that purchasers should be able to rely on brokers' representations); *Easton v. Strassburger*, 152 Cal. App. 3d 102, 199 Cal. Rptr. 383 (1984) (imposition of broker's duty is warranted because of magnitude of benefit conferred on purchasers and ease with which burden can be sustained by brokers); *Gauerke v. Rozga*, 112 Wis. 2d 271, 332 N.W.2d 804 (1983) (public opinion calls for placing loss on defendant).

169. *Lyons*, 71 Ill. App. 3d at 264, 389 N.E.2d at 628 (Moran, J., dissenting).

170. See *supra* note 30.

determining that the purchaser should recover for losses sustained because he had relied on the broker's misrepresentation or nondisclosure, such courts then find some basis for imposing broker liability.¹⁷¹

Imposition of such liability, however, fails to address any of the expectations of the purchaser-broker relationship.¹⁷² The imposition of broker liability for repeating a seller's representation in good faith,¹⁷³ for making an innocent misrepresentation,¹⁷⁴ or for failing to inspect a property for defects¹⁷⁵ will increase the likelihood of real estate transactions tainted with misinformation and confusion.¹⁷⁶ Although the application of a fiduciary duty of good faith and fair dealing¹⁷⁷ to a real estate broker is appropriate, given his status as a professional in the transaction,¹⁷⁸ it is only equitable that the broker should know precisely what this duty entails prior to entering into a transaction.¹⁷⁹

At least one court ignored these considerations when it held that broker liability was appropriate because "[a]ny other rule would permit brokers to use misleading statements in selling the property, yet remain immune from liability by simply remaining ignorant of the property's true characteristics."¹⁸⁰ In making this determination, the court did not focus on the probable outcome of its decision—namely, that in jurisdictions in which a broker is held accountable

171. See *supra* notes 90-153 and accompanying text.

172. For example, the seller expects the broker to sell his property at the highest possible price, as quickly as possible. See KRATOVIL & WERNER, *supra* note 1, at 115. The broker expects to earn a commission by introducing the seller to the purchaser. See *id.* at 99-102 (traditionally, broker earns his commission when he produces buyer who is "ready, willing, and able" to complete the transaction). The purchaser expects to obtain information about the property in question and other similar properties in the area. See *id.* at 114-19.

173. See *Hoffman v. Connal*, 43 Wash. App. 532, 718 P.2d 814 (1986) (broker liability for innocent misrepresentation where broker merely repeated seller's representations), *rev'd*, 108 Wash. 2d 69, 736 P.2d 242 (1987).

174. See *Bevins*, 655 P.2d at 763.

175. See *Easton v. Strassburger*, 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984) (broker had duty to inspect).

176. See *Arizona's Emerging Malpractice Doctrine*, *supra* note 97, at 782-83 (asserting that cautious broker will make few representations to buyer because he could be held liable for false statements).

177. See *supra* note 105 and accompanying text.

178. See *Menzel v. Morse*, 362 N.W.2d 465 (Iowa 1985) (broker's status as professional gives duty to act in good faith with all parties to transaction).

179. In order to carry out the brokerage business within the framework of the law and to meet his obligations to both the seller and the purchaser, the broker must know his obligations to all parties to the transaction.

180. *Bevins*, 655 P.2d at 763.

for innocent misrepresentations, he will attempt to avoid liability by not making any statements concerning the property.¹⁸¹ Thus, because courts have used a case-by-case basis to determine the existence and scope of a duty owed to a purchaser without considering the potential adverse consequences of their decisions, a need for legislation remains.¹⁸²

V. Recommendations

As early as 1926, Justice Cardozo stated "[t]he intrinsic nature of the [brokerage] business combines with practice and tradition to attest the need of regulation."¹⁸³ Although states have enacted statutes governing the licensing of real estate brokers,¹⁸⁴ they have failed to examine the purchaser-broker relationship and to set forth the precise duties a real estate broker owes to a prospective purchaser.¹⁸⁵

State legislatures must address this issue and set forth regulations containing coherent express guidelines for practicing brokers and the general public. One approach, which would achieve the policy goals of protecting the innocent purchaser, would be to enact regulations that would prevent the transfer of defective real estate¹⁸⁶ without making the broker the "insurer"¹⁸⁷ of the transaction. Such legislation should require a broker to disclose fully to prospective purchasers the inherent conflict¹⁸⁸ presented by the broker's representation of both the purchaser and the seller in a transaction. This disclosure prevents an inexperienced investor from assuming that the broker represents his interests.¹⁸⁹

Furthermore, legislatures concerned with consumer protection should impose requirements regulating the transfer of real estate. For example, requiring the purchaser to obtain a structural report,¹⁹⁰ a

181. See *supra* note 176. In addition, to avoid liability for nondisclosure, the broker will represent the property "as is," a phrase that has been upheld as a limit to liability for any implied warranty. See Freyfogle, *supra* note 11, at 42-43 (discussing "as is" clause used to limit broker liability).

182. See *supra* notes 49-181 and accompanying text.

183. *Roman v. Lobe*, 243 N.Y. 51, 54, 152 N.E. 461, 462 (1926).

184. See *supra* note 118.

185. See *De Soto v. Ellis*, 393 So. 2d 847, 851 (La. Ct. App. 1981) (failing to define precise scope of broker's duties).

186. See *supra* note 5.

187. See *Bevins*, 655 P.2d at 764 (Alaska 1982) (Conner, J., dissenting) ("no reason to make the broker the 'insurer' of the seller's representation").

188. See *supra* notes 155-56 and accompanying text.

189. See generally *ARNOLD & KUSNET*, *supra* note 4, at 511 (prevent reliance by disclosure and avoid liability for misrepresentation).

190. See generally *H. HOAGLAND, REAL ESTATE PRINCIPLES* 54 (1940) (describing problem relating to physical condition of property).

survey,¹⁹¹ and a termite inspection¹⁹² prior to the transfer of any property would prevent later discovery of many defects upon which purchasers' suits are often based.¹⁹³ These requirements seemingly place the economic burden of inspection upon the purchaser.¹⁹⁴ While the costs of obtaining a structural report, a survey, and a termite inspection may be several hundred dollars, the costs are minimal in comparison to the purchaser's total investment.¹⁹⁵ Furthermore, the purchaser would pay these costs anyway—in the form of higher brokerage commissions—if the broker had an affirmative duty to inspect and disclose, or was subject to liability for innocent misrepresentation.¹⁹⁶ Thus, legislatures must decide the basis of real estate broker liability and the scope of duty owed to a prospective purchaser to permit the broker to carry on his business within the framework of the law.¹⁹⁷

VI. Conclusion

Real estate brokers are professionals who facilitate residential real estate transactions by bringing the purchaser and seller together. Imposition of broker liability for misrepresentation and nondisclosure on a case-by-case basis is not an equitable solution to the problem of the transfer of defective real estate. A more effective and equitable remedy is a legislative determination of the rights and responsibilities

191. For a discussion of surveys, see R. KRATOVIL, *MODERN REAL ESTATE DOCUMENTATION* 39-50 (1975).

192. See ARNOLD & KUSNET, *supra* note 4, at 832.

193. See *supra* note 2.

194. The costs, however, would likely be passed on anyway, if these duties are imposed on the broker. See *infra* note 196 and accompanying text.

195. See A. ARNOLD, C. WURTZBACH & M. MILES, *MODERN REAL ESTATE* 17-19 (1980).

196. See *Imposing Tort Liability*, *supra* note 59, at 1872; *supra* note 60 and accompanying text. If a broker has a duty to disclose defects or is subject to liability for innocent misrepresentation, the only way that he can protect himself is to hire the services of a professional to perform the inspection and disclosure obligations for him. See *id.*

197. Until legislatures address the issue of broker liability in residential real estate transactions, a broker should take several steps in order to protect himself. First, a broker should inform the purchaser that he represents the seller and explain that his role is that of an intermediary. Second, if a broker cannot truthfully answer an inquiry regarding the property he is attempting to sell, he should admit his lack of knowledge. Third, a broker should recommend that the purchaser engage the services of an experienced real estate attorney. Finally, a broker should suggest that the purchaser obtain structural reports, surveys and termite inspections prior to purchasing the property in question.

of the parties—where a broker owes a duty of good faith, but not a duty of inspection, to a purchaser.

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