

Chapter 3



Fiduciary Duty, Full Disclosure & Illegal Practices

Chapter 3 Goals:

- Learn how to determine whether an agent is performing an illegal act such as redlining, steering or using undue influence
- Duties of the agent
- Understand fiduciary duties of licensees
- Learn about the varying duties agents have dependent on the type of client they represent
- Learn the various disclosures that must be supplied to the principal
- Be aware of the disclosure statements that an agent must supply their principal with

Chapter 3: Fiduciary Duty, Full Disclosure, & Illegal Practices

This chapter explores a real estate agent's fiduciary duty, the disclosure expectations for agents, buyers, and sellers, and illegal real estate practices.

Key Terms

“as is” accounting appraisal report appraiser blind ad blockbusting caveat emptor co-mingling comparables confidentiality due care full and accurate disclosure	fiduciary duty finder's fee fraud honesty integrity intentional misrepresentation loyalty Megan's Law misrepresentation Natural Hazards Disclosure Report	obedience patent defect redlining rent skimming secret profit steering tort Transfer Disclosure Statement undue influence
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Fiduciary Duty

An Introduction

Fiduciary duty refers to the set of standards that an agent is expected to uphold in the service of his or her principal. As the agent owes the fiduciary duty, he or she is referred to as the fiduciary. The fiduciary/agent is expected to uphold the interests of the principal regardless of the type of agency relationship or how it was established.

An intentional breach of fiduciary duty on the part of the fiduciary/agent may result in the loss of their commission, or even their real estate license. An exception to breaking fiduciary duty arises if the interests of the principal violate the agency agreement or the law.

The fiduciary duties of a real estate agent include:

- Full and Accurate Disclosure
- Due Care
- Confidentiality
- Loyalty
- Integrity

- Honesty
- Accounting
- Obedience

Full and Accurate Disclosure

As the representative of the principal, the agent must act as the liaison between the principal and other buyers, sellers, and/or representative of the opposing party.

An agent must disclose all pertinent and significant information (or “material facts”) to a principal as it is presented in the transaction. Material facts are defined as facts whose concealment would reasonably result in a different decision by the principal. The purpose of full and accurate disclosure is to ensure that the principal makes the most informed decision.

An agent’s full and accurate disclosure responsibilities vary depending on whether a principal is a buyer or seller:

Agent's Full and Accurate Disclosure Responsibilities	
Representing Seller	Representing Buyer
Disclose what potential buyers are saying about the listing/property.	Disclose when the seller is willing to sell the property for less.
Disclose all material facts that may dramatically alter the value of the seller’s property, or the seller’s chances of selling the property.	Disclose all agency relationships, including when the agent is acting as a dual agent.
Inform seller of all offers, including oral, incomplete, or backup offers. This also includes offers an agent thinks the principal will not accept, and any offers made when a transaction is in escrow.	Disclose information regarding a seller’s urgency to sell a property.
Provide information about potential buyers, including names.	Disclose all material facts that may influence the buyer’s chances of purchasing a property.
Disclose all agency relationships, including when the agent is acting as a dual agent.	Disclose all material facts about a property, including: conditions; structural safety; and zoning details.
Provide updated information about the	Provide information to the buyer that

status of negotiations.	could assist in purchasing a property for a lower price.
Inform the seller of a potential buyer's intent.	

The only instance when an agent is not required to disclose information is if it has already been specified by the principal. For example, if a seller informs the agent not to entertain offers below \$720,000, the agent does not have to inform the principal when such offers are made.

Full and accurate disclosure also pertains to all costs, fees, commissions, and other financial components of a transaction. These will be further explored later in this chapter.

Due Care

An agent is the representative of a significant financial transaction in a principal's life. As such, the agent is expected to perform agency-related activities for the principal with due care (otherwise known as reasonable care). This means that an agent must conduct himself or herself with competence, responsibility, and sufficient knowledge.

As most clients are not as experienced in real estate procedures as agents, they hire agents to provide expertise and accurate advice. An agent's license signifies that he or she possesses a level of real estate knowledge that exceeds that of the average principal. Consequently, a principal should be able to expect that an agent has the necessary skills to meet reasonable real estate goals when an agent's services are employed.

Buying or selling a home can be an overwhelming experience. Oftentimes, principals do not know what is to their benefit. Legal precedents have established that agents owe an increased duty to unsophisticated buyers over other buyers. These buyers, particularly first time buyers, may not be aware of the consequences of their decisions. It is an agent's duty to help unsophisticated buyers avoid compromised positions, such as buying a property they cannot afford, signing a balloon payment provision, or signing an agreement with an acceleration clause.

A principal has the right to utilize any strategy he or she wishes within the parameters of the law, but an agent must inform a principal when a decision is not productive to his or her stated goals. For example, if a seller wishes to sell his or her home for a minimum of \$620,000, but the market suggests that the property could be sold for \$790,000, the agent should inform the principal that they should increase the listing price.

However, the role of an agent extends far beyond simply providing basic information. An agent must inform a buyer of all implications of the real estate transaction. This includes property taxes, mortgage rates, and real estate provisions. It also includes being aware of pertinent information that would adversely affect the outcome of the principal's transaction. The law recognizes the fact that although agents are not mortgage professionals, accountants, or zoning experts, agents should be aware of basic information pertaining to the ramifications of the transaction for their principals.

Each real estate transaction carries different risks. An agent has a duty to inform his or her principals of the risks and worst case scenarios associated with each type of transaction. The market is ever-changing and agents must constantly verify the accuracy of their information in order to best inform a principal's decision.

One transaction that may present risk to a principal is called **rent skimming**. This is when a buyer promises to purchase a seller's property using the current rental income of the property. An agent should inform the seller of the drawbacks of this kind of deal, which may include the forfeiture of future rental income to a buyer who simply doesn't have the credit or income to currently purchase the property.

Agents should also warn principals of the risk of directly exchanging one property for another. The task of accurately comparing multiple properties can be difficult and could result in a loss of value for the principal.

Case review: *Pepitone v. Russo* (1997)

The case, *Pepitone v. Russo* (1997) 64 Cal.App.3d 685., involved a buyer who filed suit against their broker for fraud and a breach in fiduciary duty.

Pepitone bought a property on the advice from his agent, Russo. However, Russo never disclosed the presence of an acceleration clause in the second mortgage necessary to purchase the property. The acceleration clause, which required the loan to be paid in full upon the loan's maturation, ultimately caused Pepitone to lose the property in foreclosure. Pepitone sued Russo for failing to disclose that the purchase of the property assumed a second mortgage that contained an acceleration clause.

The Superior Court held that Russo had violated his agency duties and awarded Pepitone \$85,735 in damages. Russo appealed. The Court of Appeals upheld the lower court's ruling, but reduced the damages to \$25,000.

Agents must be prepared to halt a transaction if the manner in which the transaction is occurring is not ideal to the principal.

Real estate crosses a variety of fields, such as engineering, construction, the law, and banking. It is not reasonable to expect an agent to be familiar with all aspects of related fields. In fact, an agent should refrain from offering advice in other fields in which they are not an expert. If an agent provides inaccurate information -- such as untrue legal or tax code information -- the agent could be held liable for any damages that ensue.

If an agent is unable to provide specific knowledge on a subject, he or she should advise the principal to consult a professional third party. Although having a third party review the house may result in the loss of a sale, and consequently, cost the agent his or her commission, the agent's role is to help buyers make an informed decision.

Case Review: *Carleton v. Tortosa* (1993)

In the case, *Carleton v. Tortosa* (1993) 14 Cal.4th 745., a real estate investor brought legal suit against his agent for negligence.

The investor (Carlton) was preparing to list a property with his agent (Tortosa). During the process, Carlton asked Tortosa about the tax consequences of the sale. Tortosa was not an accountant and so he suggested that Carlton talk to a professional. When Carlton could not reach his accountant, he talked to his accountant's assistant, who informed him of her belief that he had 45 days to reinvest the sale proceeds before the tax bill. After selling the property, Carlton received a tax bill of over \$30,000.

In response to the \$30,000 tax bill, Carlton sued the agent alleging negligence by failing to advise him of the tax consequences of the sale. The Superior Court ruled in favor of Tortosa on the grounds that an agent has no fiduciary duty to provide tax advice. Carlton appealed and the appellate court upheld the lower court's ruling. It held that an agent is not required to provide tax information, nor is he or she responsible for warning a client of a transaction's potential tax consequences. The agent could only be held liable if he or she had provided inaccurate information.

Case Review: *Furla v. Jon Douglas Co.* (1998)

The case, *Furla v. Jon Douglas Co.* (1998) 65 Cal.4th 1069., involved a buyer bringing legal suit against an agent for intentional misrepresentation,

concealment, and negligence.

The buyer (Furla) purchased a house that he believed to be 5,500-square feet. The square footage information was verbally stated to him by his agent, Marni Shore, an associate of Jon Douglas Co. This information was reaffirmed through multiple listing advertisements that included the phrase: “APX: 5500 sq ft” (“approximately 5,500 square feet”). Furla believed he was getting a great deal, even stating: “I’ll pay \$170 a square”. It was only when Furla went to sell the house himself that he discovered Shore had overstated the square footage of the house by 20 percent: the property was actually less than 4,400 square feet. Furla brought Shore and Jon Douglass Co. to court.

In Superior Court, Shore argued that the original seller’s daughter, Larisa Rappaport, told him that the architectural plans for the property indicated it was 5,500 square feet. He relied on such information when the property was listed.

The court ruled in favor of Jon Douglass Co. on the grounds that Shore did not know that the house was substantially less than the 5,500 square feet and that he had not breached his fiduciary duty in failing to discover this fact. Furla appealed.

The Court of Appeals reversed the lower court’s ruling, stating that there are triable issues of fact as to the cause of action. It further contended that the difference in square footage was not within reason of approximate square footage, but rather, was a “grossly inaccurate” difference.

Confidentiality

An agent has a duty to protect the vital information of his or her principal. All conversations, documentation, or occurrences related to a real estate transaction must be kept strictly confidential. This includes a principal’s request for a property not to be listed in a newspaper, on a multiple listing service, or online.



More importantly, however, this means not disclosing a principal’s position. An agent cannot reveal any information that could reduce a principal’s negotiating power, unless the principal relays his or her desire to do so. For example, agents cannot disclose the minimum price a seller is willing to sell for, or the fact that a buyer is willing to pay more for a property than what his or her initial bid suggests.

An agent is bound by confidentiality even after the execution of a transaction. To violate this would be a breach of an agent’s fiduciary duty and grounds for agent

liability.

Loyalty

A strong agency relationship begins with loyalty. The agent must be loyal to the interests of the principal throughout the duration of the agreement, and even after an agreement has been terminated. This means that the agent cannot disclose information to third parties that would affect the principal's ability to get the best outcome. Additionally, if an agent is acting as a dual agent, he or she must remain true to both party's confidentiality and interests.

A common example of a breach in agent loyalty is when an agent, or an agent's firm, purchases a property from a principal knowing that the listing price was below market value. This allows an agent to purchase a property at a falsely reduced price, and subsequently sell it at a higher, more accurate price for a profit. It is against the law for an agent to purposely reduce the listing price of a principal's property with the intent to purchase it themselves.

Integrity

Integrity is the cornerstone of an agent's fiduciary duty to their principal. Generally, this involves being truthful and placing the interests of the principal above their own financial interests.

Honesty

Like integrity, honesty plays an integral role in real estate transactions. An agent's fiduciary duty requires them to be fully honest throughout the course of a transaction.

For example, if an agent suggests additional services that would assist in a transaction -- such as contracting services or a referral for loan financing -- the agent must disclose if they are being paid for that referral to the principal.

An agent must be honest not only with a principal, but also with involved third parties, including agents, principals, and buyers. (The exception to this, of course, is when honesty would reveal confidential information that would impact the negotiating power of an agent's principal.)

Accounting

Accounting refers to all financial information involved in a real estate agency agreement, including commissions, fees, and advertising costs. Real estate agents have



the duty to manage and disclose financial-related information to the principal. An agent protects a principal's money, vital documentation, and other important documents that are relevant to the transaction.

All related information must be disclosed fully, and in a timely manner.

Obedience

As the legal owner of a property, or the prospective buyer of a property, a principal has the right to make any lawful decision they choose in a real estate transaction. An agent is required to follow the instructions of a principal, even if it goes against the agent's best advice. However, the agent does not have to follow a principal's instructions if those instructions violate the law or wrongfully violate the rights of others, including buyers, sellers, third parties, or other agents.

Summary: An Agent's Fiduciary Duties

	Seller's Agent	Buyer's Agent
Loyalty	The seller	The buyer
Confidentiality	Protects the seller's financial position and does not disclose confidential information that may allow the buyer and his/her agent to gain an advantage in negotiations.	Protects the buyer's financial position and does not disclose confidential information that may allow the seller and his/her agent to gain an advantage in negotiations.
Integrity and Honesty	Operates honestly on behalf of the seller and involved third parties, including other agents and potential buyers.	Operates honestly on behalf of the buyer and involved third parties, including other agents and sellers.
Full and Accurate Disclosure	Informs the seller of all material facts regarding the agency relationship, including: input and offers from potential buyers, and all profits and fees included in a transaction. Discloses the realistic condition of a seller's property to third parties.	Informs the buyer of all material facts regarding the agency relationship, including: reasonable conditions of potential properties, and all profits and fees included in a transaction.

Due Care	Prepares with the necessary knowledge and education to allow the seller to make the most informed decision.	Prepares with the necessary knowledge and education to allow the buyer to make the most informed decision.
Accounting	Keeps track of all expenses used to procure a sale, including all advertising and marketing.	Accounts for any money entrusted to them by the buyer.
Obedience	Obeys all lawful instructions of the seller.	Obeys all lawful instructions of the buyer.

Case Review: *Warren v. Merrill (2006)*

The case, *Warren v. Merrill (2006)* 143 Cal.4th 96., involved a buyer who sued his real estate agent for fraud, breach of fiduciary duty, and action to quiet title.

The buyer (Warren) did not have the necessary credit or down payment to qualify for the financing required to purchase a Los Angeles condominium property. The defendant, Merrill, was the real estate agent who assisted Warren in the transaction.

In order to prevent the loss of a sale, Warren's real estate agent (Merrill) agreed to lend Warren the remaining down payment amount out of her commission. Merrill also offered to help Warren qualify for financing by applying for a loan through Merrill's daughter, Charmaine. Warren agreed.

While applying for the loan, Warren's name was not placed on the property title. Merrill promised Warren that upon the close of the transaction, she would have her daughter transfer the title to Warren. However, Charmaine never signed the promised deed that would transfer the property to Warren.

During this time, Warren was facing significant personal problems, including a divorce, health problems, and losing money in his business. As a result, Warren began using drugs. Warren was also experiencing neurological disorders, such as Tourette's syndrome, which significantly affected his cognitive abilities. Warren checked himself into a drug rehabilitation facility. While in rehab, Warren stopped making mortgage payments (which he had done previously for 3 months). He had also fallen behind nearly \$5,000 in H.O.A. fees, which nearly

caused the property to go to foreclosure.

Merrill had begun making payments on Warren's behalf to avoid this. After she had brought all property-related payments current, Merrill filed an unlawful detainer action to evict Warren on the basis that Charmaine was the property owner, not Warren. Merrill secured a judgment against Warren, got a writ of possession, and evicted Warren. When Warren left rehab and discovered the situation, he filed a lawsuit against Merrill.

The Superior Court found that Merrill's testimony was "unreliable and lacked credibility." It quieted the title and found Merrill guilty of fiduciary duty and fraud. Warren was awarded \$15,000 in noneconomic damages and \$50,000 in punitive damages. Merrill appealed.

The Court of Appeals affirmed the lower court's ruling, holding that "substantial evidence supported the fact that the agent breached her fiduciary duty by fraudulently procuring title to property." The court believed that Merrill had no intention of transferring the property title to Warren. The court deemed Merrill guilty of quieting title and imposing constructive trust for a breach of fiduciary duty. The court then answered the punitive damage claims by stating that "proof of actual damages to purchaser was sufficient to support punitive damages."

Agent's Duty to Third Parties

Although the primary duty of an agent is to protect the interests of a principal, an agent must also act responsibly towards third parties. It is illegal for an agent to intentionally deceive third parties, or to fail to disclose vital information to those parties, in order to further the goals of a principal.

Agent's Full & Accurate Disclosure

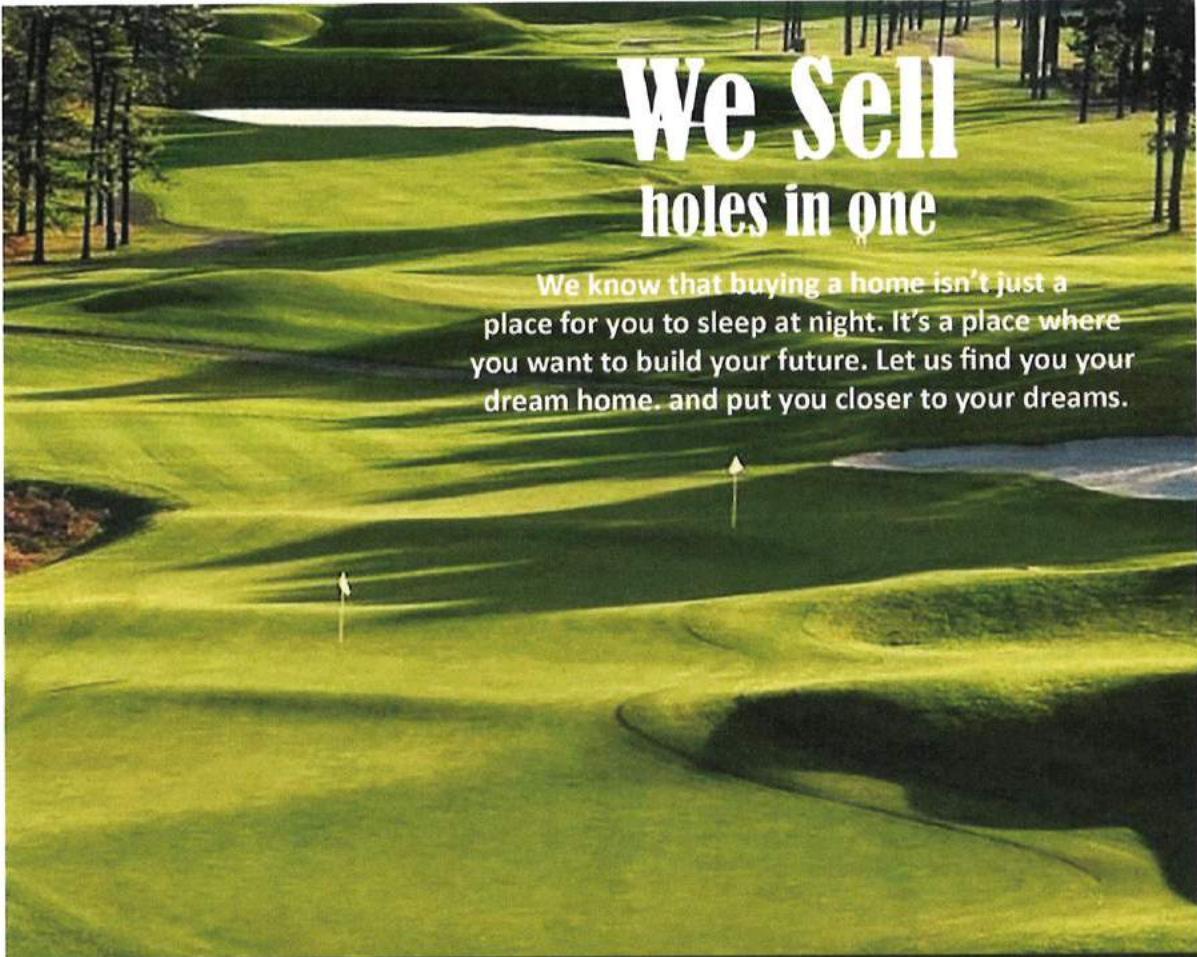
An agent must disclose all significant transaction information to a principal as it is presented. This includes material facts about a property, accurate comparable reports, and all profits and fees an agent may acquire off of a transaction. There is a two year statute of limitation for disclosures. This means cases must be brought to court within two years of the transaction's recording if they wish to have it heard.

The beginning of this chapter explores an agent's specific full and accurate disclosure duties.

Advertising

Misleading advertising by the licensee is against the law and may result in disciplinary action including suspension, revocation, and damages. No real estate licensee shall knowingly mislead prospective borrowers with inaccurate rates, terms, and conditions. In the event there is an introductory rate in the ad that may be considered misleading, the licensee must also include the actual interest rate and the purchase discount rate.

The premise of all real estate law relating to advertising is to require advertisers to disclose vital information. A **blind ad** is a type of advertisement that does not indicate the identity or credentials of the party doing the advertising. For example, a classified newspaper ad that does not include the name, license status, or license number of the agent is considered a blind ad. An agent must disclose this information in an advertisement, otherwise it is considered illegal.



**We Sell
holes in one**

We know that buying a home isn't just a place for you to sleep at night. It's a place where you want to build your future. Let us find you your dream home. and put you closer to your dreams.

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MLS MULTIPLE LISTING SERVICE   License # 1234567

Section 10235 of the Business and Professions Code states that “indicating or otherwise implying any specific yield or return on any note other than the interest rate specified in said advertisement is considered prima facie evidence that such advertisement is misleading or deceptive unless the advertisement sets forth the actual interest rate specified in the note and the discount from the outstanding principal balance which it is being offered for sale. It is against the law for a real estate licensee to advertise using a gift as an inducement to entice consumers to use their service.

Required Advertising Disclosures

Required Disclosures	Advertising Purposes		First Point of Contact Only (Business cards, email, etc.)
	Soliciting for Borrowers	Soliciting for Investors/Lenders and/or Note Purchasers	
Phrasing	CA Bur of Real Estate – Real Estate Broker; or Real Estate Broker – CA Bur of Real Estate - AND - Broker, agent, Realtor, loan correspondent or abbreviations bro., agt., or other similar terms or abbreviations	Broker, agent, Realtor, loan correspondent or abbreviations bro., agt., or other similar terms or abbreviations	Broker, agent, Realtor, loan correspondent or abbreviations bro., agt., or other similar terms or abbreviations
CalBRE License Number	8-digit license number of each licensee in the advertisement - AND - 8-digit license number of the broker	8-digit license number of each licensee in the advertisement - AND - 8-digit license number of the broker	8-digit license number of each licensee in the advertisement
NMLS Unique Identifier*	Unique identifier of each licensee in the advertisement* - AND - Unique identifier of the broker*	N/A	Unique identifier of each licensee disseminating the materials* (Unique identifier of the employing broker or corporation <i>not</i> required)
Font Size Requirement	No less than the smallest font used in the advertisement	No less than the smallest font used in the advertisement	No less than the smallest font used in the advertisement

Appraisal Reports

An appraisal report estimates the current and fair market value of a property. These reports can differ based on who is doing the appraising, and how familiar he or she is with the area. Consequently, one cannot assume that the stated value is definitive.

Agents have a duty to establish the most competitive listing price for their clients. This means that agents are responsible for verifying appraisal reports during the sales and purchase process. The listing price of a property must be substantiated with factual evidence, including market trends, average price per square foot, and recently sold comparable properties.

Appraisers

An appraiser is a professional with an expertise in estimating and/or evaluating the value and/or condition of an asset or property.

California law requires that any person or party who conducts a real estate appraisal be licensed by the state. Additionally, “no person or entity shall act in the capacity of an appraisal management company without first obtaining a certificate of registration from the office” (Business and Professions Code 11320.5).

A prospective appraiser must take and pass an examination in order to become licensed. A license is valid for two years.

It is unlawful for an appraiser to engage in activity that intentionally alters the value of an appraisal for a fee.

The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) was passed in 1989 to reinforce the appraisal process.

An unlicensed individual who intentionally misleads homeowners, buyers, or lenders about the status of his or her license status may be punished by a fee and/or imprisonment. The maximum prison sentence is one year, while the maximum fine is \$10,000.

Comparables

Comparables are properties with similar characteristics to the property whose value is being determined. They are used to verify an appraisal report and/or the true value of a property. Conducting comparable research ensures that the agent is equipped to provide their client with the most up-to-date and accurate information possible.

Providing false comparables to induce a buyer into buying a property is a form of misrepresentation, and therefore, unlawful. This includes comparing sales that are not in the same location, same size, features, age, condition, and/or zoning. Agents must only use properties that are actually similar to the property at hand in order to verify the value of the subject property for the buyers. Additionally, agents who use dated comparables -- such as those that extend beyond one year -- may be held liable for fraud in court, unless there are no other comparable sales. Using properties that are not near the subject property is also unlawful unless no other comparables exist.

For example, assume a buyer wants to purchase a property. The maximum amount she wants to spend is \$450,000. Her agent presents a home that is listed at \$430,000, and shows "comparables" that indicate property values in the area are over \$520,000. The buyer is led to believe that the \$430,000 home is a good deal. But if the "comparables" used by the agent are farther than a mile away, they are false comparables.

Case Review: *Schoenberg vs. Romike Properties (1967)*

In the case, *Schoenberg v. Romike Properties* (1967) 251 Cal.App.2d 154., a seller brought action against the purchasers, the broker, and the three agents involved for fraud and negligence in a transaction.

The seller (Schoenberg) was friends with the potential buyer of his home for

over 20 years. On the advice of his agent/broker (Romike Properties), Schoenberg planned to directly transfer his property to the buyer. The buyer, who was using his own property as collateral in the transfer, supplied an appraisal report that valued his property at \$895,000.

Romike Properties did not perform any inspections or gather comparables to verify the value put forth in the appraisal report. However, Schoenberg relied on the buyer, Romike Properties, and the appraisal report and decided to transfer the property. It was only later that Schoenberg discovered the value of the buyer's property value had been grossly misstated: rather than \$895,000, the actual value was only \$117,500. In short, he had transferred his valuable property for a worthless property. Schoenberg sued.

The Superior Court argued that Schoenberg had a right to reasonably rely on the appraisal report provided by the buyer. Therefore, the buyer and Romike Properties were liable. The Court of Appeals affirmed the lower court's ruling.

Fees

Full and accurate disclosure includes all costs, fees, commissions, and other financial components of a transaction.

A standard listing (or agreement between an agent and a client) rewards an agent with a straightforward percentage commission based on a property's final sale price. Typically, this percentage is agreed-upon prior to an agent and principal entering into an agency agreement. Other types of listings, however, can create non-standard commission structures. These will be discussed further in Chapter 7.

Agents can be referred to clients by businesses or other real estate professionals. A **finder's fee**, or referral fee, is a commission paid to such a third party in return for a referral. (The third party is not entitled to commission on any subsequent activity that requires a real estate license, such as the sale of a property.) The finder's fee practice is completely legal, although an agent must disclose the presence of any referral fees to his or her principal.

For example, a licensed agent can pay an unlicensed agent a referral fee for introducing them to a client. However, Business and Professions Code Section 10137 stipulates that a licensed agent may not compensate an unlicensed agent for any actions that require a valid agent license.

As a general rule, side deals, bonuses, kickbacks, and other "sweetheart deals" are strictly prohibited unless they are already included in the agency agreement. Many real estate firms choose to bar any additional profits, even if they are handled legally.

Also stated in Business and Professions Code Section 10236.1: "A real estate licensee may not offer premium gifts or anything of value to a purchaser or lender as an inducement to buy a promissory note or sales contract."

Case Review: *Tenzer v. Superscope, Inc. (1985)*

The case, *Tenzer v. Superscope, Inc. (1985)* 39 Cal.App.3d 18., involved an affluent businessman who sued a corporation for its failure to pay a finder's fee.

The businessman, Tenzer, was hired on as a director at the corporation, Superscope, Inc. Shortly after, Tenzer was informed of the company's tenuous financial situation. In order for the company to avoid bankruptcy, it needed to sell off one of its most expensive assets, a building valued at \$16 million. However, the property had been on the market for nearly a year with no prospective buyers.

Tenzer agreed to deliver a prospective buyer that he had found in return for a 10 percent finder's fee. Superscope agreed. However, after the sale of the property, Superscope refused to pay the finder's fee. Consequently, Tenzer sued Superscope.

The official charges included breach of contract, unjust enrichment, and fraud. The Superior Court granted summary judgment in favor of Superscope. Tenzer appealed until the case reached the Supreme Court. The Supreme Court argued that the case centered on whether Tenzer merely introduced the buyer to Superscope, or whether he actively participated in contract negotiations. It ruled in favor of Tenzer, indicating that Superscope had intentionally defrauded Tenzer without ever intending to pay the finder's fee.

Secret Profit

A **secret profit** is an additional profit made by an agent that is not disclosed to one or both of the principals. For example, say a buyer tells her agent that she is willing to pay the agent \$7,000 dollars if the agent can convince the seller to offer seller financing. Even if the agent believes this secret profit does not affect the seller, the agent must disclose it to the seller. Should an agent fail to do so, the principal is entitled to that profit.

Seller / Listing Agent Disclosure

There are various disclosures that must be made by a seller and his or her agent in the

listing of a property.

Transfer Disclosure Statement

A **Transfer Disclosure Statement (TDS)** is a legal statement that describes a property's current condition and discloses known material facts. The disclosure statement must include defects, physical damages, and/or building code violations. For example, if a seller previously built a patio without a permit, he or she must disclose this.

In terms of materials facts, a **latent defect** is a defect that is not clear to the average party. A **patent defect** is a defect that is obvious to the average party. Sellers and agents should be aware of all patent defects of a property.

The term “**as is**” refers to a seller’s wishes to sell a property in its current condition without making any necessary repairs. More simply, it’s a “take it or leave it” clause. Sellers typically employ this clause when they wish to sell a property quickly and avoid extensive negotiations over potential defects of the property.

However, “as is” clauses do not preclude sellers from disclosing and/or verifying vital information related to the sale. Such clauses are typically accompanied by inspection periods that may result in a discount on the purchase price or termination of the purchase contract.

The Transfer Disclosure Statement also includes any neighborhood conditions that are considered a nuisance. It is, however, a violation of the Civil Code for the seller to mention the ethnicity, background, religion, or culture of the people who live in the community.

When a seller signs a Transfer Disclosure Statement, he or she indicates that the information within it is accurate to the best of his or her knowledge. A seller must provide prospective buyers with a TDS as soon as possible, and before the execution of a sale. Furthermore, the buyer’s agent is required to acknowledge and execute the TDS in order to indicate that all parties are aware of the conditions of the property prior to purchase.

Information provided in the TDS is not guaranteed. As sellers are not expected to be aware of every component of the house (i.e. mold, soil, structural engineering), the disclosure is more informative than all-inclusive. Buyers are advised to conduct their own inspections or to hire a professional third party to do so on their behalf.

Case Review: *Wigmann & Rose International Corp. v. NL Industries, Inc.* (1990)

The case, *Wigmann & Rose International Corp. v. NL Industries, Inc.* (1990) 735 F.Supp 957., involved a new property owner who discovered hazardous waste on the property.

A property owner (NL Industries, Inc.) sold a property “as is” to a buyer (Wigmann & Rose International Corp.). However, NL Industries failed to disclose the presence of hazardous waste on the property. Upon this discovery, Wigmann & Rose International Corp. sued for recovery costs and the future costs of cleanup.

In Superior Court, Wigmann & Rose International Corp. claimed that NL Industries had violated its duty to inform them of all material facts. NL Industries cited that the purchase agreement had an “as is” clause. The court argued that “as is” clauses protected previous sellers from breaches of warranty, not from negligent liability. It concluded that NL Industries’ awareness of the contamination and subsequent failure to disclose it made them liable. The court ruled for NL Industries to pay for all cleanup costs.

Case Review: *Realmuto v. Gagnard* (2003)

In the case, *Realmuto v. Gagnard* (2003) 110 Cal.4th 193., a seller sued real estate investors for specific performance and breach of contract.

Real estate investors (represented by Gagnard) entered into a purchase contract with the seller of a residential property in Alpine, California (Realmuto). The investors’ goal was to assign the contract to the Cuyapaipe Band of Mission Indians in order to develop a casino. However, the Mission Indians ultimately chose not to purchase the property. When Gagnard told Realmuto that they would not be buying his property, Realmuto sued.

In Superior Court, Realmuto contended that Gagnard violated the purchase contract and thus, owed specific performance. In this case, he was arguing that Gagnard had to purchase the property. However, Gagnard contended that Realmuto had also violated the contract, as he had never provided Gagnard with the required TDS inspection. He also pointed out that paragraph 6 of the purchase agreement had not been signed or initialed by Realmuto. Realmuto responded by saying that Gagnard never requested the disclosure statement in question. The Superior Court ruled a summary judgment in favor of Gagnard

and the investors.

Realmuto appealed. The Court of Appeals affirmed the lower court's ruling, maintaining that Realmuto was not entitled to specific performance.

Mobile Home Disclosure

Mobile home owners and their agents must execute a disclosure statement in order to sell a mobile home. The statement serves the same purpose as other standard disclosure statements, which includes informing the buyer of the condition of the property.

Natural Hazards Disclosure Reports

Natural hazards disclosure reports inform a buyer of a property's condition in relation to natural hazards. Such reports disclose the presence of anchor bolts and the structural patterns of a property's walls, as well as a property's relation to natural hazard zones (i.e. flood zones, fire zones, earthquake fault zones, and seismic hazards zone). Reasonable buyers cannot ascertain with certainty whether a property falls within a specific hazard zone or not. As a result, a buyer relies on the seller and his or her agent to inform them of these facts.

Other examples found within natural hazard disclosure reports include:

- The seller and/or agent of one to four unit properties built before 1960 are required to provide buyers a Homeowner Guide to Earthquake Safety.
- A seller or seller's agent must inform prospective buyers when a property is in special flood hazard areas, such as Zone A or Zone V.
- Buyers are also entitled to know whether a property is in a high fire hazard zone. Sellers with properties that border, or on state-owned lands, or those that are in designated wild land areas, must inform buyers of these zoning labels.

Death on Premises

If a death previously occurred on a listed property, the agent and seller are only required to disclose it to the buyer if the death occurred within a period of three years.

Conversely, Civil Code Section 1710.2 (a) states: "*No cause of action arises against an owner of real property or his or her agent, or any agent of a transferee of real property, for the failure to disclose to the transferee the occurrence of an occupant's death upon the real property or the manner of death where the death has occurred more than three years prior to the date the transferee offers to purchase, lease, or rent the real property, or that an occupant of that property was afflicted with.*"

If, however, a buyer asks an agent directly about the deaths, the agent must disclose this information.

Case Review: *Reed v. King* (1983)

In the case, *Reed v. King* (1983) 145 Cal.App.3d 261., an elderly woman brought legal suit against her real estate agent for failing to disclose a homicide that had occurred in the home she purchased.

Reed bought a property from her real estate agent (King). After the purchase, she learned from a neighbor that a family of five had been murdered in the new home she purchased. King had not disclosed this information. Reed sued King for damages and the rescission of the sale.

The Superior Court ruled that Reed had not stated a cause of action, and ruled in favor of King. Reed appealed. The Court of Appeals overturned the lower court's ruling. It contended that King had been aware of the murders at the time of the sale. (The value of the property had actually been reduced because of the murders.) Thus, King had had a fiduciary duty to disclose this information to Reed. The court ruled in favor of Reed and charged King with fraud.

AIDS Disclosure

The recently updated Civil Code states that the seller and listing agent are not required to disclose whether or not the seller has AIDS. Prior to the updated Civil Code, there was confusion within the real estate community as to whether such a disclosure was required.

Megan's Law

Megan's law is a federal law which requires local and state law enforcement agencies to publish a list of registered sex offenders. The purpose of the law is to make these records easily accessible to the public. Information includes the name, location, picture, incarceration date, and offense information of the sex offender.

Civil Code Section 2079.10 (a) requires residential purchase and rental agreements of one to four residential units to inform prospective buyers of the publicly available information about the registered sex offenders list.

The website meganslaw.ca.gov provides this information.

Full List of Real Estate Disclosures

Availability of Title Insurance	House Energy Rating System Booklet
Agency Disclosure Form and Agency Confirmation	Industrial Use Zone Location
Airport in Vicinity	Lead-Based Paint Pamphlet and Form
Area of Potential Flooding	Material Facts
Broker's Statutory Duty to Inspect Property	Megan's Law Disclosure
Carbon Monoxide Detector Disclosure & Compliance	Mello-Roos 1915 Bond Act Assessments, and voluntary contractual assessment
Commercial Property Owner's Guide to Earthquake Safety	Meth Lab Clean-Up Order
Commercial Property Owner's Guide to Earthquake Safety	Military Ordinance Location
Death	Mining Operation Mold (Disclosure of Excessive Mold or Health Threat)
Earthquake Fault Zone	Natural Hazard Disclosure Statement
Energy Use Report	Pest Control Inspection Report and Certification
Farm or Ranch Proximity	Private Transfer Fee
FHA/HUD Inspection Notice	Residential Earthquake Safety Booklet and Residential Earthquake Hazards Report
Federal Withholding and California Withholding Tax	Residential Environmental Hazards Booklet
Flood Disaster Insurance Requirements	Seismic Hazard Zones
Gas and Hazardous Liquid Transmission Pipeline Notice	Smoke Alarms Must Be In Compliance
Groundwater Basin Comprehensive Adjudication Notice	Smoke Alarm Written Statement of Compliance
Homeowner's Guide to Earthquake Safety Booklet	Special Flood Hazard Area

State Responsibility Area	
Supplemental Property Tax Notice	
Subdivision Map Act	
Transfer Disclosure Statement	
Very High Fire Hazard Severity Zone	
Water Conserving Fixtures Compliance	
Water Conserving Fixtures Disclosure	
Water Heater Brazing Statement of Compliance	
Window Security Bars and Safety Release Mechanism	

Buyer / Buyer Agent's Disclosure

A buyer and his or her agent are also responsible for various kinds of disclosures.

Caveat Emptor

The legal principle of **caveat emptor** holds a buyer alone responsible for verifying the condition and quality of a property prior to purchase. When vital information is unknown, the buyer is the ultimate authority on hiring a professional third party -- such as an engineer, contractor, or surveyor -- to offer advice and conduct necessary inspections.

That being said, agents today are expected to provide a buyer with the obvious material facts of a property. They have a duty to review the property and complete additional walkthroughs to verify what is being offered. As California's Civil Code Section 2079 states:

“(a) It is the duty of a real estate broker or salesperson, licensed under Division 4 (commencing with Section 10000) of the Business and Professions Code, to a prospective purchaser of residential real property comprising one to four dwelling units, or a manufactured home as defined in Section 18007 of the Health and Safety Code, to conduct a reasonably competent and diligent visual inspection of the property offered for sale and to disclose to that prospective purchaser all facts materially

affecting the value or desirability of the property that an investigation would reveal, if that broker has a written contract with the seller to find or obtain a buyer or is a broker who acts in cooperation with that broker to find and obtain a buyer."

The measure of whether an agent should be held liable for something is based on what a reasonably prudent licensee would be aware of in the given situation. In situations where the skill required to properly inspect a property extends beyond an agent's expertise, the agent should inform the buyer to hire a third party.

Case Review: *Jue v. Smiser (1994)*

The case, *Jue v. Smiser (1994)* 23 Cal.4th 312., involved a buyer who believed he was buying an authentic Julia Morgan built home.

Jue read a local article about a home that was supposedly built by Julia Morgan, a prestigious early 20th century architect. The official brochure for the listed property also claimed this fact to be true. Jue made an offer on the house that was accepted by the seller (Smiser). After executing the purchase agreement, Jue was asked to sign a disclosure form which recognized that while the home is believed to have been built by Julia Morgan, there are no official blueprints to verify the authenticity of those claims. Jue still bought the home, but refused to sign the disclosure form.

After the purchase was complete, Jue brought action against Smiser, his real estate firm, and its two agents. The suit alleged fraud, concealment, negligent misrepresentation, and emotional distress claims. Jue contended that he had entered into the agreement based on the brochure claim that the home was built by Julia Morgan. The trial court granted summary judgment in favor of the seller and real estate agents, citing that Jue went ahead with the purchase despite knowing there were no official records to authenticate the Julia Morgan design. Jue appealed. The appellate court reversed the lower court's ruling and awarded Jue damages amounting to \$43,118.

Case Review: *Easton v. Strassburger (1984)*

In the case, *Easton v. Strassburger (1984)* 152 Cal.App.3d 90., a buyer sued a listing agent for concealing a property's true conditions.

The buyer, Easton, purchased a property through his real estate agent, Strassburger. The property had an uneven floor in the guest house, which was

evidence of soil and structural problems. The previous owners had hired someone to install a net in order to repair and protect the property after a landslide had taken place. Strassburger did not advise Easton to order a soil report, nor did he inform him of the landslide that had previously damaged the property. Easton bought the property for \$170,000.

Shortly after, another landslide occurred. The property was decimated and its value plummeted to \$20,000 after damages. After conducting research, experts concluded that the landslide took place because portions of the property were built on fill, which was in violation of city structural codes.

Easton sued Strassburger for the intentional concealment of the property's condition. The Superior Court awarded Easton \$197,000 in damages. Strassburger appealed to the Supreme Court of California. The state denied his motion to retry the case, stating that it was Strassburger's responsibility to verify the condition of the property and disclose known facts to Easton.

Buyer's Intent

A buyer has no duty to disclose his or her intention to purchase a property to a seller, agent, or other third parties. This includes whether a buyer intends to use a property to live in, for investment purposes, or for any other reason.

Case Review: *Nussbaum v. Weeks (1989)*

In the case, *Nussbaum v. Weeks* (1989) 214 Cal.App.3d 1589., a seller brought legal action against a buyer for failing to disclose material facts about a property.

A seller (Nussbaum) sold a home to a buyer (Weeks). Weeks was also the General Manager of a Water District. After purchasing the property, Weeks implemented changes to the District's water policy. These changes affected the purchased property and actually increased the value of that land. When Nussbaum discovered this, he sued Weeks.

In court, Nussbaum claimed that Weeks had plans to change the water policy at the time of purchasing Nussbaum's property. Weeks' failure to disclose his intention to do so affected Nussbaum's ability to properly list the value of the house and obtain a fair price.

The court held Weeks liable for failing to disclose material facts to Nussbaum. Weeks appealed, and the Court of Appeals reversed the lower court's ruling. The court contended that Weeks' plans to change the water policy were not

material fact, and thus, Weeks had no duty to disclose the information.

National Association of Realtors Code of Ethics

The following are the Code of Ethics laid out by the National Association of Realtors®:

Article 1

When representing a buyer, seller, landlord, tenant, or other client as an agent, REALTORS® pledge themselves to protect and promote the interests of their client. This obligation to the client is primary, but it does not relieve REALTORS® of their obligation to treat all parties honestly. When serving a buyer, seller, landlord, tenant or other party in a non-agency capacity, REALTORS® remain obligated to treat all parties honestly. *(Amended 1/01)*

- **Standard of Practice 1-1**

- REALTORS®, when acting as principals in a real estate transaction, remain obligated by the duties imposed by the Code of Ethics. *(Amended 1/93)*

- **Standard of Practice 1-2**

- The duties imposed by the Code of Ethics encompass all real estate-related activities and transactions whether conducted in person, electronically, or through any other means.

- **Standard of Practice 1-3**

- REALTORS®, in attempting to secure a listing, shall not deliberately mislead the owner as to market value.

- **Standard of Practice 1-4**

- REALTORS®, when seeking to become a buyer/tenant representative, shall not mislead buyers or tenants as to savings or other benefits that might be realized through use of the REALTOR®'s services. *(Amended 1/93)*

- **Standard of Practice 1-5**

- REALTORS® may represent the seller/landlord and buyer/tenant in the same transaction only after full disclosure to and with informed consent of both parties. *(Adopted 1/93)*

- **Standard of Practice 1-6**

- REALTORS® shall submit offers and counter-offers objectively and as quickly as possible. *(Adopted 1/93, Amended 1/95)*

- **Standard of Practice 1-7**

- When acting as listing brokers, REALTORS® shall continue to submit to the seller/landlord all offers and counter-offers until closing or execution of a lease unless the seller/landlord has waived this obligation in writing. REALTORS® shall not be obligated to continue to market the property after an offer has been accepted by the seller/landlord. REALTORS® shall recommend that sellers/landlords obtain the advice of legal counsel prior to acceptance of a subsequent offer except where the acceptance is contingent on the termination of the pre-existing purchase contract or lease. *(Amended 1/93)*

- **Standard of Practice 1-8**

- REALTORS®, acting as agents or brokers of buyers/tenants, shall submit to buyers/tenants all offers and counter-offers until acceptance but have no obligation to continue to show properties to their clients after an offer has been accepted unless otherwise agreed in writing. REALTORS®, acting as agents or brokers of buyers/tenants, shall recommend that buyers/tenants obtain the advice of legal counsel if there is a question as to whether a pre-existing contract has been terminated. *(Adopted 1/93, Amended 1/99)*

- **Standard of Practice 1-9**

- The obligation of REALTORS® to preserve confidential information (as defined by state law) provided by their clients in the course of any agency relationship or non-agency relationship recognized by law continues after termination of agency relationships or any non-agency relationships recognized by law. REALTORS® shall not knowingly, during or following the termination of professional relationships with their clients:
 1. reveal confidential information of clients; or
 2. use confidential information of clients to the disadvantage of clients; or
 3. use confidential information of clients for the REALTOR®'s advantage or the advantage of third parties unless:
 - a. clients consent after full disclosure; or
 - b. REALTORS® are required by court order; or
 - c. it is the intention of a client to commit a crime and the information is necessary to prevent the crime; or
 - d. it is necessary to defend a REALTOR® or the REALTOR®'s employees or associates against an accusation of wrongful conduct.
- Information concerning latent material defects is not considered confidential information under this Code of Ethics. *(Adopted 1/93, Amended 1/01)*

- **Standard of Practice 1-10**

- REALTORS® shall, consistent with the terms and conditions of their real estate licensure and their property management agreement, competently manage the

property of clients with due regard for the rights, safety and health of tenants and others lawfully on the premises. *(Adopted 1/95, Amended 1/00)*

- **Standard of Practice 1-11**

- REALTORS® who are employed to maintain or manage a client's property shall exercise due diligence and make reasonable efforts to protect it against reasonably foreseeable contingencies and losses. *(Adopted 1/95)*

Article 2

REALTORS® shall avoid exaggeration, misrepresentation, or concealment of pertinent facts relating to the property or the transaction. REALTORS® shall not, however, be obligated to discover latent defects in the property, to advise on matters outside the scope of their real estate license, or to disclose facts which are confidential under the scope of agency or non-agency relationships as defined by state law. *(Amended 1/00)*

Article 3

REALTORS® shall cooperate with other brokers except when cooperation is not in the client's best interest. The obligation to cooperate does not include the obligation to share commissions, fees, or to otherwise compensate another broker. *(Amended 1/95)*

- **Standard of Practice 3-1**

- REALTORS®, acting as exclusive agents or brokers of sellers/ landlords, establish the terms and conditions of offers to cooperate. Unless expressly indicated in offers to cooperate, cooperating brokers may not assume that the offer of cooperation includes an offer of compensation. Terms of compensation, if any, shall be ascertained by cooperating brokers before beginning efforts to accept the offer of cooperation. *(Amended 1/99)*

- **Standard of Practice 3-2**

- Any change in compensation offered for cooperative services must be communicated to the other REALTOR® prior to the time that REALTOR® submits an offer to purchase/lease the property. After a REALTOR® has submitted an offer to purchase or lease property, the listing broker may not attempt to unilaterally modify the offered compensation with respect to that cooperative transaction. *(Amended 1/14)*

- **Standard of Practice 3-3**

- Standard of Practice 3-2 does not preclude the listing broker and cooperating broker from entering into an agreement to change cooperative compensation. *(Adopted 1/94)*

- **Standard of Practice 3-4**

- REALTORS®, acting as listing brokers, have an affirmative obligation to disclose

the existence of dual or variable rate commission arrangements (i.e., listings where one amount of commission is payable if the listing broker's firm is the procuring cause of sale/lease and a different amount of commission is payable if the sale/lease results through the efforts of the seller/landlord or a cooperating broker).

- **Standard of Practice 3-5**

- It is the obligation of subagents to promptly disclose all pertinent facts to the principal's agent prior to as well as after a purchase or lease agreement is executed. *(Amended 1/93)*

- **Standard of Practice 3-6**

- REALTORS® shall disclose the existence of accepted offers, including offers with unresolved contingencies, to any broker seeking cooperation. *(Adopted 5/86, Amended 1/04)*

- **Standard of Practice 3-7**

- When seeking information from another REALTOR® concerning property under a management or listing agreement, REALTORS® shall disclose their REALTOR® status and whether their interest is personal or on behalf of a client and, if on behalf of a client, their relationship with the client. *(Amended 1/11)*

- **Standard of Practice 3-8**

- REALTORS® shall not misrepresent the availability of access to show or inspect a listed property. *(Amended 1/87)*

- **Standard of Practice 3-9**

- REALTORS® shall not provide access to listed property on terms other than those established by the owner or the listing broker. *(Adopted 1/10)*

- **Standard of Practice 3-10**

- The duty to cooperate established in Article 3 relates to the obligation to share information on listed property, and to make property available to other brokers for showing to prospective purchasers/tenants when it is in the best interests of sellers/landlords. *(Adopted 1/11)*

Article 4

REALTORS® shall not acquire an interest in or buy or present offers from themselves, any member of their immediate families, their firms or any member thereof, or any entities in which they have any ownership interest, any real property without making their true position known to the owner or the owner's agent or broker. In selling property they own, or in which they have any interest, REALTORS® shall reveal their ownership or interest in writing to the purchaser or the purchaser's representative. *(Amended 1/00)*

- **Standard of Practice 4-1**

- For the protection of all parties, the disclosures required by Article 4 shall be in writing and provided by REALTORS® prior to the signing of any contract. *(Adopted 2/86)*

Article 5

REALTORS® shall not undertake to provide professional services concerning a property or its value where they have a present or contemplated interest unless such interest is specifically disclosed to all affected parties.

Article 6

REALTORS® shall not accept any commission, rebate, or profit on expenditures made for their client, without the client's knowledge and consent.

When recommending real estate products or services (e.g., homeowner's insurance, warranty programs, mortgage financing, title insurance, etc.), REALTORS® shall disclose to the client or customer to whom the recommendation is made any financial benefits or fees.

- **Standard of Practice 6-1**

- REALTORS® shall not recommend or suggest to a client or a customer the use of services of another organization or business entity in which they have a direct interest without disclosing such interest at the time of the recommendation or suggestion. *(Amended 5/88)*

Article 7

In a transaction, REALTORS® shall not accept compensation from more than one party, even if permitted by law, without disclosure to all parties and the informed consent of the REALTOR®'s client or clients. *(Amended 1/93)*

Article 8

REALTORS® shall keep in a special account in an appropriate financial institution, separated from their own funds, monies coming into their possession in trust for other persons, such as escrows, trust funds, clients' monies, and other like items.

Article 9

REALTORS®, for the protection of all parties, shall assure whenever possible that all agreements related to real estate transactions including, but not limited to, listing and representation agreements, purchase contracts, and leases are in writing in clear and understandable language expressing the specific terms, conditions, obligations and commitments of the parties. A copy of each agreement shall be furnished to each party to such agreements upon their signing or initialing. *(Amended 1/04)*

- **Standard of Practice 9-1**

- For the protection of all parties, REALTORS® shall use reasonable care to ensure that documents pertaining to the purchase, sale, or lease of real estate are kept current through the use of written extensions or amendments. *(Amended 1/93)*

- **Standard of Practice 9-2**

- When assisting or enabling a client or customer in establishing a contractual relationship (e.g., listing and representation agreements, purchase agreements, leases, etc.) electronically, REALTORS® shall make reasonable efforts to explain the nature and disclose the specific terms of the contractual relationship being established prior to it being agreed to by a contracting party. *(Adopted 1/07)*

Article 10

REALTORS® shall not deny equal professional services to any person for reasons of race, color, religion, sex, handicap, familial status, national origin, sexual orientation, or gender identity. REALTORS® shall not be parties to any plan or agreement to discriminate against a person or persons on the basis of race, color, religion, sex, handicap, familial status, national origin, sexual orientation, or gender identity. *(Amended 1/14)*

- **Standard of Practice 10-1**

- When involved in the sale or lease of a residence, REALTORS® shall not volunteer information regarding the racial, religious or ethnic composition of any neighborhood nor shall they engage in any activity which may result in panic selling, however, REALTORS® may provide other demographic information. *(Adopted 1/94, Amended 1/06)*

- **Standard of Practice 10-2**

- When not involved in the sale or lease of a residence, REALTORS® may provide demographic information related to a property, transaction or professional assignment to a party if such demographic information is (a) deemed by the REALTOR® to be needed to assist with or complete, in a manner consistent with Article 10, a real estate transaction or professional assignment, and (b) is obtained or derived from a recognized, reliable, independent, and impartial source.

- **Standard of Practice 10-3**

- REALTORS® shall not print, display or circulate any statement or advertisement with respect to selling or renting of a property that indicates any preference, limitations or discrimination based on race, color, religion, sex, handicap, familial status, national origin, sexual orientation, or gender identity. *(Adopted 1/94, Renumbered 1/05 and 1/06, Amended 1/14)*

- **Standard of Practice 10-4**

- As used in Article 10 “real estate employment practices” relates to employees and

independent contractors providing real estate-related services and the administrative and clerical staff directly supporting those individuals. *(Adopted 1/00, Renumbered 1/05 and 1/06)*

Article 11

The services which REALTORS® provide to their clients and customers shall conform to the standards of practice and competence which are reasonably expected in the specific real estate disciplines in which they engage; specifically, residential real estate brokerage, real property management, commercial and industrial real estate brokerage, land brokerage, real estate appraisal, real estate counseling, real estate syndication, real estate auction, and international real estate.

REALTORS® shall not undertake to provide specialized professional services concerning a type of property or service that is outside their field of competence unless they engage the assistance of one who is competent on such types of property or service, or unless the facts are fully disclosed to the client.

- **Standard of Practice 11-2**

- The obligations of the Code of Ethics in respect of real estate disciplines other than appraisal shall be interpreted and applied in accordance with the standards of competence and practice which clients and the public reasonably require to protect their rights and interests considering the complexity of the transaction, the availability of expert assistance, and, where the REALTOR® is an agent or subagent, the obligations of a fiduciary. *(Adopted 1/95)*

- **Standard of Practice 11-3**

- When REALTORS® provide consultive services to clients which involve advice or counsel for a fee (not a commission), such advice shall be rendered in an objective manner and the fee shall not be contingent on the substance of the advice or counsel given.

- **Standard of Practice 11-4**

- The competency required by Article 11 relates to services contracted for between REALTORS® and their clients or customers; the duties expressly imposed by the Code of Ethics; and the duties imposed by law or regulation. *(Adopted 1/02)*

Article 12

REALTORS® shall be honest and truthful in their real estate communications and shall present a true picture in their advertising, marketing, and other representations. REALTORS® shall ensure that their status as real estate professionals is readily apparent in their advertising, marketing, and other representations, and that the recipients of all real estate communications are, or have been, notified that those communications are from a real estate

professional. *(Amended 1/08)*

- **Standard of Practice 12-1**

- REALTORS® may use the term “free” and similar terms in their advertising and in other representations provided that all terms governing availability of the offered product or service are clearly disclosed at the same time. *(Amended 1/97)*

- **Standard of Practice 12-2**

- REALTORS® may represent their services as “free” or without cost even if they expect to receive compensation from a source other than their client provided that the potential for the REALTOR® to obtain a benefit from a third party is clearly disclosed at the same time. *(Amended 1/97)*

- **Standard of Practice 12-3**

- The offering of premiums, prizes, merchandise discounts or other inducements to list, sell, purchase, or lease is not, in itself, unethical even if receipt of the benefit is contingent on listing, selling, purchasing, or leasing through the REALTOR® making the offer.

- **Standard of Practice 12-4**

- REALTORS® shall not offer for sale/lease or advertise property without authority. When acting as listing brokers or as subagents, REALTORS® shall not quote a price different from that agreed upon with the seller/landlord. *(Amended 1/93)*

- **Standard of Practice 12-5**

- REALTORS® shall not advertise nor permit any person employed by or affiliated with them to advertise real estate services or listed property in any medium (e.g., electronically, print, radio, television, etc.) without disclosing the name of that REALTOR®’s firm in a reasonable and readily apparent manner either in the advertisement or in electronic advertising via a link to a display with all required disclosures. *(Adopted 11/86, Amended 1/16)*

Agent Misconduct

An agent breaches an agency relationship when he or she fails to perform his or her fiduciary duty, breaks the conditions laid out in the agency agreement, and/or engages in unethical or illegal activity. In these cases, an agent may be held liable for damages.

Undue Influence

Undue influence involves one party using his or her fiduciary relationship to gain an

unfair advantage over another party.

Overstatements / Puffing

Overstatements, or **puffing**, is when an agent promotes an overly optimistic future for a property, or exaggerates the material facts of a property with the intent of making a principal believe a false narrative. Selling a property and its potential is part of the job, but an agent's statements should remain realistic and grounded in fact. For example, an agent employs puffing when he or she says that a property can be converted into a massive auditorium without the proper permits.

Misrepresentation

Misrepresentation is the act of providing false or misleading information to another party. The misrepresentation can be inadvertent, or deliberate. **Intentional misrepresentation** is when one party purposely misleads, misstates, or exaggerates information with the hope that the other party will rely on the information and make wrong choices.

Regardless of the manner in which it occurred, courts will hold defendants liable for substantiated misrepresentation claims.

In terms of real estate, there are three common types of misrepresentation:

1. *Innocent*: an agent unintentionally misrepresenting material facts about a property.
2. *Negligent*: an agent's failure to disclose material facts about a property due to his or her inability to understand concepts that a real estate professional should have reasonably been expected to understand.
3. *Fraudulent*: an intentional omission of material facts about a property out of intent to procure a sale.

For example, an agent selling a condominium may only show a potential buyer a few units on the property. However, if those units have been recently renovated, whereas the rest of the units are outdated by over 15 years, this is misrepresentation. As the value of the condominium is based on the sale price of other units in the building, the buyer may believe purchasing the condominium is a better investment than it really is.

Fraud

Fraud is the legal term used to describe the act of one party achieving an unfair gain at the expense of the other party. The act is deliberate, and may involve either deceptive

language or actions. It usually involves one party inducing another party into making a decision to his or her detriment. It is unlawful for agents to misinform clients to his or her own benefit. Courts and juries view fraud allegations against agents as a serious offense and will routinely rule accordingly.

Case Review: *Storage Services v. C.R. Oosterbann et al. (1989)*

The case, *Storage Services v. C.R. Oosterbann et al. (1989)* 214 Cal.3d 498., involved a seller and his agent being convicted of fraud.

A buyer (Storage Services) was interested in buying a commercial real estate property being offered by a seller and a seller's agent (C.R. Oosterbann et al.). However, the seller's agent did not inform Storage Services that the state was interested in the property, and was going to institute eminent domain. Therefore, Storage Services went ahead with the purchase. When Storage Services discovered that the government was going to implement eminent domain, he sued C.R. Oosterbann et al. for misrepresentation and fraud.

The trial court ruled in favor of Storage Services and instituted punitive damages against C.R. Oosterbann et al. on the basis of fraud and malice. C.R. Oosterbann et al. appealed. The Court of Appeals upheld the lower court's ruling with the exception of the punitive damage claims. It contended that such penalties were unjust and excessive given the income and net worth of C.R. Oosterbann et al.

Co-Mingling

Co-mingling is the illegal act of transferring funds from one account to another without the express written consent of the account owner. Combining funds from various accounts of different parties for the sake of loan qualification is also considered co-mingling.

Real estate law mandates that a broker deposit a principal's funds into a trust account no later than three business days after securing the funds. The broker has the option to deposit the funds into an escrow account, whereby the escrow company is granted permission to safeguard and/or disperse the funds at the principal's instruction (Business and Professions Code, Section 10145 and 10146).

It is the duty of the broker to document all money that comes in and out of said account, and to keep it separate from other principals' accounts.

Tort

A **tort** is a wrongful act that results in injury to a person, property, or reputation, and that entitles the injured party to compensation. For example, an agent intentionally misleading a seller regarding the value of his or her property.

Other Illegal Practices

Blockbusting: an agent, investor, or other real estate individual induces a property owner to sell his or her properties for below market prices with the claim that the racial makeup of the neighborhood is changing.

Redlining: denying lending services to specific “high risk” demographics, such as first time home buyers, older individuals, or minority populations.

Steering: advising principals to avoid specific neighborhoods due to the prevalence of certain races, religions, or ethnicities in that area.

Case Review: *Greater Baltimore Board of Realtors v. Baltimore County (1990)*

In the case, *Greater Baltimore Board of Realtors v. Baltimore County (1990) 752 F.Supp. 193.*, the Baltimore Board of Realtors claimed that Baltimore County’s restrictions on certain advertising activities were a violation of the First and Fourteenth Amendment.

In response, Baltimore County claimed that the advertising methods in question -- door to door and telephone solicitations -- constituted a practice known as “blockbusting”. “Blockbusting” is the process of advising white property owners to sell their properties when minority people move into a neighborhood.

However, Baltimore County could not provide substantial evidence of these “blockbusting” claims. Thus, the court determined that barring real estate agents from engaging in the advertising activities in question was a violation of free speech. The court ruled that Baltimore County’s county code was unconstitutional.

Case Review: *Madrid v. Department of Real Estate 1984*

The case, *Madrid v. Department of Real Estate (1984) 152 C.A.3d 454*, involved a real estate agent applicant who was wrongly approved for a real estate license,

then had it revoked for failing to inform the Department of Real Estate of bingo fraud that occurred 5 years prior in another state. The plaintiff, Madrid, contended that he did not intentionally fail to disclose the fraud violation on his real estate license application. The applicant licensee did however inform the DRE of a 20 year old conviction where the plaintiff conducted construction activities without a contractor's license.

In trial, the plaintiff indicated that he was not aware that out of state convictions applied. The court held the plaintiff liable for fraudulently procuring a real estate license by misrepresenting personal facts. They further concluded that there was substantial evidence that the would-be agent purposely omitted vital facts regarding the misrepresentation of information and that the Department of Real Estate would not have granted the license had they been aware. The court indicated that although convictions do not always prevent an individual from being licensed, the prior convictions were not minor and therefore the real estate department's decision to bar the applicant from a real estate license was valid.