CALIFORNIA DIVISION OF REAL ESTATE

BULLETIN

FEBRUARY 1944

EARL WARREN, GOVERNOR OF CALIFORNIA — HUBERT B. SCUDDER, REAL ESTATE COMMISSIONER

TO ALL REAL ESTATE BROKERS:

It has come to my attention through complaints from various property-owners that some of our licensees are engaging in practices which are unfair and in some cases illegal. The greater part of these complaints concern transactions in which brokers have secured extraordinary fees through the use of options and net listings. These agreements may be used properly, or they may be used improperly or dishonestly. In the latter case, there is usually involved a violation of the broker's duties as an agent.

The purpose of this bulletin is to be informative and helpful. It is not my purpose to attempt to control your acts in the conduct of your business if they are not in violation of the law I have been appointed to administer. I desire, however, to point out to each licensee the dangers surrounding certain practices, so that they may be informed and guided accordingly.

Following the preparation of this material it was submitted to representative licensees throughout the state, and in each instance they have agreed that it would be of benefit to the licensees. The comments and suggestions of Mr. Herbert L. Breed, Counsel for the California Real Estate Association, are particularly appreciated.

The Division wishes to assist you in every way possible, and in turn requests your cooperation. Complaints are unpleasant. Strict adherence to the law elevates the business and promotes harmony.

I ask you to read this bulletin carefully, have every salesman in your employ do likewise, and file same for reference.

Sincerely yours

Hubert B. Scudder.
Real Estate Commissioner
of California

AGENCY AND FIDUCIARY RELATIONSHIP

The possession of a license to engage in the real estate brokerage business in California imposes upon the holder certain definite legal and ethical restrictions in the conduct of his business. It is not, as regarded by some, a license to launch into dealing in real estate for the purpose of gaining the greatest amount of earnings without regard to the interests of the persons for whom the licensee acts as agent. The broker and his salesmen owe a definite loyalty to their clients, and are prohibited by law from personally profiting by virtue of their agency, except for the agreed compensation for their services.

Numerous complaints have come to the attention of the Division of Real Estate resulting from the efforts of licensees to secure large profits from the transactions they handle by attempting to act as principals. In this connection they have resorted to the use of option forms, net listings and other types of contracts which are a combination listing and option form. It is not contended that the use of options, net listings and combination form contracts is illegal or necessarily unethical, in those cases where a full disclosure of the broker's status and the legal effect of the paper signed is made to the persons with whom he is dealing. The prospect, under these circumstances, must be given to understand that he is dealing with a principal and not an agent, so that he may deal "at arms length" if he so desires.

The licensed broker or salesman should be particularly careful in this respect, as his contacts with real estate owners and prospective purchasers are made largely because of the fact that he is a licensed agent. His office signs, signs on property, and printed stationery all advertise the fact that he is a licensed real estate broker and care must be taken to dispel this impression if he chooses to act as a principal in dealing with real property. It is particularly dangerous for the broker to start out on a transaction with the status of an agent, and subsequently during the time the deal is progressing to switch his status to that of a principal. Various court decisions indicate that the burden of proof under these circumstances is upon the agent to show that the persons with whom he was dealing were fully informed of his change of status. Merely advising a principal that the agent "controls" a property, or making some other vague reference to the fact that the broker is not acting as an agent, will not necessarily be held by the court to constitute sufficient notice of a change of status from broker to principal.

This point arose in the case of *Thompson* v. *Stoakes*, 46 Cal. App. (2d) 285. In this case it was alleged that the real estate agents acted as principals in an exchange transaction without revealing this fact to the other principal, and contrived to make a secret profit in the transaction. The trade involved a residence valued at $7,500 on one side, and an apartment house valued at $15,000 on the other side. In the course of the dealing, the agents secured an exclusive option to purchase the apartment house for $11,400 and proceeded with the exchange without revealing that they had

secured said option, although the exchange agreement indicated that the agents "controlled" the apartment house. When the owner of the residence being exchanged questioned the agents as to why the deed she signed conveyed her property to someone other than the person whom she was told was the owner of the apartment, she received an evasive answer and was not advised of the true facts. The judgment rendered by the lower court for the amount of the secret profit was affirmed.

The court commented: "It is elementary, of course, that an agent is in duty bound to disclose to his principal all material facts and circumstances of the transaction handled by him; that the agent must exercise the utmost good faith; that he must acquire no secret interests adverse to his principal; that he can not lawfully make a secret personal profit out of the subject of the agency; that if an agent conceals his interest in the property sold he is liable to his principal for all secret profits made by him; that where an agent falsely represents the figure at which property can be purchased and then purchases it himself at a lower figure, charging his principal the larger price and pocketing the difference, he will be compelled to disgorge the secret profits; that the fact that the principal was willing to pay the larger amount, or that the property may have been worth the amount charged the principal is immaterial.

Most brokers are aware that it is an established rule of agency that an agent can not represent two parties to a transaction without the full knowledge and consent of both parties. The license law also sets out as a cause for revocation of a license the violation of this principle. Occasionally a broker who engages in the practice of taking net listings overlooks the fact that any amount over the net listing sales price secured by him is a commission for his services. He is being compensated just as surely as if the listing agreement provided for a commission equivalent to a definite percentage of the sales price.

A fiduciary relationship exists between the broker and the property owner who enters into the net listing contract with him. Therefore, if a broker accepts a net listing he may not legally accept any compensation from the purchaser, unless he reveals this fact to the seller and reveals to the purchaser the fact that he is securing a commission from the seller. A usual excuse given by a broker confronted with violation of this principle of agency is, "the buyer received sufficient value for his money, and the seller received his asking price—no one was hurt." The courts have held that these facts are immaterial in instances where the broker has violated his duty as agent in that he has failed to make his true position clear.

The case of *Robson* v. *Hahn,* 98 Cal. App. 671, illustrates the difficulties which a broker may encounter in the use of net listings and for failure to reveal that he is compensated by both parties to a transaction. This action was commenced for the purpose of recovering from the real estate brokers the sum of $1,000 paid to them as compensation for their services in effecting a sale of property belonging to the plaintiff upon the allegation that without the knowledge of the plaintiff or the buyer the brokers collected commissions from both.

Briefly, the owners of a piece of real property employed the brokers to sell it for them for the sum of $21,000, agreeing to pay a 5 per cent commission. The brokers, after one of the purchasers had agreed to purchase, called on the sellers of the lot and informed them that it could not be sold for $21,000 and induced them to sign a different listing in which the sellers agreed to take $19,000 net and allow the brokers as their commission any sum received in excess of the net selling price. Following that, the brokers advised the prospective purchasers that they had the property for sale at a net selling price to the sellers of $20,000, and that the purchasers would be required to pay the brokers for representing them as purchasers an additional $1,000 as commission. The sale was handled in escrow, and neither the buyers or sellers knew of the payment of a commission by the other until the escrow was completed. Judgment for the commission was given to the seller, and the judgment was affirmed by the appellate court.

In its opinion the court commented as follows: "The Appellants were employed in a supposed confidential, advisory capacity for the respondents, who relied upon them for their advice and assistance. The betrayal of that confidence constitutes a fraud. (*Brison* vs. *Brison,* 75 Cal. 525; *Hageman* vs. *Colombet,* 52 Cal. App. 350.) Or, as is said in *Rauer's Law, etc. Co.* v. *Bradbury,* 3 Cal. App. 255, "Whenever he (the agent) has an interest in making the sale which is antagonistic to that of his principal, he is unable to discharge his full duty to the latter, and by continuing to act as his agent, without disclosing to him the fact of such interest, he commits a fraud upon him which will deprive him of all right to compensation for his services."

The court further commented "When, therefore, the complaint in the present case alleged that the appellants had charged and received commissions from the purchasers as well as the sellers who employed them, it did in fact allege that they were guilty of a fraudulent act, and the door was thrown open to determine whether they had in fact been endeavoring to serve two masters. One of the earliest authoritative pronouncements, and one which illustrates the fraudulent nature of the act alleged is found in the gospel of Matthew (chap. vi:24) as follows: 'No man can serve two masters; for either he will hate the one and love the other: or else he will hold to the one and despise the other. Ye can not serve God and mammon.' The act alleged is said to be 'against sound public policy and good morals' (*Glen* v. *Rice,* 174 Cal. 269 (162 Pac. 1020). This case also says: 'His contract for compensation being thus tainted the law will not permit him to enforce it against either party. It is no answer to this objection to say that he did, in the particular case, act fairly and honorably to both. The infirmity of his contract does not arise from his actual conduct in the given case, but from the policy of the law, which will not allow a man to gain anything from a relation so conducive to bad faith and double dealing.' The irresistible conclusion, therefore, is that the allegation of double dealing is an allegation of fraudulent conduct sufficient to warrant the court in rending the veil of legality with which the transaction was cloaked by the admission of oral testimony, for the purpose of discovering the true conduct of the parties. Or, as is said in *Hageman* v. *Colombet,* supra: 'In case of fraud no mere form of words of which the parties have made use can shut out inquiry as to the real facts.' And this is true regardless of the fact that other fraudulent acts, not alleged, may have been made use of for the purpose of securing a written contract presenting the surface of lawfulness."

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A real estate agent when acting as such is duty bound to inform his principal of every fact material to the advantage of the principal. He, in effect, contracts to protect his employer. Confidence is imposed and he acts in a fiduciary capacity and owes an affirmative duty of disclosure. These admonitions are set forth more fully by the Court in the cases *Jolton* v. *Minster, Graf & Co.,* 53 Cal. App. (2d) 516, and *Haswell* v. *Costellanos,* 126 Cal. App. 427. Not only does failure to abide by these fundamentals place the broker in a position of jeopardizing his license, but the courts have held that the agent is not entitled to any profit from transactions in which he is guilty of violating these principles.

Recently a complaint was received by the division against a broker who had secured a listing on residential property

and who shortly thereafter received an offer in excess of the listed price. His evident duty was to inform the owner of this offer, for as broker he was in a position of trust and owed that duty to his client. Instead of doing so, however, this broker persuaded his client to give him an option to purchase the property at a price lower than the original listed price, whereupon he exercised the option and realized the entire profit on the transaction for himself.

The broker in this instance apparently disregarded all of the obligations imposed upon him by law while acting as an agent. He apparently had no interest in the welfare of his client, and was solely intent upon gaining for himself the greatest possible profit from the transaction. Somewhat the same situation is treated in the case of *Anderson* v. *Barney Co.*, 1 Cal. App. (2d) 340. In this case a seller of real estate recovered judgment for $1,726.50, being $300 real estate commission paid to the broker and $1,426.50 secret commission, or profit, received by the broker while acting as agent for the exchange of real property.

The plaintiff owned property in Seattle, which she desired to exchange for property in San Diego. These agents had listed a property in San Diego for $2,300 which they induced the plaintiff to accept in exchange for her Seattle property. In the meantime, however, they had obtained information that the Seattle property could be sold for $4,000 cash. Through a double escrow, they sold the Seattle property for $4,000 and paid the San Diego owner $2,300, his asking price. In this manner they secured a profit without knowledge of the plaintiff amounting to approximately $1,426 and in addition accepted from her a $300 commission. The court found that this practice constituted fraud and quoted at length from the case *Thomas* v. *Snyder*, 114 Cal. App. 397, in which it is stated:

"What is required of an agent toward his principal is clearly set forth in the text found in 1 California Jurisprudence, Page 789, as follows: 'The proposition is conclusively settled that an agent is charged in full measure with the duty of good faith in his dealings with his principal, touching the subject of his authority. The animating principle in this proposition is that no one should, nor will he be permitted to enjoy the fruits of an advantage taken of a fiduciary relation whose dominant characteristic is the confidence reposed in one person by another. The law requires perfect good faith on the part of agents not only in form but in substance, and not only from agents receiving compensation, but also from gratuitous agents. Indeed, the rule is so familiar as to be trite that the obligation of an agent to his principal demands of him the strictest integrity and most faithful service.' Other requirements are set forth in the section containing the text from which we have quoted, suffice to say that the requirement of the law of the relation of agent and principal is to the effect that the agent cannot be allowed to profit at the expense of his principal, whether the result be reached by misrepresentation or concealment or other fraudulent device. This is further set forth in Section 1709 of the Civil Code which reads: 'One who wilfully deceives another with intent to induce him to alter his position to his injury, or risk, is liable for any damage which he thereby suffers.' This is the definition of 'deceit', and Section 1710 of the Civil Code, defining 'deceit' in subdivision 3, contains the following: 'The suppression of a fact by one who is bound to disclose it,' etc. We do not need to cite authorities to the effect that an agent is bound to disclose to his principal every fact within his knowledge which bears upon the value of the property with which the parties are dealing, and the concealment of which would lead to the injury of the principal. As stated in 1 California Jurisprudence, 799, Section 85: 'Any act of an agent with respect to the subject matter of the agency, injurious to the principal, may be avoided by the principal as between themselves.' And as further said in the same section: 'An agent will not be allowed to deal in his own behalf with his principal with reference to the subject matter of the agency unless he makes full, complete and honest disclosure of the truth of the transaction.' To the same effect is the case of *Curry* v. *King*, 6 Cal. App. 568 (92 Pac. 662, 665), where this court, speaking through Mr. Justice Hart, took occasion to set forth the law showing that an agent is absolutely prohibited from dealing with the subject matter of the agency by concealment or otherwise, so as to enrich himself. The case of *Curry* v. *King*, supra, also holds that the value of the property involved is immaterial. The unlawful profits obtained by the agent by reason of his fraudulent conduct, is all that is necessary to be ascertained.

'In *Rempel* v. *Kells*, 62 Cal. App. 81 (215 Pac. 1042), it is likewise held that the profits obtained by an agent through fraudulent conduct, constitutes the basis for recovery. This case also goes further and holds that an agent obtaining profits by fraudulent conduct and concealment from his principal, is not entitled to recover expenses incurred by him in connection with the property."

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A real estate salesman is also subject to the obligation created by a fiduciary relationship. As an employee of the broker, he is duty bound to disclose all information to the broker's clients which affects them in their transactions. Violation of the principles of agency by the salesman places him in a position whereby he may lose his license, and also may place his employing broker in a position whereby he is held responsible civilly for the acts of his salesmen. The salesman must be careful to abide by the rules of the office and to follow the directions of the broker in the treatment of clients.

If the salesman fails to fulfill the duties of an agent to a client of the office, and attempts through dummy transactions or through manipulations with other salesmen to gain a secret profit, these actions may result in a financial loss to the employing broker and in the loss of the salesman's license. It has also been held that a broker who sells property listed with him to a salesman so that a second sale may be made at a profit is also guilty of violating his confidential relationship with the client. Some of these points are well illustrated in the case *Firestone* vs. *O'Brien*, 97 Cal. App. 43.

This case arose from a situation briefly related as follows: An owner listed his property for sale with a real estate broker for a price not less than $8,500. A salesman in the employ of the broker persuaded the owner to lower his price to $7,500 and the property was thereupon sold to another salesman in the employ of the same broker. In a subsequent resale, the price received by the salesman was $1,000 greater than the price for which he had purchased the property. The same escrow agency handled both transactions. A judgment was secured by the original owner against the broker for the amount of commission paid to the broker and also the amount of profits secured in the subsequent transaction by the salesman. The broker argued that he received nothing from the profits and was ignorant of the transaction; that he was a large real estate operator having many branch offices and employing many salesmen; that he received no profits and ought not to be held liable. The court commented that so far as the evidence showed the broker was uninformed as to the actions of the salesmen, however, the court held that the broker must be held legally responsible, however unfortunate it may be.

In setting forth the basis for its opinion, the court quotes various cases which treat with the relation of the broker to his client. Quoting from the case:

"The first proposition of appellants is that, conceding that a real estate firm cannot sell to itself, without disclosing the fact that it is buying to its principal, yet this rule has no application to a case where the agent did not sell to itself, but to one of its salesmen. We think that an examination of

the authorities shows that the agent cannot sell to one of its salesmen or employees without first disclosing all the surrounding facts to the principal. One of the leading cases upon this subject is the case of *Burke* v. *Bours,* which was before our Supreme Court three times, and this particular phase of the case was quite fully discussed in 92 Cal. 108 (28 Pac. 57), where the following language is found:

In Sugden on Vendors, p. 887, it is said: 'Any persons who by being employed or concerned in the affairs of another, have acquired a knowledge of his property are incapable of purchasing such property themselves.' In *Gardner* v. *Ogden,* 22 N. Y. 350 (78 Am. Dec. 192), 'The defendant Smith was the clerk, or assistant, of his principals. . . . Whatever disabilities they labored under equally attached to him. It would work an entire abrogation of this rule to hold the principal subject to the operation of the rule and exempt his clerks and agents from its effect. It would be opening the door to its evasion, so that it would lose all its vitality and virtue.' The decision goes on: 'I think this is the spirit of all the authorities, and that the honesty and fairness of transactions between principals and their agents demand a firm adherence to these rules, and to bring under their operation, not only the agent himself, but those in his immediate employ, and who are engaged in the transaction of his business, which is, necessarily, the business of the agent's principal.'

These principles are cited with approval in the cases of *Newell-Murdoch Realty Co.* v. *Wickman,* 183 Cal. 39, at page 44 (190 Pac. 359), and *Salisbury* v. *Younger,* 184 Cal. 783 (195 Pac. 682).

The rule is to place the burden on the agent to make full disclosure promptly. See the case of *McCallum* v. *Grier,* 86 S. C. 162 (138 Am. St. Rep. 1037, 68 S. E. 466), in which the court said in part: 'A broker employed to sell goods for his principal can not buy them for himself, nor can a broker employed to buy, buy his own goods, unless the principal, with full knowledge of the facts, assents to the transaction. The decision states: 'It is immaterial that the broker acts in good faith. . . . The reason of the rule is that if the broker were permitted to buy from or sell to himself, there would be combined in him the incompatible relation of purchaser and seller, and an interest adverse to that of his principal would be created such as would ordinarily lead to a violation of his duty as agent.' (4 Ency. of Law, 966; 19 Cye. 207.)"

There are various other California cases which treat with the undesirability and illegality of a real estate agent dealing with his client's property for solely his own personal gain. The various courts have defined the obligations of a broker in their own peculiar language, but upon analysis they all boil down to the fact that the broker must make full disclosure and act in the utmost good faith.

In *Curry* v. *King,* 6 Cal. App. 575 (92 Pac. 665), it is stated: "Therefore an agent will not be allowed to deal in his own behalf with his principal with reference to the subject matter of the agency, unless he makes full, complete and honest disclosure of the truth of the transaction. He is bound to treat with his principal concerning the property over which he has been vested with authority in the utmost good faith, and so religiously does equitv require adherence to this rule that a transaction between them as to the property whereby the agent acquires the ownership thereof, is upon its face deemed by law to be fraudulent."

In the case of *McCallum* v. *Grier,* supra, it is stated: "It is the duty of an agent to disclose fully to his principal every step taken by him in the transaction of the principal's business. If it be the sale of real estate he should keep nothing concealed in his efforts to bring the owner and prospective purchaser together. The identity of the purchaser and the true consideration should be instantly disclosed."

* * * * * * *

It has come to the attention of the division that listing forms, which also provide for the broker to take an option if he so desires, are being used by some brokers. It would appear that the purpose of these contracts is to enable the broker to garner an earning from the transaction in excess of the normal commission rate should the opportunity present itself. The present condition of the real estate market lends itself to these practices. In the use of such contracts, it is a reasonable assumption that the broker will not exercise the option provision unless he is reasonably sure that the property can be sold for more than the listed price. If he fulfills his legal and ethical obligations as an agent, he will inform his client of these facts rather than secure an option whereby he may profit from them. As in the case of net listings and straight options, it is legal to use such contracts and perhaps it is possible to use them without breaching a fiduciary relationship. The very nature of such contracts, however, places the broker using them in a position where he must exercise utmost caution not to violate his obligations to his client.

Dealing in all fairness with his client, who in most cases is the seller, is not sufficient. Buyers must not be considered as prey. Certain definite obligations to disclose known facts to the buyer regarding properties offered for sale are imposed upon the broker. Unlawful concealment of material information regarding property may place the broker's client in a position whereby he is civilly liable for damages. Honesty in real estate dealings must work in both directions.

This discussion of the broker's obligations may be summed up briefly: "Whatsoever ye would that men should do unto you, do ye also unto them."

LICENSE RENEWAL

1. *Present licenses expire June 30, 1944, and must be renewed for the ensuing fiscal year.*
2. *Renewal applications for 1944-45 were sent you with your present license. If lost or mislaid, substitute blanks may be obtained from any Division Office after March 15, 1944* **(upon your request),** *in person or by mail.*
3. *Please file renewal applications promptly and early—If no change of address or broker affiliation is contemplated, as near May 1, 1944, as possible.*
4. *Your attention and promptness will greatly help your Division to issue your licenses and to solve the problems of labor shortage and mail delay.*

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