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REAL ESTATE AGENTS AND THE LAW: A NEW NET GOES FISHING

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Abstract

Historically the role of the real estate agent has been to act as agent for the principal, usually the vendor, in the sale or lease of property. The agent has earned a commission on the sale by inducing a third party, usually the purchaser, to enter into a binding contract with the principal. Real estate agents are now increasingly finding themselves on the horns of a dilemma in balancing the requirements of their fiduciary relationship with their principal against the third party's (purchaser's) right to protection under consumer law. The dilemma grows as Western countries, including New Zealand, move toward strengthening consumer rights through statutory law. Courts have repeatedly confirmed the very special nature of the agency relationship, and the protection afforded the principal under the doctrine of 'utmost good faith'. However, a number of recent landmark decisions confirm the legal responsibility that agents now have under consumer law toward third parties. Whilst agents have always owed a 'duty of care' as an 'expert' toward third parties recent court decisions appear to place an expectation on the agent to act as steward of the property transaction to ensure the best interests of parties on both sides are met. This trend would seem to imply that the agent is a 'middleman' in the process, a role which would appear to be in direct conflict with the traditional/legal relationship of agent acting for and on behalf of one party. This paper will discuss the legislative changes which have occurred and examine some of the recent court decisions which have created the dilemma. The paper will also explore the challenge facing real estate agents in managing their client/customer relationships within an environment of burgeoning legal accountability.

Agency Relationships

Agency relationships have been historically determined and defined in common law over a wide range of legal jurisdictions. They are a natural and necessary part of relationships between parties. "The concept of agency arises for practical reasons, since many everyday activities would be impossible without it...." (Gunasekara, 1995, p 8). Indeed, if it were not for the concept of agency, and its recognition in law, every party to a transaction would have to be personally and directly responsible in making and carrying out the contract. With the extent and complexity of transactions in the modern business environment this would be a daunting prospect, creating severe limitations on trading and non-trading activities alike. One

definition of an agent is a 'person who is engaged for the purpose of bringing a third party into a contractual relationship with the principal'. In law and tradition the principal, or first party, is the agent's employer, the agent is the second party and the person entering into contract with the principal is deemed the third party. The extent to which the agent assumes authority to act on behalf of the principal is determined by the nature of the relationship, and the terms of the contract of agency. Gunasekara refers to the ability of the agent to bind the principal in dealings with third parties as a key aspect of agency and much of what the law of agency is all about. For this reason real estate agents are in somewhat of an unusual position in that they do not normally have the authority to bind the principal into contract with third parties. Unlike, for example, a stockbroker. Webb and Webb, in *Luxford's Real Estate Agency* (1979), asserts that "a real estate agency is an agency of a somewhat specialised and limited nature" (p 1). Nonetheless real estate agents are subject to all the normal features of agency law, such as duties of performance and fiduciary duties owed by the agent to the principal, and the agent's right to commission from the principal. Duties of performance are sourced from the common law whilst fiduciary duties are based on equity. (Gunasekara, 1995) states the duties of performance as:

- (i) to perform the contractual undertaking in accordance with the instructions given by the principal;
- (ii) to act within the authority given by the principal (express, implied or customary);
- (iii) to use due skill and care.

Fiduciary duties, which are strict and on-going, focus on the requirement for an agent to avoid a conflict of interest with the principal. Webb and Webb (1979) refer to the fiduciary relationship as one of trust and confidence with the agent's duties and liabilities increased accordingly. The agent stands in a fiduciary relationship and is required to reveal all that he/she knows which may affect the principal's interest. "If he knows something material which, if known to his principal, might cause his principal to refuse to deal, he must disclose it, notwithstanding the possible resultant loss of commission" (pp 110-111). Thus, the principles of undivided loyalty and full disclosure are implicit within the agent's fiduciary obligation. Davis and Wills (1991) refer to the need for an agent to be aware that the obligation to the principal is one of utmost good faith. They state that any breach of duties resulting in loss to the principal may render an agent liable for damages. "The first requirement, of course, is to follow instructions. Because the relationship of agency is a fiduciary one, an agent must act in the principal's interest. This also involves not divulging confidential information" (p 11-1). Under the bundle of duties owed to a principal, therefore, an agent must disclose all things material to the principal but cannot divulge confidential information to a third party. The duty of care owed by an agent towards the principal is also the duty of care of an expert, sometimes referred to as the "Hedley Byrne Duty". In *Hedley Byrne and Co Ltd v Heller and Partners Ltd* [1964] AC 465, the judge found that the duty of care owed by an expert is somewhat higher than that owed by a layperson. Nevertheless, Duncan (1990) points out that, in tort, particularly where there is negligence to a third party, both agent and principal may each be liable. "..... it is beyond doubt that where a principal gives his express authority to do a particular act or make a particular omission which is wrongful in itself, the principal is responsible jointly and severally with the agent to the third party for any loss or damaged occasioned" (p 160).

In summary, the real estate agent 'stands beside' the principal (normally the vendor) as more than a mere representative and, whilst stopping short of "stepping into the shoes" of the

principal, owes the principal undivided loyalty, is bound to follow the principal's instructions, act in the principal's best interest, fully disclose anything material to the principal, and not to divulge confidential information to a third party. On the other hand, the principal is jointly and severally liable to any third party for damages arising from any wrongful acts or omissions carried out by the agent under the express authority of the principal. This paper will now turn to an examination of the rather more complex, and increasingly controversial, common law relationship between the agent and the third party (traditionally the buyer).

Third Party Relationships

In the traditional sense, the buyer is the third party to any agency contract, and the second party to any contract of sale entered into with the agent's principal. The agent owes the same duty of care of an expert (the Hedley Byrne Duty) towards the buyer but has no fiduciary relationship with them. Indeed, in the absence of full disclosure by the agent to both parties, conflict of interest prevents the agent from entering into such a dual relationship. In common law, therefore, the buyer clearly stands outside the special relationship which binds the agent and principal and, historically, the principle of 'caveat emptor' (let the buyer beware) has applied to buyers. In effect this has meant that the buyer must rely on their own judgement and independent advice, and not upon representations made by the agent, either their own or, those made on behalf of the vendor. Indeed, it is common to see disclaimers to this effect included as part of a sale and purchase agreement. Duncan (1990) cites a Queensland case of *Rootes V. Oentory Pty Ltd* [1983] 2 Qd R. 745, where the judge said "...of course the ordinary purchaser knows that the agent is acting for the vendor, and that he is a salesman. In a robust society he ought to take the agent's statements with the proverbial grain of salt. But he is entitled to expect that the agent's statements will be honest and that some care will be exercised in their making." (p 160). Webb and Webb (1979) also state that "...in ordinary matters where parties come together to make a contract, the rule is that each must look after his own interests. In a contract of sale of goods, for example, the seller, at most, must not make any false representations or actively mislead; he is not bound to tell all he knows, and the buyer must take care of himself" (p 111). Agents who are in a real estate agency contract are reminded by Webb and Webb that they stand in a fiduciary relationship with the principal, to whom they must disclose all that they know which may affect their principal's interest. They reiterate the concept of undivided loyalty to the principal who is entitled to require in the agent the possession of "... integrity, care and skill. More than that he is entitled to have these qualities unreservedly, and in his interests only, placed at his disposal" (p 111).

In summary the buyer is protected from false representations or being actively misled by the agent but must look after their own interests. They are assumed to be aware that the real estate agent is a salesperson who owes undivided loyalty to their principal, and will act in the principal's interest only. Further, the buyer must rely on their own judgement and not upon representations made by the agent, which may be taken with a 'grain of salt'. Historically, therefore, the third party (the buyer) has been left in little doubt that they stand on their own and outside the special relationship which closely binds the agent and principal.

The law in most Western jurisdictions has always been quite clear in applying what Marsh and Zumpano (1988) call the 'one master' test to disputes over agency relationships. They refer to the agent's task as relatively straightforward and objective - to expedite the sale of the vendor's home "at the highest possible price and most favourable terms" (pp 151-152), and in undertaking this responsibility they have the full backing of the law. The 'one master' theory clearly evolved over time to provide protection to the agent's principal, and to create certainty

in the minds of participants to the transaction (including buyers) as to the nature of the agency relationship. Marsh and Zumpano, however, suggest that the markets are normally not sophisticated enough to absorb this theory, and that buyers seeking remedies for alleged misconduct by agents are usually surprised to discover that the agent who led them through the transaction was really the vendor's representative. "It is clear that if buyers were made aware of the status of the agents in a typical residential real estate transaction, at least some buyers would take greater care to protect themselves" (p 156).

Thus, more uncertainty than certainty may well have existed in the minds of the participants, (particularly buyers) about the nature of the traditional agency relationship in a typical real estate transaction. Against this backdrop the paper now explores the arrival of the age of consumerism, the effects on agency law of the rapidly changing legal environment and the perceived uncertainty about agency relationships which now exists, not only in the minds of market participants but also in the minds of agents themselves.

Consumer Legislation - The New Net

Beginning with the Ralph Nader movement in the United States in the 1960's, consumers of goods and services throughout the Western world began to express their collective dissatisfaction with the standard of goods supplied and the level of service offered to customers by trade and service organisations. The drive towards consumer protection requirements was adopted by governments and a plethora of consumer laws was introduced. The laws brought new benefits to customers in areas such as safety, minimum standards of goods and services and the rights of customers to product information. Real estate agency was no exception and, against this background of a changing legal environment, characterised by lifted expectations amongst consumers, a growing body of case law has emerged which challenges the nature of agents' relationships with market participants. Levi and Terflinger (1988), reflecting on the arrival of the age of consumerism and its effects on real estate agents, suggest that "new expectations are being defined on both the buyer and seller sides of real estate transactions" (p 133). They point out that the area of greatest litigation activity is misrepresentation. Claims are typified by buyers claiming that information pertinent to a real estate transaction was inaccurate or withheld. These claims are important because they "serve to broaden the focus beyond the traditional concern with the agency relationship between the broker and the seller" (p 133). Levi and Terflinger conclude that the legal duties of real estate agents still include the fiduciary duty to the seller plus an emerging duty, imposed by law, for the protection of the buyer. This emerging duty requires the agent, who represents the seller, to not only provide accurate information to the buyer, but to affirmatively disclose pertinent information which a reasonably competent and diligent investigation would discover.

In essence, the role of the real estate agent is now much more complex and the potential for conflict of interest in recognising legal duties to both buyer and seller is clear as agents find themselves endeavouring to serve the expectations of both parties to the transaction. Levi and Terflinger refer to a "battleground" of legal cases, and to the dilemma now facing agents. ".....the disclosure needs of the buyer, if served forthrightly, as the law is demanding, may tend to undercut the position of the seller, to whom a fiduciary duty is owed" (p 134). Marsh and Zumpano (1988) further assert that agents are "being increasingly put into untenable situations where their training makes it impossible to satisfy all the functions now being required of them by the public (p 153)". They pose typical situations which might expose agents to liability. Should an agent who independently discovers a defect in a property pass that information on to a potential buyer? If revealing the information leads to a loss of sale

does the vendor have recourse against the agent? If the agent remains silent does the buyer have recourse against the agent? Other situations could include; does an agent accept instructions from a vendor not to reveal defects? If the agent remains silent does the buyer have recourse against the agent? If the agent ignores the vendor's instructions to remain silent and informs the buyer of the defects does the vendor have recourse against the agent for breaching fiduciary duty? If the agent simply passes on a vendor's mis-information about the property to the buyer does the buyer have recourse against the agent?

As part of the move towards greater consumer protection (and perhaps to avoid the preceding situations) a number of American states have implemented mandatory disclosure laws which require home sellers, and agents, to provide information about their property. Referring to an increasingly complex and growing number of federal and state requirements on real estate disclosure laws, Inman (1996) states that home sellers and agents are now required to disclose "everything imaginable about a property and the surrounding neighbourhood" (p 1). The Californian statute, for example, obligates a vendor to reveal facts materially affecting the value or desirability of the property which are known or accessible only to the seller and which are not known to, or within reach of, the diligent attention or observation of the buyer. Clearly the enactment of mandatory vendor/agent disclosure legislation joins the vendor in accountability for information provided and removes the agent from exposure to most of the untenable situations previously discussed. The paper will now turn to a discussion on the New Zealand experience with the drive toward tighter consumer legislation, and its inevitable impact on real estate agents in that jurisdiction.

The New Zealand Experience

Real Estate Agents in New Zealand operate under some of the most stringent agency legislation anywhere. The Real Estate Agents Act, last amended in 1976, provides for the licensing of all real estate agents and prescribes a list of duties which the agent owes to their principal (normally the vendor). In addition the special nature of the agency relationship which exists in most Western jurisdictions is recognised in New Zealand, and has been consistently reaffirmed by the courts. Principals are afforded the same protection as elsewhere in both common law and in equity. A fiduciary relationship exists, agents owe their principal undivided loyalty and agency contracts are contracts of utmost good faith. Historically, the buyer has been subject to the principle of 'caveat emptor' (let the buyer beware), i.e the buyer relied upon their own judgement and not upon representations made about a property by the seller's representative, the agent. The buyer was protected, however, in common law and in equity. The seller, and the seller's agent could not make any false representations or actively mislead.

The first statutory attempt to protect real estate buyers, as a direct result of the new consumer movement, was the Contractual Remedies Act introduced in 1979. The Act replaced the rules of common law and of equity regarding circumstances in which a party may rescind a contract, or treat it as discharged, for "misrepresentation or repudiation or breach" (Section 6). Section 6 provides a party to a contract (by implication the buyer) recourse to damages if induced to enter into contract by misrepresentation, whether innocent or fraudulent, made to them by or on behalf of another party to the contract. For the first time real estate buyers were provided with some statutory protection against misrepresentations made by vendors and/or their agents.

Further protection was to follow with the passing of the Fair Trading Act in 1986, a statute which was to have a much more profound affect upon agency relationships than the Contractual Remedies Act. Section 9 of the Act makes it an offence for persons in trade to engage in conduct that is misleading or deceptive or is likely to mislead or deceive. Section 14 specifically prevents people in trade from making false representations and from engaging in other misleading conduct in relation to land. The Act provides recourse for anyone affected by breaches (whether a party to the contract or not) to sue. It also provides for heavy fines in the event of serious breaches. Most significantly, the Act provides protection against people in trade, which includes real estate agents but excludes their principal (normally vendors) unless they are also in trade. Although the Act was operative from 1986 the enforcement agency, the Commerce Commission, recognised a period of grace during which a policy of 'education before enforcement' was informally applied. Traders were generally given time to absorb the implications of this potentially powerful piece of legislation, to institute compliance programmes, and to train staff, before the full force of the law was implemented. Mainly for this reason the statute's impact upon real estate agents and upon real estate transactions remained largely unclear until the landmark court decision *Smythe v Bayleys Real Estate Ltd and others* (unreported, Thomas. J, High Court, Auckland, 12 November 1993, C.P. 789/92).

The buyers of a leased commercial property (*Smythe and Smythe*), sought damages against the real estate agent (*Bayleys Real Estate Ltd*) and the agent's salesperson. The vendor and the tenant of the property were joined as second defendant and third parties to the action. The buyers sought recourse as a result of loss sustained soon after purchasing the property when the tenant experienced financial difficulties and was unable to continue paying rent. The buyers were awarded \$408,000 damages against the real estate agent and the salesperson. Although the vendor and tenant were also joined in the action they were excluded by the judge as parties to the final award. The judge found that, just prior to the sale, the tenant advised the vendor that they were in financial difficulties and were unable to pay the rent. The vendor then entered into an arrangement whereby they (the vendor) would make up the difference in the meantime, i.e. the vendor devised a mechanism that would make it appear that the rent was being paid when in fact it was being subsidised by the vendor to the amount of \$20,000 p.a. The buyers was unaware of this arrangement whereas, prior to the sale, the real estate agent had been advised of it by the tenant. When the agent approached the vendor to corroborate this agreement with the tenant the vendor informed the agent that no such agreement existed. The agent remained silent on the matter to the buyers and proceeded to conclude the sale by auction. As events transpired following the sale, the buyers discovered that the arrangement was in place and, that all parties to the transaction (including the agent) were aware of it except for them. In addition, the property had been advertised during the promotional period using slogans such as a 'quality investment', 'long term tenant', 'a sound investment' 'suitable for family trust in the lower price range'. The real estate agent claimed, in defence, that these slogans consisted merely of puffery. They also claimed that their silence on the matter of doubt over the strength of the tenant was based on the fact that they accepted instructions from the vendor only and that the vendor had advised them that no variation to the lease agreement existed.

In summing up the judge asserted that Section 9 of the Fair Trading Act was enacted by the legislature to promote fair trading for the protection of the consumers. The common law had not developed sufficiently to protect consumers and the section was enacted to fill the gap. "There is no reason why the impugned statements of a defendant [the agent] need amount to a misrepresentation as construed in the law of contract, or to negligent misstatement as defined

in the law of tort for them to be misleading or deceptive. nor are the rules which have developed in the law of contract related to the silence of the defendant [the agent] to be incorporated into the section [Section 9 of the Fair Trading Act]”. The judge stated that the limited circumstances in which silence amounted to misrepresentation at common law had “little if any relevance to the present enquiry”. The judge then found the agent in breach of section 9, with the conduct of the agent’s employees certainly misleading “and probably ultimately deceptive”. The defence that the promotional statements were merely puffery was dismissed by the judge who held that they were incorrect and to accept them as puffery would be to reassert the doctrine of ‘caveat emptor’ in the context of Section 9 in an extreme form. The agent’s decision to proceed with the auction in the face of warnings that all was not well was also criticised by the judge who pointed out that the auction could have been stopped, or at least the buyers acquainted with the information that had come to hand. The judge also rejected the relevance of a number of disclaimers which were included in the sale contract to protect the agent from claims by the buyer. He pointed out that the requirements of the Act are mandatory and contracting out was not an option available to traders.

Ladbrook (1994), in commenting on the decision, highlights the judge’s contention that Section 9 of the Fair Trading Act should not be burdened with a vast baggage of case law, and that the section should be taken literally. Referring to partial success in Australia to import common law principals into similar legislation, the judge reiterated that common law should not be imposed on the statutory regime in New Zealand. Ladbrook also draws attention to the unsuccessful action against the tenant and third parties who were joined with the agent as respondents. The agent was the only party considered to be ‘in trade’ and therefore bound by the requirements of the Fair Trading Act. On the surface the landmark decision in *Smythe v Bayleys Real Estate Ltd* would appear to signal a profound change in the balance of relationships between the real estate agent, their principle (normally the vendor) and the third party (normally the buyer). In fact the agent/principal relationship in law remains substantially unchanged by the decision. It is the relationship between the agent and the buyer which has been radically redefined, i.e. the agent now appears to have a legal relationship with the buyer as well as with the principal. The agent is now the implied steward of the transaction, charged with the responsibility of ‘professionally managing’ the transactional process and acting in the best interests of both parties.

Although only a District Court case, the judges decision in *Shahroodi v Lochores Real Estate Ltd* [1997, DCR349] (REINZ, 1997) further underpins the uncompromising approach taken by courts towards the Fair Trading Act. In this case the agent had passed on incorrect information to the buyer (Mr Shahroodi) about the size of the land area and potential for zoning of a property for sale. The information had been provided by the vendor. Mr Shahroodi purchased the property, discovered that the land area was 128 sq.m. smaller than indicated, and that the zoning potential was not as indicated by the agent. He sued the agent for damages arising from incurred losses. In defence, the agent argued that they were entitled to repeat information provided by the vendors and that they had merely acted as a conduit from the vendors to Mr Shahroodi. The judge found against the agent stating that the salesperson realised the seriousness and importance of the information that was given to Mr Shahroodi, indicating to him that it was correct and referring him to the listing document. Damages of \$14,500 were awarded in favour of the buyer.

In summary, agents engaging in conduct which is misleading or deceptive or is likely to mislead or deceive may be liable under Section 9 of the Fair Trading Act, even when that conduct is innocent, silent, passive or merely passing on information provided by others (including vendors). The Act also imposes strict liability for honest mistakes, negligence and dishonesty. Neither the vendor nor any other party to a claim, other than the agent, can be held liable under the Act unless they are also in trade. If there are also allegations of misrepresentation against a vendor or other parties then it must be remembered that the test is more stringent for breach as construed in the law of contract, or to negligent misstatement as defined in the law of tort. In other words actions for breaches of the Fair Trading Act are much more likely to succeed and, in most cases, the vendor or third parties associated with a sale and purchase transaction would not be liable. The paper will now explore the challenges facing real estate agents in managing their client/customer relationships within this new environment of burgeoning legal accountability.

Coping With The New Net in New Zealand

The courts in New Zealand have confirmed that the focus of the new legal environment is to provide enhanced certainty and protection to consumers. In the case of real estate transactions that has translated into enhanced certainty and protection for buyers. Although court decisions on new consumer legislation have left the special nature of the agency relationship essentially intact, a number of the legal principles that underpin the relationship would appear to be significantly disturbed. Whilst certainty and protection remain for the principal (the vendor) and have been substantially enhanced for the buyer, elements of confusion abound as to the new role of the real estate agent in the property transaction. The role of 'steward of the transaction' which has been thrust upon agents is in stark contrast to the general tenets of agency law which require undivided loyalty and vigorous representation by the agent on behalf of the principal. Fiduciary duties, for example, focus on the requirement to avoid a conflict of interest and to follow instructions. Further, any breach of duty resulting in loss to the principal may render an agent liable for damages. On the other hand the agent has been able to rely on the fact that the principal is jointly and severally liable to third parties for wrongful acts carried out with express authority. Clearly the agent is now on their own in matters of liability under the Fair Trading Act and must exercise considerable judgement when entering into contracts of agency where they may be exposed to claims from either party to the real estate transaction. As Marsh and Zumpano (1988) point out, the agent is in the precarious position of seeking the trust and confidence of the prospective buyer whilst still claiming faithfulness to the seller - "...it is almost impossible to satisfy all the functions now being required of them by the public" (p 153).

Real estate agencies in New Zealand have adopted a range of approaches to manage the risk now associated with the supply of services to buyers and sellers. Because the breaking of new ground in legal responsibilities to new buyers has been the result of judicial decision rather than the original legislative enactment, the response from the real estate profession has been somewhat uneven and often confused. Some agencies have adopted a proactive approach, others have been reactive whilst many have retained the status quo in their approach to client/customer relationships.

Aware that the skills and knowledge of the current real estate workforce are insufficient to cope with the new legal environment, the Real Estate Institute of New Zealand has moved quickly to develop a Trade Practices Compliance Programme (1996) for the guidance of its members. The programme is designed to avoid the consequences of contravention under the

country's consumer legislation, including the Fair Trading Act¹. Five recommended operating principles for real estate agents, managers and salespeople are embedded within the programme:-

1. Absolute honesty and good faith
2. Care and skill
3. A professional approach
4. Accurate and factual statements
5. Full disclosure

Training and education programmes, often sponsored by the Institute, have evolved to acquaint the industry with the implications of the law change. One model set of guidelines for assisting agencies to manage the risk was developed by Crews (1994) and is summarised as follows:-

1. Adopt the five operating principles of the Real Estate Institute's Trade Compliance Policy
2. Prepare a Fair Trading Act check list.
3. Review marketing strategies.
4. Train and educate staff.
5. Introduce policies to avoid contravention.
6. Take complaints seriously.
7. Handle complaints swiftly.
8. Keep good records.
9. Hold adequate professional indemnity insurance.

The model also suggests guidelines for agencies when listing property. They are summarised as follows:-

1. The listing salesperson should have the appropriate knowledge and research skills to obtain the required listing information.
2. The listing salesperson should take steps to verify information provided by the vendor or the vendor's advisers.
3. The listing salesperson and the agency should resist the temptation to place the listing on the market before listing information is verified.
4. Management should implement a policy of scrutinising each listing as a check on the salesperson's verification of information, and monitoring all advertising related to that listing.

¹ Other consumer legislation affecting real estate agents has also been introduced in New Zealand, including the Residential Tenancies Act (1986), Commerce Act (1986), Privacy Act (1993), Human Rights Act (1993) and Consumer Guarantees Act (1993).

Real estate agents are now strongly advised to avoid entering into contracts of agency where principal's instructions might lead them to a breach of their legal responsibilities to buyers. Agents already in a contract of agency are advised to decline to accept a principal's instructions which might lead to a breach. It is not surprising that some principals (vendors) have pressured agents to accept such instructions, first on the basis that refusal to comply is at variance with the common law requirement of 'undivided loyalty', and second, that principals are not personally liable for breaches of the Fair Trading Act. Some agents continue to accept instructions from vendors which might be contrary to the interests of buyers, in exchange for the vendor providing them with a personal indemnity against loss. This strategy has yet to be tested in court. However, there is considerable risk that the court may find an indemnity contract unenforceable on the basis that it is a device to avoid compliance with the law. Disclaimer clauses exempting vendor/agent liability for the provision of incorrect information, commonly used on promotional flyers, in real estate auction transactions and in commercial real estate contracts, are still widely used. Ladbroke (1994) points out his concern about the effectiveness of these clauses as a defence against breaches of the Fair Trading Act. He cites the *Smythe v Bayley* decision. "The court addressed the various disclaimer clauses with yet more hidden in the undergrowth" (p 18). Ladbroke cites the judge as further saying "I do not think that these clauses have the effect of excluding the operation of the Fair Trading Act" (p 18). In the absence of mandatory Vendor Disclosure Statements, such as those that apply in many U.S. jurisdictions, agents are unwise to expose themselves to the risk of claims from buyers through accepting non-complying instructions from vendors, or relying on disclaimer clauses to protect themselves from liability.

New Zealand agents may also have much to learn from a summary of additional preventative measures listed by Marsh and Zumpano (1988) and Levi and Terflinger (1988) and referred to by Inman (1996).

Increased Agent Education

Classroom education is minimal for real estate agents and salespeople when compared to other professions. There is some evidence to show that raising levels of skill and product/legal knowledge will have a "positive affect on reducing the number of complaints against real estate agents" (Marsh and Zumpano, p 159).

Greater disclosure

Mandatory disclosure provisions, requiring vendors to disclose extensive information about their property, would serve to remove uncertainty for buyers and provide a significant element of protection for agents. Many U.S. jurisdictions have adopted variations of this approach.

A formal disclosure statement, issued by the agent at the outset to both the vendor and the buyer, would also avoid confusion about the role of the agent, particularly for the buyer. The statement would set out the nature of the agency relationship and explain the fiduciary duty that the agent owes to the vendor.

Property Inspection

Inserting a clause in the Sale and Purchase Agreement making the agreement contingent on the satisfactory outcome of a property inspection, such inspection to be conducted by an independent expert.

Finally, with the arrival of the age of consumerism, and the growing complexity of the 'one master' theory of agency, where the vendor is commonly the principal, the paper will briefly examine the potential for real estate agents to adopt non-traditional approaches to client/customer relationships.

Alternative Relationships

The 'one master' theory of agency law, where the vendor is the traditional principal, has increasingly come into conflict in the market place with the burgeoning needs of buyers and sellers seeking adequate representation and increased protection. This widespread phenomenon, backed by consumer statutes and reinforced by court decisions, has only recently become evident in New Zealand. One alternative solution, which is increasingly being adopted in the United States, is for the industry to provide agents for the buyer. The balance of expectations, which has now shifted to the buyer, could be more effectively met through the agent establishing a fiduciary relationship with the buyer, i.e. the buyer becomes the principal and the vendor the third party. Buyers, who normally spend more time with an agent than sellers, may feel more comfortable with this arrangement. The agent would be free to assist the buyer in searching for a suitable property, and in areas of discovery relating to a particular property. They would also feel less constrained in offering advice and consulting services on a range of peripheral matters such as finance, investment and property appraisal. Conflicts of interest and the agent's exposure to liability could be considerably reduced. Total transactional costs should not vary, with the major cost, the commission, simply being transferred to the buyer leaving the negotiating process and the ultimate property price predominantly unaffected by the shift of payment. In circumstances where a buyer's agent works through a seller's agent, rather than directly with the vendor, arrangements could be made for one commission fee to be split between the two agents. The appointment of an agent by the buyer also leaves the 'one master' theory of agency law undisturbed, and may well be a better fit. Conflicts of interest, which arise where the seller's agent and buyer's agent in a transaction work from the same office, may need to be resolved. One possible solution would be to establish a set of rules similar to those applied where two clients use the same lawyer.

The second proposed alternative is a dual agency arrangement where one agent is appointed by both buyer and seller. The agent adopts the role of 'middleman' or intermediary, a role that has often been assumed in practice in the traditional agency relationship. Agents "...must often seek compromise and concessions from both parties in order to affect the sale, actions that may be at variance with the agency relationship presumed to exist with the seller" (Marsh and Zumpano 1988, p 152). Facilitating, mediating and negotiating are natural skills possessed by real estate agents and they use them frequently. Marsh and Zumpano's findings are therefore not surprising - that the perceptions and expectations of buyers and sellers and the actual performance of the agents themselves are often at variance with the prescriptions of agency law. As already acknowledged, at least part of the legal problems facing the industry arises from buyer and seller confusion over the actual role of the real estate agent. Representing both parties may merely be acknowledging customary practice currently applied in the traditional environment and may reflect the most effective use of a real estate agent's natural skills. In addition, court decisions now bind the agent to act in the best interests of the seller whilst not acting contrary to the interests of the buyer. In other words the agent is already required by law to act as steward of the transaction and to 'professionally manage' the sale process. Therefore, acting for both parties may be formal recognition that the balance of the law has now substantially changed to ensure protection for both participants in the real estate transaction. Whilst there are few models of this arrangement available for study, a dual

agency relationship would obviously be at odds with the ‘one master’ theory of agency law which exists in most Western jurisdictions. The problems associated with potential conflicts of interest would need to be addressed in law before a move to widespread adoption of the arrangement in the marketplace. Commencing with the requirement for mandatory full disclosure² to both parties, a set of legal rules would need to be established to meet the expectations of market participants and to provide certainty for those buying and selling real estate through an intermediary.

Summary and Conclusions

Historically real estate agents have acted for the vendor, who is the principal in the contract of agency, and in the sale transaction. The contract of agency with the vendor is one of utmost good faith where the agent stands in a fiduciary relationship and owes undivided loyalty and full disclosure to the principal. In common law the agent ‘stands beside’ the principal, is bound to follow the principal’s instructions, to vigorously pursue a sale and not to divulge confidential information to a third party (normally the buyer). The third party (the buyer) clearly stands outside this special relationship, is expected to rely on their own judgement, and is subject to the principle of ‘caveat emptor’ (let the buyer beware). The buyer is protected from false representations or being actively misled by the agent and, when the agent acts wrongfully towards a third party on the express instructions of the principal the principal is jointly and severally liable. The nature of the three party relationship, and the special bond between agent and principal, has had the full recognition and protection of the law. With the arrival of the age of consumerism, legislation has been passed in most Western jurisdictions to strengthen the rights of buyers and this has had the effect of seriously disturbing the common law relationship which has existed between the three parties.

These changes, which have been evolving in Western countries over the past thirty years, have come relatively late to New Zealand. New statutory laws and court decisions have placed real estate agents on the horns of a dilemma in that the rights of the principal have been left firmly in place whilst a range of stringent rights for the buyer have been added. Agents are now required to act in the best interests of their principal, the vendor, but must also act in the interests of the third party, the buyer. Under current statute law (Fair Trading Act 1986) vendors in New Zealand are, in effect, exempt from liability to third parties, even when that liability results from actions of an agent acting under instructions from the vendor. In these situations the agent is now normally the sole party to carry liability. Real estate agents practising in this new legal environment can find themselves in untenable situations where it may be impossible to meet the expectations of both parties to the sale transaction. A wide range of proactive and reactive strategies are being developed by real estate agents, and their professional bodies, to respond to these increased legal responsibilities.

The growing complexity of the “one master’ theory of agency law, and to the traditional approach of the vendor as principal, may lead to the evolution of alternative client/customer relationships to meet changing market needs and expectations more effectively. One example is the development of the buyer agency, already prevalent in parts of the United States, i.e. the buyer becomes the principal and the vendor the third party. Another is the potential for dual/agency, where the same agent acts for both seller and buyer. Whilst this arrangement

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In the absence of full disclosure an agent is currently prevented in common law from entering into a fiduciary relationship with both parties.

would represent a radical departure from the 'one master' theory of agency it would more accurately reflect common practice in the marketplace. Both buyers and sellers are familiar with agents acting as 'middlemen' and intermediaries, despite the apparent conflict of interest, and they may well be comfortable with the more practical approach.

The rules of liability, and the balance of responsibility which real estate agents owe towards market participants, are unlikely to remain static. They are closely related to increased expectations from consumers and a growing trend towards a litigious society. Real estate agents, aided by their professional representatives, and academic researchers, must continue to be vigilant in exploring and developing a range of proactive responses to ensure that the changing needs of society, and of buyers and sellers of real estate, are more effectively and efficiently met.

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