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Real Estate Transactions Seventh Edition

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Seventh Edition

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Preface

This book is intended to supplement law school elective courses in real estate conveyancing and transactions, mortgages and finance, and business planning and investment in real property. First-year students whose basic property course deals with real estate transactions will also find many parts of the book helpful. *Real Estate Transactions: Examples and Explanations* covers basic information needed for these courses and deals with the issues and leading cases likely to be discussed in class. It is divided into three parts: transactions, financing, and business planning.

Real Estate Transactions: Examples and Explanations begins with simple residential transactions and proceeds to more complex commercial transactions. It discusses the various actors who play a role in these transactions and presents them chronologically in the order in which they are likely to appear. The book traces the general organization of the leading casebooks on the subject.

Explanations of the examples (or problems) are provided for your convenience. After reading the examples, I recommend that you pause to think about your answer. You will profit from considering your own explanation, and you may enjoy arguing with mine. This kind of mental engagement is the real value of a book like this.

The seven editions of this book have been prepared during very different real estate markets. Many of the additions to the current edition reflect recent changes in the marketplace, particularly in the mortgage market.

This edition retains the most valuable features of its predecessors: condensed documents of various types, abridged statutes, and, above all, example after example. New examples emphasize trends in the current market. Examples from the previous editions that proved especially instructive have been retained.

My hope is that this book will help students to understand the issues and cases that make up real estate transactions, a fascinating and basic field within the general practice of law.

Barlow Burke
March 2021

Acknowledgments

A teacher is constantly learning and relearning the subject he teaches. I am grateful, first, to the authors of the many casebooks I have used over the years, as well as the authors of the treatises I've consulted, and of the numerous law review articles and cases I read to stay current. Second, my students' comments and questions in class have proven to be a wellspring for this book. I thank them all, too numerous to mention. Third, all my research assistants over the past decade — Julie Richmond, Catherine Brown, Les Alderman, Stephanie Quaranta, Catherine Thomas, Meryl Eschen, Michael Vila, William Weaver, Stacy Pine, and for this edition particularly, Brad Jensen — have pursued the answers to my questions with steady and patient research. Finally, Aspen Publishers has provided solid encouragement and excellent support. I thank all.

CHAPTER 1

American Conveyancing and Professional Responsibility

An attorney's practice in this country is likely to present matters arising in residential purchase and sales and/or commercial transactions involving real property. In the former capacity, the real estate attorney functions amid the work of many other actors—brokers, property inspectors, surveyors, mortgage lenders, appraisers, title abstractors, and title insurance companies, to name a few of the principal ones. Succeeding chapters will deal with each of these. Often residential work comes to the attorney's attention in mid-transaction—most significantly, after the contract of sale has been executed. Thus, often in residential sales practice, the attorney's role is limited by the contract and is limited to interpreting the contract as the executory period proceeds.

In commercial real estate transactions, the attorney's role is similar to that of an attorney in other areas of corporate or commercial practice. The attorney is interested in limiting the risks the client faces in proportion to the rewards the client expects. This entails a balancing of business and legal concerns in the context of reviewing the title of the property to be purchased, selecting a note and mortgage, and negotiating their covenants. The following documents detail the typical transaction:

1. The broker's listing agreement. It is the real estate broker's employment contract and defines the terms of the broker's agency with the vendor. The purchaser in a commercial transaction may employ a broker as well.
2. The contract of sale. Whether the attorney helps negotiate the contract or is given it only after the fact to interpret and implement,

the contract is the product of two English statutes: the Statute of Frauds (1677), one of whose sections required that the transfer of interests in real property be written, and the Statute of Uses (1535). The latter statute validated a new form of future interests, known as executory interests. (Thus the period of time between the execution of the contract and the closing is known as the "executory period.") Americans have taken the common law contract of bargain and sale, added the idea of an executory contract as it developed in the eighteenth century, and adapted it for use in this country—that is, filled it with conditions, contingencies, and "subject to" clauses. In some regions of the country, escrow instructions implement the contract.

3. The note, along with a mortgage or deed of trust. These provide the two financing instruments—an IOU and a security agreement for the loan—necessary for either the vendor or a third-party (often institutional) lender to provide a loan to finance the purchase of the property.
4. Closing documents. The deed from the vendor to the purchaser, plus a welter of documents that (1) account for the money changing hands in the course of the transaction, (2) protect the lender from defenses to the note or mortgage, (3) protect the purchaser's title as offered by the vendor (e.g., an attorney's title opinion or a title insurance policy), or (4) indicate compliance with various state and federal consumer and regulatory statutes. Americans do not use the common law forms of conveyances. Instead we have adopted statutes authorizing the transfer of title to real property by simple forms for deeds and authorizing the recording of all documents transferring an interest in realty on public land records. The documents memorialized on the public record are available later as evidence of the history of the title transferred.

An attorney may be involved in the preparation of all of these documents, ranging from filling them out to drafting them completely. Whether in residential or commercial work, the attorney is arranging a transaction that both parties consider will work to their benefit, adjusting the risks to be commensurate to the benefits expected by the client. The work is not adversarial in the same sense that litigation is—although, as changing markets and circumstances produce new risks for the parties, it can come to that. It is when markets and circumstances change or unanticipated risks arise that professional responsibility issues also are likely to arise. Those issues are the subject of the next section.

With the Statute of Uses providing a legal mechanism for executing contracts of sale and the Statute of Frauds requiring written contracts and deeds, Americans added another new element to their conveyances—the public record, from which vendors could show title to their purchasers.

The system of public records, maintained typically at the county or city level, relies on each purchaser of an interest in real property promptly recording it.

The earliest purchasers were interested in only one interest or estate in real property — the full fee simple absolute. Anything less felt reminiscent of the feudal relationships that Americans had left the Old World to escape. Thus early American legislatures enacted legal reforms to make the fee more freely alienable with regard to feudal interests: They abolished primogeniture, abolished the common law presumption for the joint tenancy with a right of survivorship in favor of the tenancy in common, and limited the common law marital estates of dower and curtesy to land seised at death — all done to make real property free of familial interests. Yet at the same time, they often viewed land as a commercial commodity, so state legislatures created restraints on the fee for commercial interests (such as mechanic's liens and new forms of mortgage liens) — interests unknown in England. Thus, our conveyancing simultaneously became both simpler and more complex.

While the public records reflected the state of the title, it yielded its answers as to what a particular vendor has to transfer with some difficulty. With the passage of time, as the records came to reflect a greater number of transfers, this difficulty became extreme. In theory, the records had to be searched on every transfer back to the sovereign — the proprietor of the colony, the king, or the state or federal land office patent. Eventually, on the mistaken notion that the Statute of Limitations on every conceivable common law writ had run after 60 years, that length of time came to be the period of search for real property titles. However, in states where land was obtained out of the public domain of the federal government (and so not subject to state statutes of limitations), title is often still searched "back to the sovereign."

Attorneys quickly acquired the skills necessary to search titles, and the law of conveyancing and title search became their domain. Of course, attorneys were not available everywhere, and where they were not, deeds drafted by laypersons often became confused. If a deed of bargain and sale (or, in New York, a deed of lease and release) was not used, the lay conveyancer and often the attorney threw in every legal verb that came to mind. Thus the vendor would "give, enfeoff, grant, convey, bargain and sell, lease and release, covenant to stand seised, assign and transfer" whatever property it was that was changing hands. This potpourri of legal verbs eventually came to mean "what I (vendor) have, I transfer it to you (purchaser)." Thus the warranty-free quitclaim deed was recognized. This type of deed is another American conveyancing invention intended to make a title more freely transferable.

A title search is necessary because every purchaser wants to know not only that the vendor is entitled to transfer the title but also that the title is "marketable"—that is, is transferred in such a state that it in turn can be transferred to a future purchaser. Even for a quitclaim deed, therefore, the law read a standard of marketable title into every contract of sale as an implied term. The title-searching attorney's job is to determine whether the vendor is eligible to transfer the title and whether there are any liens or encumbrances attached to it. The attorney's notes on these two issues are gathered together and arranged chronologically into an "abstract of title."

As attorneys did more and more title searches, they accumulated stacks of abstracts as their work product; these abstracts had value if and when they handled a later transfer of the same property. Some firms hired nonattorney employees as title searchers. Thus began the practice of having a lay abstractor search the title and an attorney review the resulting abstract and issue an opinion on the state of the title.

The next question was what to do about abstractor negligence. The possibility of an expensive and time-consuming lawsuit always loomed. Title insurance responds to this threat. Early policies were designed to substitute for a vendor's deed warranties and to provide a remedy for abstracting mistakes, as well as to protect against interests that the abstractor could not discover by searching the public records. Thus title insurance policies protected against both record and nonrecord defects. This double coverage became their great selling point. By the beginning of the twentieth century, title insurers were established as abstractors, reviewers, and insurers of titles in many large urban areas. In rural communities, attorneys and abstractors continued to do the business of conveyancing as before. Today, however, the conveyancing industry evidences three patterns for attorney participation. Attorneys function as title searchers, title reviewers, or employees of title insurance companies.

This pattern of participation still means that attorney involvement comes usually after the contract of sale is executed and the executory period under way, at a time when real estate brokers, lender mortgagees, appraisers, property inspectors, and title insurers—and, in some regions of the West, escrow agents—are also involved. Some attorneys bemoan this lateness, arguing that the provisions of the contract of sale determine what will happen during the executory period and that consequently, vendors and purchasers need legal advice while they are still able to affect the provisions of the contract.

In the twentieth century, the reform of American conveyancing patterns was statutory. One generation of statutes took; the other didn't. First, the failed effort: From the 1890s to the 1930s, more than 20 state legislatures enacted Torrens, or title registration, statutes. Under them, a title search was performed, and a certificate of title reflecting the state of the title was issued; thereafter, a transfer of the certificate, amended to reflect new less-than-fee interests, was a transfer of the title. The states enacting such laws acted with many jurisdictions around the world to implement some versions of a title registry (as opposed to a public records office). In this country, this reform did not take. For many reasons, the Torrens statutes were repealed or fell into disuse during the 1930s, and a conveyancing reform that had proved efficient for many countries around the world was here discarded. However, a title registry is still available in a few states as an alternative form of conveyancing.

The problem of title searches becoming increasingly longer and ever more mired in paper did not go away. After World War II, the process of searching title, no matter how it was conducted, needed further definition, and a second generation of statutes, less comprehensive than the Torrens acts, followed. The problem was this: As time passed, title searches covered a longer and longer period of time and involved ever more diverse types of interests. The need to shorten and simplify them was addressed by two types of state legislation. First, Marketable Record Title Acts shortened the period for the search from the 60-year, common law search to periods of 30 to 40 years. Second, statutes of various types enacted shorter statutes of limitations for encumbrances on the fee simple (particularly for old mortgage liens) and for curing defects appearing on the face of documents on the public records for a certain length of time. Attorneys supported enactment of these two types of legislation. These second-generation statutes are still with us.

PROFESSIONAL RESPONSIBILITY

Real property transactions generate a disproportionately great number of malpractice claims, perhaps in part because investigations are conducted in hindsight. Absent a client's informed consent to an alternative arrangement, attorneys representing clients must maintain the confidences and secrets of the client and exercise "independent professional judgment" on their behalf, judgment free of self-dealing and dual representation. This requires that no representation of a client be undertaken if it will be directly adverse to the interest of another client unless (1) the attorney believes reasonably that the representation otherwise prohibited will not adversely affect the relationship with the other client and (2) each client consents after consultation and disclosure of all relevant facts. *See* Am. Bar Assn., Model Code of Profess'l Responsibility (first adopted in 1969 and the basis for several states' ethical rules); Disciplinary Rule (DR) 5-105(A)-(C)), and Canons 4 and 5 (EC 4, 5-1). Self-dealing is prohibited absolutely, and there are, moreover, reasonable arguments for abolishing dual representation outright.

The structure of a real estate transaction requires constant communication—a virtual monologue with the inexperienced client and communication about new aspects of the transaction with experienced ones, from the engagement letter forward. This is so because the transaction culminates in a closing, or the close of escrow, and a client should never experience any surprises when sitting at the closing table. In order to satisfy themselves about potential problems, levels of knowledge, and conflicts of interest in the transaction, attorneys need to assess existing representations for conflicts—their own, their partners', and their firms'—both before and after undertaking the representation. When conflicts are reasonably foreseeable, and before they arise, attorneys have a professional obligation to avoid them, even if that means withdrawing from the representations and the transactions.

Moreover, because attorneys often represent developers and mortgage lenders on a continuing basis and vendors and purchasers of property on an irregular basis, they must diligently watch for potential conflicts of interest.

Enforcement of these rules is uneven, but that is no reason to ignore their precepts. They should be incorporated in an attorney's ongoing duties. Some believe that every real estate transaction should involve two attorneys, one for the vendor and another for the purchaser, but in the many transactions in which the purchase price is not paid in cash but is instead financed by a third-party lender, at least one other party needs representation. In fact, a third-party lender seldom goes unrepresented, and indeed in some regions its attorney is often the only attorney present, handling the closing of the title as well as the lending transaction. This raises an interesting issue: Does an attorney violate any rule of professional responsibility by representing both parties to the transaction? No. Merely representing both parties, except in negotiating the contract of sale, does not violate any rule so long as the attorney meets the requirements of consultation with the client. *See ibid.*, DR5-105(C).

In the following short examples, assume that the attorney has checked and found no past conflicts of interests in the representations of two parties, vendor and purchaser.

EXAMPLES

Examples

Example 1a

Once hired by one party, could an attorney obtain a written consent from both parties at closing, and satisfy DR5-105?

Explanation

No. The timing shows conclusively that the parties consented too late in the transaction.

Example 1b

Could an attorney have obtained the same consent at the execution of the contract of sale?

Explanation

No again. Why? Because the rule requires that there be a consultation. Simply signing the consent form does not meet that requirement.

Example 1c

What sort of consultation is required? Suppose an attorney once hired by one party consulted with both together and explained the potential problems to them. Is that sufficient?

Explanation

Maybe not. A separate meeting with each client may be required. When a vendor is first represented, there must be a separate meeting with her to obtain her consent to multiple representation; with her consent, then a separate meeting with the purchaser is in order.

Example 1d

If the vendor and the purchaser in the prior examples proceed to close the transaction, suppose the attorney does not attend and instead sends her very competent paralegal. Is she violating the canons or encouraging the unauthorized practice of law?

Explanation

Yes to both questions in some states like South Carolina but not in most states (*see, e.g.*, North Carolina Ethics Opin. 9 (02 FEO 9), issued Jan. 24, 2003 (a nonattorney assistant may identify the documents at the closing, even with no attorney present); and N.C. Gen. Stat. §84-2.1 (defining the practice of law)).

Example 1e

Suppose the vendor and purchaser ask the attorney at the closing to act as an escrow agent for a fixture on the property when the parties disagree on whether it was sold. Is this allowed?

Explanation

Sometimes. Some cases make the agent only liable to carry out the terms of the escrow, so they had better be clear and in writing. Other cases say that the agent is the fiduciary of each party to the escrow.

Example 1f

Suppose the attorney, practicing in a jurisdiction that makes the post-closing escrow agent a fiduciary of the parties, breaches a fiduciary's duty of loyalty to one of the parties. Is breach of that duty proof of malpractice?

Explanation

No, *see* Dunn v. Leepson, 830 A.2d 325 (Conn. App. Ct. 2003). First, a breach of fiduciary duty is self-proving, but malpractice will require expert testimony. Second, the rules of the ABA canons and rules do not form a basis for civil liability; they are meant to police the profession.[1]

Real estate attorneys often say that they are expert in the processes required to complete a transaction, but that in many situations, what they know is to step down the office hallway to consult with their more specialized partners.

Example 2a

You are representing a developer in a complex real estate transaction. You see a looming tax problem for the developer that will prevent the deal from closing. You consult your firm's tax partner by e-mail. In later litigation over the transaction, is the e-mail discoverable?

Explanation

Be careful what you write in an e-mail, but many courts do recognize an intrafirm attorney-client privilege generally.

Example 2b

Your client in the previous example is sued by the mortgage lender in the transaction. You now discover that a partner of yours has represented the developer in the past and never ended the relationship with him. Is your e-mail discoverable?

Explanation

Yes, it is. The conflict of interest of you and your firm abrogates the attorney-client privilege. *See* Douglas R. Richmond, Law Firm Internal Investigations: Principles and Perils, 54 Syracuse L. Rev. 69 (2004). In addition, once the e-mail is disclosed, the tax partner's opinion attached to the e-mail is discoverable, too.

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1. A controversial issue splitting the courts is whether an attorney's ethical violation may be admissible as evidence in a malpractice action against him, and a real estate transaction gone wrong provides the leading case for inadmissibility. *See* Hizey v. Carpenter, 830 P.2d 646 (Wash. 1992), discussed at 109 Harv. L. Rev. 1102, 1104-1106 (1996). But *see* Lazy Seven Coal Sales v. Stone & Hinds, P.C., 813 S.W.2d 400 (Tenn. 1991) (admissible). The traditional rule is one of inadmissibility, justified as protecting attorney-client confidentiality and fostering the attorney's duty to serve clients zealously.

Example 2c

Once the partner's opinion is disclosed, is the metadata (when the e-mail was created, versions and revision history, the server where saved, comments, etc.) also discoverable and subject to potentially embarrassing further discovery and cross-examination?

Explanation

It might be discoverable, but now the shoe is on the other foot: Mining such data presents an ethics question in some states. State professional responsibility opinions are split on such mining. It is not unethical in some states. *See* Md. State Bar Ethics Comm'n, Op. 2007-09 (Oct. 16, 2006) and ABA Standing Comm. on Ethics and Prof. Respon., Op. 06-442 (Aug. 5, 2006). But it is unethical in New York and Florida. *See* e.g., Flor. Bar Prof. Ethics Comm'n, Op. 06-12 (Sept. 16, 2006). Lesson: Send e-mails as a PDF, which has much less metadata, or use software that will strip out the metadata from the transmission. Generally, an attorney can be disbarred for mishandling someone else's privileged information. *See* Richard v. Jain, 168 F. Supp. 2d 1195 (W.D. Wash. 2001). So consult with a client, but don't send an e-mail or leave a voicemail with anything other than a "come see me" message.

Once an attorney is found guilty of professional malpractice, he may not retain the complaining client's fee when asked for its return. Disgorgement of fees is the rule everywhere. Only when the client seeks additional compensatory damages does the client need to show that the malpractice proximately caused the damages claimed. Otherwise, disgorging the fee follows the showing of a breach of professional responsibility. When an attorney is paid by the hour and a client asks for the return of the fee, cases split on whether the attorney must return only that portion of the fee charged after the malpractice or all fees charged for work before and after the malpractice occurred. If proximate cause need not be shown, the better view is that the entire fee must be returned.

In the following longer examples, we go from a single attorney to a law firm setting, as follows.

EXAMPLES

Examples

Example 3

You (Abe Abel) graduated from law school last year and are very busy practicing law in a two-person firm with Nancy Willing, an attorney with ten years of practice experience. Dick and Debbie Developer, local developers and friends of Nancy, are the sole owners of Blackacre Company, a single-asset entity that they've established to subdivide and develop a large land parcel (the Company's sole asset, acquired from Dick) in your community.

Dick asks your law firm, Abel and Willing, to represent the Company in a real estate transaction in which Worldwide Realty, a large, out-of-state, national residential builder, will acquire an interest in the Company and become Developers' partner in building homes on the parcel. Will you accept the representation?

Explanation

You may, but you first need to consider three matters: your competency, your and your firm's conflicts of interest, and a letter of engagement or retainer agreement, often called the three Cs: competency, conflicts, and cash.

The first is your competency. Attorneys duly licensed to practice law are assumed competent to handle matters brought to them. For this reason, professional rules about this matter are often statements phrased negatively: e.g., an "attorney shall not handle matters that he knows or should know he is not competent to handle. . . ." This assumption holds even when an attorney's learning curve is a steep one. *See* Am. Bar Assn., DR 6-101(A)(1) (2004). A newly admitted attorney may be as competent as a long experienced one. "Preparation adequate in the circumstances" (Am. Bar Assn., DR 6-101(A)(2)) and skills, not specialized knowledge, are the measure of competence.

As you read this example, you probably thought that it would be nice for a local practice to have a national client who might bring in more future business than any local client would. In order to avoid a charge of unauthorized practice of law, the national out-of-state business will probably hire local counsel. *See* Birbrower, Montalbano, Condon, & Frank, P.C. v. Superior Court, 949 P.2d 1 (Cal. App. Ct. 1998). Local counsel will have similar tempting thoughts. Your competency creates opportunities, not the other way around, so stay focused on it. For example, if you are very busy already, you have to think about how you will meet your obligation to represent a new client adequately.

The second matter to consider is whether you or your firm has any conflicts of interest. Larger firms have in-house, sometimes full-time, counsel to make decisions about this matter, but you will need to talk to Nancy Willing about it.

Example 4

In your discussion with Nancy, you learn that she once worked as an in-house counsel for Worldwide Realty and is well acquainted with Worldwide's acquisition of an interest in local developers' projects, although during her employment by Worldwide it never showed any interest in any of Dick and Debbie's projects. Is your firm disqualified from representing Dick and Debbie?

Explanation

Yes, it is. When any attorney would be required to disqualify himself under any disciplinary rule, her firm and all its partners and associates are disqualified as well. DR 5-105(D). If the rule were not one of imputed disqualification, what's to prevent Nancy from becoming local counsel to Worldwide while you represent Dick and Debbie? That would be an impossible situation, in which the confidences of each client would be imputed to everyone in the firm. However, Nancy's prior experience may be the very reason that your client came to you and your firm about this. Nancy may know (not in a transaction-specific way, but generally) how Worldwide approaches this type of transaction as well as what's important to it, and what's not so important. Nonetheless, her duty to preserve the confidences and secrets of a former client continues after the termination of her employment, except when the relevant client information is in the public domain. Disqualification from later representation of adverse parties is intended to protect present and past clients alike. However, after its disclosure, consent to and waiver of this disqualification is possible under Model Rule 1.6 (requiring consent only after consultation) and DR 5-105(C). Advance waiver of conflicts of interest is possible so long as the client was given all the advance information about the conflict that is reasonably necessary to make an informed decision about it. Under some state professional responsibility codes, screening of the matter from Nancy's participation in the work and the fees is possible, but in a two-person firm, that may be difficult in practice and create the appearance of improper conduct in any event. Further, if your own learning curve on the matter is steep, Nancy's supervision and advice may benefit you to the point where screening, even if possible, is not desirable.

So there is a lot to discuss with the client before dealing with the third matter—a retainer agreement. This agreement should be clear, defining the scope of the work and the terms of the firm's employment, including a cash retainer and other fees and charges. Many jurisdictions require that this agreement be in writing. Having it written is a prudent practice in any event.

Example 5

In the previous example, who is your client?

Explanation

Dick asked for the representation, but he and Debbie have formed Blackacre Company for the project, and so the client might be Dick individually, or the entity, the Company itself. Model Rule 1.13. Dick's interests may during the transaction become adverse to the entity's. What if in the future you discover that the land parcel was purchased by Dick from a vendor who has the right to rescind the Company's purchase of its sole asset because Dick acted fraudulently? Your future representation of the Company would give you a duty to disclose your discovery to Debbie and, with the client's consent and in the case of fraud that is likely to produce substantial financial injury, to Worldwide as well. *See* Model Rule 1.2(d). Otherwise you would be assisting in the perpetuation of the fraud. Without a disclosure to Worldwide, your other option would be to withdraw from your representation of the Company, and then you would have the problem of whether your withdrawal can be explained to Worldwide—a matter on which states have different rules. To the Company's successor counsel, no explanation is required. *See* Model Rule 1.6. Receiving no explanation, however, will set successor counsel on a quest to secure further waivers of confidentiality in order to protect his own professional standing. *See* Model Rule 1.6(a). If successor counsel went ahead, but learned of the fraud later, after the transaction with Worldwide was closed, his duty to protect the confidences of his client would trump any duty to disclose to Worldwide. But think about it: What attorney would want to be in such a position?

Given all of the foregoing considerations, the prudent as well as the professionally responsible course of action is probably to assume that Dick is now the client and the entity Blackacre Company is the proposed client. Dick will have to consent to this new, possibly adverse, representation. Likewise, if a multiple representation is proposed for Dick, Debbie, and Blackacre Company, they will have no right to confidentiality *inter se*. All consent and waivers (of Dick, Debbie, and Worldwide) must be obtained in advance of the letter of engagement, in separate documents. Likewise, since you are presently very busy, any new professional arrangements that the firm of Abel and Willing will have to make—temporary attorneys, new associates or staff, etc.—will have to be fully disclosed and explained to the client beforehand. *See* Model Rule 1.2(a) (requiring an attorney to discuss with a client how a client's objectives will be met). The letter will have to define the client as "Blackacre Company, and not any or all persons (including Dick) interested in the Company." Representing the Company also may have the advantage of forestalling conflicts when you seek to represent other components of the real estate industry (that is, brokers, title insurers, etc.) in the future.

Example 6

After Dick and Debbie execute a written retainer agreement for Blackacre Company, Fred Dolittle, of the firm of Dolittle and Stahl, is retained as local counsel for Worldwide Realty. Fred is approached by the consumer fraud division of the state attorney general's office investigating the fraudulent procurement of the land parcel by Blackacre Company. May Fred speak with Dick about this matter?

Explanation

Not without notifying you first and receiving your permission. Model Rule 4.2 (prohibiting communication with a person represented by counsel). Fred need not disclose to you, unless asked, why he needs to speak to Dick. If you ask why, Fred may disclose the reason; in doing so, he may not make a false statement of any fact material to his request. *See* Model Rule 4.1. Your representation of Blackacre Company, or your joint representation of Dick, Debbie, and Blackacre, requires your attendance. Even if your representation ended of Blackacre Company ended and it was unrepresented, Fred still could not proceed to meet Dick without first informing him that he represents Worldwide and is not a disinterested party. *See* Model Rule 4.3. At the start of the meeting, advise Dick anew that you still represent Blackacre either solely or jointly and that at some point during the meeting its interest and his may become adverse, at which point Dick should be advised to retain independent counsel before proceeding.

Example 7

Blackacre Company's development of its residential subdivision proceeds on time and on budget until the first houses are about to be conveyed to their contract purchasers. Then an environmental law violation is discovered. It will cost $500 per house to fix. The purchasers are unrepresented by counsel. What should you do?

Explanation

Even if you are sure that the contracts allocate the risk of this violation to the purchasers, your letting them close their transactions is imprudent. They are not your clients, but generally you may be liable to a nonclient if the client intended that your work benefit the nonclient and you know or should know that he will rely on your work. The duty of due care that then arises applies only when it does not interfere with the attorney's obligations to the client. *See* In the Matter of the Estate of Drwrenski, 83 P.3d 457, 464-467 (Wyo. 2004). Reasonable arguments may be made that this rule applies to these purchasers. Blackacre Company by contract means to convey a benefit on them—the houses—and they are unrepresented at meetings with you (their closings). The very events (the closings) will, after they are all over, become evidence of reliance. One way to handle this is to think how you would behave if any of them showed up with an attorney to represent them: Early, preclosing disclosure of the problem, and a proposal to share the costs of fixing the violation, seem in order. Proceeding otherwise may even harm your client, subjecting its subdivision to litigation, so there is a good argument that your preexisting duty to Blackacre Company will not be breached by such a disclosure and proposal. Liability of attorneys to nonclients runs counter to many of the traditions of our adversary system, so state rules vary—and should be checked.

CHAPTER 2

Real Estate Brokers

The first person any prospective vendor of real property is likely to consult is a real estate broker. Today a broker is likely to specialize in selling particular types of property — residential or commercial, sales or rentals, and so forth. An agreement to employ a broker is called a listing agreement. A short form of such an agreement appears a little later in this chapter. It is often promulgated in a standard format by the local trade group representing brokerage firms. In most jurisdictions, this agreement must be in writing, either because the jurisdiction's Statute of Frauds applies or because of a special statute or regulation in the law governing brokers.

For his services, the broker receives a commission computed as a percentage of the selling price of the property. Because the broker is normally employed by the vendor, he is usually considered to be the agent of the vendor in the subsequent transaction; but many purchasers hire a broker, either to search for property of a specific type or to represent her during the course of a transaction. Each party to a commercial lease, for example, often hires a broker to oversee lease negotiations. In this chapter, we will deal with the broker's role in the purchase and sale of real property.

An agent or broker usually employs associate agents or brokers, often known as salespersons, who do most of the actual selling, often for a set percentage of the commission. Often the listing broker is not the selling broker or salesperson, which sometimes causes the prospective purchaser to think that the selling broker, salesperson, or firm is working for her. Not so. The selling broker is typically the subagent of the listing broker, and the selling salesperson is the subagent of the selling broker. Confusing perhaps for the purchaser, but think of it this way: The vendor is the principal, the listing broker is her agent, the selling broker is the subagent of the listing broker, and so on until the final contact is made, by the ultimate sub-subagent of the vendor, with the purchaser. These relationships form a chain of agency and subagency reaching to the purchaser, who is (legally) on her own. For purchasers, one cannot lay too much stress on those last three words — on her own. Hopefully, too, she is on her guard, warily evaluating the words of the broker or salesperson presenting properties and describing their features. Some commentators have found this arrangement misleading when viewed from a purchaser's perspective.

EXAMPLES

Examples

Example 1

O, the owner of Blackacre, is anxious to sell this choice parcel of real property. Real estate broker B tells her that P is interested in purchasing it and that B would be happy to have a listing for it.[1] "Forget it," says the owner, who nonetheless does not forget what B said about P. The owner negotiates directly with P for the sale of Blackacre and then executes a contract of sale to transfer Blackacre to her. Can B recover anything for the information that he gave the owner?

Explanation

Only if the owner and B had a prior relationship of mutual trust and confidence or if the owner expressed a desire to help the blurting broker in his business would B have even a chance of a recovery. There is no basis for an implied contract, and no written one exists either. In some jurisdictions, the special statute of frauds for listing agreements would also be a bar to B's recovery. The lesson is that B should obtain a listing of the property before blurting out the information that is the broker's stock in trade.

THE LISTING AGREEMENT

A listing agreement is the real estate broker's employment contract. It is typically in writing. Indeed, in most states, a writing may be required either by a special-purpose statute of frauds for such agreements or by regulation of the state regulatory agency in charge of broker licensing and supervision. With such requirements in force, it is also likely to appear on a standard and preprinted form issued by the local brokerage board or trade group. It must

1. In the examples in this chapter, O or V (for vendor) will be the listing owner, B the broker, and P a prospective purchaser.

usually identify the parties, the listed property, the commencement and termination dates, the sales price, and the commission. Consider the following, quite typical document.

LISTING AGREEMENT

I, Victor Vendor, agree to *employ the services* of ________________, a real estate broker duly licensed in the State of ________________, to list my real *property known as* ________________ with him, and to permit him to *sell* that property.

This listing *begins* on ____________ (date), ______ (year), *and ends* at midnight on ____________ (date), _______ (year). During this period, I promise to accept offers to sell the property for a *total price* of $________________, payable as follows: ________________________________

I agree to pay a commission of 6 *percent* of the total selling price when the property is sold by *the undersigned, or any other broker*.

This agreement is executed on ____________ (date), _________ (year), at ________________ (city), ________________ (state).

______________________________ ______________________________

Broker Vendor-Owner

Employ the services? What does that refer to? More particularly, what is it that the broker is promising to do? We know that the owner is promising a commission for whatever-it-is, but what is it? At a minimum the broker is making a promise to expend reasonable effort, in good faith, to procure an offer meeting the prospective vendor's terms. Beyond that, the listing agreements one typically sees are not specific. This raises the question of whether, at the listing's inception, it is a unilateral or bilateral contract. If it is the former, it is not binding on either party until the effort is expended—a *de minimis* effort won't do.

Listing agreements generally provide few details about the broker's efforts. In some instances—and from the broker's hopeful perspective—a phone call will line up a purchaser. In others, a month of open house Sundays won't do the job. In other words, the broker is playing the odds, hoping that over the whole of her accumulated inventory of unsold, listed properties, some will sell each month. Perhaps the services required of the broker should be spelled out in a listing agreement. A broker can be required to put a "for sale" sign on the property, advertise its availability for purchase, show the property at agreed times, and even accept a deposit (or earnest money) or a down payment in an agreed amount. Some of these things the broker will want to do anyway without being required to do so. A "for sale" sign, for example, really advertises the broker's firm—the more of them appearing around town, the better for the firm. Even though the broker will want to do most of these things, some things a vendor may want to do: holding the deposit, for example. Is it a good idea to let the broker do that?

Property known as? A legal description of the property is not needed to fill in this blank. This is a contract for personal services. It is not a contract or a conveyance of real property, so the legal description is not necessary. A street address will do. Simply because a legal description is not necessary, however, does not mean that it is not good practice to use one. This agreement is the first of many documents needed to generate a closing of the title. The use of a full description here might flesh out the intent of later documents or more formally be incorporated by reference into those later documents. Each of these documents might then be construed together to establish a conveyance of the property. Unless it is agreed otherwise, it is presumed that a fee simple absolute in the title will be sold and that the listing vendor warrants that he has good title.

Sell? This cannot mean literally that the broker is given the authority, via a power of attorney, to convey the property in the name of the owner. No, no—in early cases, in which brokers actually argued this, the courts rejected this notion. But is the property "sold" if a binding contract of sale is executed? Can the legal doctrine of equitable conversion be applied to it? Or is it sold when the title is conveyed, at the closing? Thus in this one simple word lurks the problem of timing the broker's right to a commission. A bit of drafting advice: Make sure the timing is clear!

In most jurisdictions, if the offer meets the terms of the listing agreement, the making of the offer is the time at which the commission becomes due so long as the broker has procured the purchaser and the latter is ready, willing, and (financially) able to purchase. There is no need for a contract of sale. But is this the common meaning of the word "sell"? *See* Tristram's Landing, Inc. v. Wait, *infra*, this chapter, holding that because a contract of sale had conditional language, it was not considered a sale.

Begins . . . and ends? That's it!? When the listing ends, it's over? What about the vendor who accepts a qualified offer the next day? What about the vendor who holds off accepting the offer in the expectation of not having to pay the commission? How should this problem be handled? As written, this agreement may stand as an invitation to vendor fraud. So most listing agreements provide that the listing is effective if the property is sold within (say) six months after the termination date to someone the broker introduced to the vendor during the listing period. This provision is known as an extension period provision. This period may end earlier than the specified time if the property is relisted with another broker.

Total price? Inclusive of the commission? Of any mortgage on the property? Again, clarify these matters.

Six percent? The percentage is seldom preprinted on a brokerage board standard form. It is something that the listing broker hastens to supply. Consent agreements in several price-fixing antitrust actions brought by the federal government in the 1970s prevent preprinting of the percentage. Some judicial opinions have inferred that a "usual and customary" fee is intended when this portion of the agreement is left blank. Negotiation over the fee is possible but, as an empirical matter, is seldom undertaken.

The undersigned, or any other broker? What type of listing is this anyway? Consider the section that follows.

The Types of Listing Agreements

Listing agreements typically fall into one of three main types: (1) the open listing, (2) the exclusive agency listing, and (3) the exclusive right to sell. An open listing is a broker's authority to procure an offer but reserves the owner's right to sell the property herself or to authorize other brokers to procure offers too. An exclusive agency listing is again a broker's authority to procure an offer, but it denies the owner the right to deal in a similar way with other brokers without paying the first broker the agreed-on commission. An exclusive right to sell listing has the same effect as an exclusive agency but, in addition, denies the owner the right to sell the property herself without incurring liability for the commission. Each of these three types of listings increases the number of situations that entitle the broker to collect a commission and, concomitantly, restricts the number of situations that assign the owner liability for the same.

There are other types of listings as well: The net listing is one. Here the broker agrees to accept as his commission any portion of the purchase price over an agreed-on figure. A considerable number of states have prohibited this type of listing.

The following problems will help you sort out the three main types of listings.

EXAMPLES

Examples

Example 2

Bill, a licensed real estate broker, hears that Peter is interested in purchasing Sam's residence. He tells Sam this and obtains Sam's signature on the following agreement, dated in January this year:

BROKER'S AGREEMENT

I agree to pay *Bill*, broker, a commission of 5% of the selling price of the following property, *my residence at 1234 Big Shot Way, Potomac, MD* if and when this property is sold by me to *Peter*.

____
Sam, Owner

Is this agreement a valid listing?

Explanation

No. It sets neither a listing price for the property nor a termination date for the listing, as required by many state regulatory statutes and regulations for brokers. A listing agreement is not merely an agreement to pay a commission; it is an employment contract for personal services.

Example 3

In the letter agreement in the previous problem, what if the body of the letter states:

> I agree to list the property below with Bill, broker, on an open listing basis for a period of ninety days from the date of this letter, and pay Bill any of the net proceeds over $5,000,000 of the selling price of the following property [thereafter the letter continues as above].

Explanation

This letter contains a termination date and arguably also contains a listing price. A 90-day listing period allows computation of a termination date measured from the date of execution. A 60- to 90-day period is standard for most listings. If the broker wants more time, the listing might be for (say) 180 days, but terminable by either party on (say) 15 days written notice. This would give the listing's effectiveness an outer limit — fulfilling the purpose of regulations requiring a termination date — but makes it subject to termination sooner. The change in the structure of the commission creates what the brokerage trade calls a "net listing." But the amount of the commission may be uncertain: There may be difficulties in defining what deductions the vendor may use to calculate the net proceeds of the sale, and so the agreement may still lack a material term. In addition, a net listing creates some conflicts of interest between the broker and the listing vendor. The broker may be less willing to discuss the fair market value of the property with the vendor and the broker is working for himself, rather than as the vendor's agent, on any sale over the stipulated price. To the extent that the broker is self-dealing, he is violating a longstanding principle of agency law. For such reasons, net listings are prohibited by the regulatory statutes governing brokers in many states.

Example 4

Assuming the agreement in the previous two problems is a valid listing, will Bill recover if the property is sold to Peter?

Explanation

No. A further issue is whether Bill expended any effort to procure the sale of the property to Peter. If the answer is no, then the further issue is whether the regulatory code for brokers requires that he do so. Many codes will require the expenditure of broker effort as a precondition to any entitlement to a commission. Assuming that it is valid as a listing, this is an open listing and so if more than one broker claims the commission, the issue of effort and which broker procured the sale will be all-important.

Example 5a

V lists her property with real estate brokers B1, B2, and B3 for sale at $100,000. B1 produces a customer at that price; B2 produces a customer at $110,000. V refuses to execute a contract of sale with B1's customer but does so with B2's customer. That latter customer suffers financial losses and cannot close the transaction. B3 then produces a customer at $95,000. V executes a contract with B3's customer and closes this transaction. All three brokers invoice V for a commission. What type of listing is involved here? And who should V pay? (This problem comes from Casner & Leach, Property 700 (3d ed. 1984).)

Explanation

Because the type of listing is not identified, the listing is presumed to be an open one. As to whom V should pay, the answer is all three: B1 because she first produces a customer satisfying the known terms of the listing. B1 is the only broker with whom V initially has a duty to deal, but V goes on and signs a contract with B2's customer. The contract is the best evidence that B2's customer is a presumptively suitable purchaser, which entitles B2 to his commission. B3's customer has the same status, only more so: That customer closes the transaction.

Example 5b

Would your answer change if B1 did not hold a real estate broker's license and instead is a salesperson?

Explanation

Yes. A broker's license is a precondition to filing suit for a commission. Further, salespersons hold licenses that contain a condition—that is, they generally cannot sue for a commission on their own behalf; rather, the broker who supervises the salespersons must sue on their behalf.

Example 5c

Would your answer change if B2 had agreed to share his commission with B4, an unlicensed broker?

Explanation

Yes, in many states. Agreeing to share a commission with an unlicensed person is grounds for denying the commission entirely, even to a properly licensed broker.

Example 5d

Would your answer change if B3's customer proposed that V syndicate the property and sell the resulting limited partnership shares in it to the customer?

Explanation

Yes. A limited partnership interest is personal property, not real property. A broker may only deal in realty as defined in the regulatory code, and when the broker steps beyond the bounds of code-authorized conduct, he or she forfeits the commission. A contrasting case might be a corporate vendor listing its real property assets for sale, then transferring a controlling interest in the corporation to a prospect produced by the broker; in this situation, a commission would be due.

Example 6

V orally agrees to list her farm, Blackacre, with B, who then advertises the farm for sale and makes contact with several prospects. V then notifies B that she is trying to sell the farm herself and a week later executes a contract of sale with P1. B then produces a contract executed by P2 to buy the farm for a higher price. V and P1 close the first contract. B sues V for a commission. What result?

Explanation

Judgment for V. Absent a written listing or an express agreement to the contrary, most courts will construe a listing as open, which has two characteristics relevant here. First, the B-V agreement is an agency agreement but not an exclusive agency—it is not V's agreement to deal with only one broker. Second, in an open listing the vendor retains the right to sell the property herself without liability for a commission. This implied term of the listing is made express by V's notice to B. Finally, the listing agreement cannot be construed as just an agreement to sell for the highest price offered. A vendor can refuse a contract tendered by a broker for many reasons, price being just one of them.

Example 7a

V executes a brief but enforceable[2] listing agreement granting B, a broker, an "exclusive right to sell" V's farm, Blackacre. During the listing period, V executes a contract of sale for the property with P. B sues V for a broker's commission. What result?

Explanation

Judgment for V. The negation of the vendor's right to deal with the property, when expressly stated in the listing agreement, results in an exclusive right to sell. However, there is no magic in those four words, standing alone and without spelling out their implication for the vendor. Thus, unless B could show that P came to V through his efforts, V has no liability to B for a commission.

Example 7b

Would your answer change if the listing agreement provides that a commission would be due B if "the undersigned, or any other broker" procured a purchaser for the farm?

Explanation

Probably. The negation of V's right to deal with the property is express here, although even more explicit language is possible—and would show a litigation-avoiding prudence.

Example 7c

Before B procures a purchaser, V leases the farm for the listing period and beyond. Is B entitled to a commission?

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2. Read this phrase "brief but enforceable"—which appears often in this book—as one meaning that you should assume that the contract is enforceable unless the context, the facts presented in the problem, indicate otherwise.

Explanation

Yes. The broker would be due the commission because V's action here has made the broker's procuring a suitable purchaser impossible. V must deal in good faith with B, and the execution of the lease is not good faith dealing.

Example 8

After listing and advertising V's house for sale in local newspapers for a month, what if there are no offers and B proposes to hold a public "open house"? Is an open house a good idea?

Explanation

Only if it sells the house. Will it? The answer is that it might, but seldom does. Most brokers would like to hold an open house, though. Why? Because (1) it shows broker activity for the listing owner, (2) it allows the broker to meet curious neighbors who might one day be clients, as well as purchasers who are in the market, but not for this house, and (3) it gives the novice salespersons employed by B a chance to get field experience. B probably knows that the open house seldom sells the property, so he or she will probably be doing something more important during it. V should ask what other ideas B has. One better idea would be to hold an open house for other brokers, because it is the broker's peers who will actually sell the house. Another would be a "virtual tour" video that can be posted on the broker's firm's Web site. It's possible that V has listed with a broker who collects listings—too many to give each personal attention—but relies on selling a certain percentage of the listed properties through other brokers. A short term for the listing agreement is the best antidote for this problem.

THE MULTIPLE LISTING SERVICE

The mechanics of the Multiple Listing Service (MLS) affect the types of listings discussed so far. Most MLSs are organized as a nonprofit corporation run by the local real estate brokers' trade group. Its regulations permit member brokers to list properties with the Service, to share their listings with other MLS members, and to sell any property so listed. Its records constitute an inventory of all properties available for sale at any one time. For purposes of effecting any one sale, the MLS divides its members into selling brokers and selling brokers; its regulations often also permit a broker to attempt to sell the property for which he has procured a listing himself for a short time (e.g., 72 hours) after the listing is obtained; thereafter, it must be submitted to the MLS.

Access to the MLS is limited to its members, and the MLS usually processes a listing only if it is based on an exclusive right to sell agreement. A description of the property is processed with the listing.

When a commission is due on a listed property, the listing broker and the selling broker (or their firms) split it. The split is sometimes a 50-50 one, but sometimes it is 40-60, respectively. Further, the commission will be split within the listing broker's firm between the listing salesperson and his broker; and the same split occurs in the selling firm.

In most areas with MLSs, over 90 percent of all residential vendors employing a broker have the listing submitted to it. Thus the MLS is a pervasive factor in residential sales. Without being a member, a broker would find it difficult to compete for this type of brokerage business.

Examples

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Example 9

V executes a brief but enforceable listing agreement with B1, a broker. The agreement is entitled a "Nonexclusive Listing." It has a 90-day listing period. It also reserves a commission for B1 "if within a year after the primary listing period, V sells the listed property to any prospect B1 procures within the primary listing period." B1 procures customer P, but no contract results within the 90 days. On the 85th day of the listing's primary term, V cancels the listing, then lists the same property with B2, who receives an inquiry from P about the property. P purchases the property within a year after the execution of B1's listing. B1 sues V for a commission. What result? *See* Galbraith v. Johnson, 373 P.2d 587 (Ariz. 1962).

Explanation

Judgment for B1. The extension clause is meant to protect against vendor fraud. Such a clause may extend liability for the commission from 90 days to 1 year and 90 days. However long the extension period, it is always express. It is not intended to keep the broker working beyond the primary term of the listing agreement. As a result, the level of broker effort beyond the expiration can decline markedly; in *Galbraith*, the court only required that his effort be substantial during the primary term. In this sense, the extension clause becomes a separate agreement—or, an agreement within an agreement.

This result would not change if after V cancelled the listing she leased the property to P for two years with an option to buy effective at the end of the lease and at the end of the first year of the lease, the tenant exercised the option. The vendor's fraud on the broker is then shown by the terms of the lease with the option, and the benefit that the lease confers on V is substantially the same as a sale. Thus both to discourage V's behavior and to prevent

V's unjust enrichment, the judgment should still go to B1. An extension clause does not empower a broker who has produced several prospects but has no purchaser during the primary term to continue negotiations with any of his prospects during the extension period. The prospect's readiness, willingness, and ability to purchase is freeze-framed as of the expiration date of the listing's primary term. By the same token, the listing vendor's right to negotiate and sell the property herself is reestablished after the expiration of the primary term.

Example 10

A listing contract contains a provision stating that the commission is payable *inter alia* "when the listing owner, for any reason, withdraws the listing during the primary term of the agreement." Before the broker expends any significant amount of effort to sell the listed property, the owner withdraws and the broker seeks to enforce this provision. Can he?

Explanation

Yes. *See* Blank v. Borden, 524 P.2d 127 (Cal. 1974). Because the listing agreement is completely result-oriented—that is, the broker receives no compensation without a sale, with compensation measured by a percentage of the sale price and paid regardless of the amount of broker effort—the vendor's exercise of the "withdrawal from sale" is an anticipatory breach of the agreement, with the damage to the broker measured not by the amount of his effort, but by his lost opportunity. The clause is also an indication that the prospective vendor has a choice. She can either accept the broker's services or withdraw from the agreement. *But see* Wright v. Schutt Constr. Co., 500 P.2d 1045 (Or. 1972) (refusing to follow a California case similar to *Blank* involving a withdrawal from sale clause when the trial court found, as a matter of fact, that there was no reasonable probability of sale within the terms of the net listing). Alternatively, the withdrawal clause might be examined as a provision for liquidated damages, finding it either a reasonable calculation of damages or a penalty (in the latter instance, the clause would be avoided and the broker reduced to recovering actual out-of-pocket damages).

THE VENDOR'S LIABILITY FOR A COMMISSION

The vendor is liable for a brokerage commission when the broker procures a purchaser ready, willing, and able to purchase the listed property on the vendor's terms, unless the vendor and the broker agree otherwise. Procuring the purchaser is defined as being the proximate cause of the offer.

The broker must set off a chain of events leading to negotiations and the offer. No sale is necessary; only an offer need be made.

As to the attributes of the purchaser, ready and willing means being in a state of mind (and *compos mentis*, at a minimum) to make the required offer. Able? That means financially able, not capable of buying for cash (unless the vendor required it in the listing) but appearing to be creditworthy. In most jurisdictions, it is largely for the vendor to decide when a purchaser is ready, willing, and able, up to the execution of a contract of sale. In many jurisdictions, when a vendor executes a contract of sale with a would-be purchaser, this act in itself indicates an acceptance of the fact that the purchaser is ready, willing, and able. The vendor's terms are stipulated in the listing agreement; the broker's duty is to procure an offer on terms substantially the same as, but not identical to, the vendor's. *De minimis* variations are permitted. The vendor may not add conditions after the listing is executed.

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Example 11

O lists Blackacre with B. B introduces P to O during the term of an exclusive right to sell listing, but O and P do not execute a contract of sale until the primary term of the listing has ended and its extension period clause applies. Their contract's provisions are quite different from the terms with which the negotiations opened. Does O owe B a commission?

Explanation

A broker must "procure" a purchaser. The answer to the question posed is yes if this means that but for the broker, there would be no contract of sale, but no if the so-called procuring cause doctrine requires an unbroken chain of events leading to the contract. In some states, courts hold that an extension period clause is a waiver of the doctrine. The better view is that it applies all the time. If B had procured an option to purchase instead of a contract from P and the option was exercised during the extension period, O would still owe B a commission. This is a typical situation in which extension periods are useful for brokers, but it leads courts to the (mistaken) view that the doctrine of procuring cause does not apply during the extension period: here B's efforts led to the sale, even though no further efforts were necessary during the extension period.

Example 12

When is a purchaser qualified as ready and willing? As able? Do these occur simultaneously or at different times?

Explanation

The times are different. A purchaser is ready and willing at the time the contract is executed, but is not yet financially able; her mortgage loan must be approved before she can be called able. Thus the latter term refers either to a finding that the purchaser is able at the time of the contract or to an allocation of the risk that the purchaser will be found "unable" later. In a majority of jurisdictions, the risk that the purchaser will prove unable to buy rests on the vendor.

Example 13

A contract of sale is executed by the vendor and the purchaser, but during the executory period the purchaser fails to qualify for a mortgage loan called for in the contract. Is the broker due his commission? What if the purchaser was qualified for the loan at the execution of the contract of sale but thereafter suffered financial reverses (through no fault of her own) that render her unqualified?

Explanation

As to the first question, the answer is yes in most jurisdictions. The risk that the purchaser will prove unable to buy is on the vendor when the issue is the vendor's liability for a commission. That is, the vendor must make a judgment when executing the contract that the purchaser is financially able to purchase the listed property. It is sometimes thought that the vendor's contract rights against the purchaser support this result.

As to the second question, the fact that the purchaser's financial reverses occurred during the executory period means that it is more difficult to allocate this risk to the vendor. Some authority supports the idea that the broker should not obtain a commission in this situation. This authority exists in jurisdictions that have adopted the (minority) rule governing the vendor's liability for a broker's commission: the rule of "no closing, no commission."

Example 14

V agrees in writing to permit B, a broker, to "handle the sale" of Blackacre. B produces a customer, C, with whom V executes a contract of sale for the property. C fails to close the transaction. B sues V for a commission. What result?

Explanation

As a matter of contract interpretation, the quoted phrase can be interpreted as providing that if there is no closing between the vendor and the procured purchaser, the vendor is not liable for the broker's commission.

In short, "no closing, no commission" becomes the rule governing the broker's entitlement. As a matter of law, a minority of states beginning with New Jersey in 1967 have adopted such a rule as a matter of public policy and, later in Massachusetts, as a matter of contract law. Under either version of this rule judgment goes for V, although if the matter were to be decided under the majority "ready, willing, and able" rule the word "sale" would be interpreted in accordance with prevailing law and found to mean "handle the procuring of a contract of sale"; judgment would then go for B. Language like the quoted phrase has provided the opportunity for a majority rule state to accommodate the purposes of the minority rule.

Example 15

The listing agreement states, without further elaboration, that the commission "is to be paid on the sale." If the broker procures a prospective purchaser who executes a binding contract of sale but later refuses to close, is the listing vendor liable for a commission?

Explanation

No, although the case presents (first) a question of fact—what did the parties mean by the word "sale"?—and (second) one of law. Because evidence on the fact question appears nonexistent, and the contract is construed against the drafter or its beneficiary, the broker, the second issue is a closer one than in Example 14 because the listing agreement might only be defining a time at which the commission is to be paid, not whether it is payable. A Massachusetts opinion held that the use of the word "sale" is to be given its common meaning and refers to a completed transaction—a closing is required before a commission is payable. Tristram's Landing, Inc. v. Wait, 327 N.E.2d 727 (Mass. 1975).

Ellsworth Dobbs, Inc. v. Johnson, 236 A.2d 843, 30 A.L.R.3d 1390 (N.J. 1967), is the leading case for the "no closing, no commission" rule. In this case, the facts indicate that the broker clearly brought the parties together, but the purchaser's inability to obtain financing several times postponed the closing until finally the vendor released the purchaser from further liability under the contract of sale. The broker sued the vendor. Holding for the vendor, the court said that the vendor, like most listing vendors, expected to pay the commission out of the proceeds of the closing, and further that the broker assumed the risk that the purchaser's inability to finance the sale would balk the closing. The broker was in the best position to assay the purchaser's financial worth. So when the purchaser expects to pay for property with the proceeds of a sale of stock, but the stock market drops so that the sale produces insufficient funds, the risk is the broker's. Thus the broker, under the rule of *Dobbs*, bears this risk as a result of his expertise. He also bears it because he is in the best position to, so if the property is destroyed by fire or is condemned, the risk is still on the broker. The court held:

> When a broker is engaged by an owner of property to find a purchaser for it, the broker earns his commission when (a) he produces a purchaser ready, willing, and able to buy on the terms fixed by the owner, (b) the purchaser enters into a binding contract with the owner to do so, and (c) the purchaser completes the transaction by closing the title in accordance with the provisions of the contract. If the contract is not consummated because of lack of financial ability of the buyer to perform or because of any other default of his? there is no right to commission against the seller. On the other hand, if the failure of completion of the contract results from the wrongful act or interference of the seller, the broker's claim is valid and must be paid.

236 A.2d at 855. The court held as it did as a matter of public policy, not as a matter of contract interpretation.

Example 16

What if the listing agreement says that the commission is payable "from the proceeds of the closing"? When is it due?

Explanation

There is a split in the cases here. Some cases (like Maine) hold that the phrase only defines the source of the commission payment, not when it need be made. For example, the "ready, willing, and able" rule is not trumped expressly by this language, nor should it be presumed to be. Others (like Arizona) hold that the phrase is more comprehensive, defining both the source and the timing of the payment.

Example 17

Using the two rules on vendor liability for a commission presented so far, consider the following: Vendor and Purchaser execute a brief but enforceable contract of sale, but the purchaser does not complete the purchase because she develops an acute phobia and refuses to leave her present residence. If the broker procuring the purchaser sues for a commission, what result?

Explanation

In a ready, willing, and able jurisdiction, the vendor's acceptance of the purchaser, evidenced by the execution of the contract with her, signifies the broker's procuring a purchaser and therefore an entitlement to a commission. *See* Blackman de Stefano Real Estate, Inc. v. Smith, 550 N.Y.S.2d

443 (N.Y. App. Div. 1990) (holding that when the purchaser develops agoraphobia—an unreasonable fear of open places—the broker is nonetheless entitled to a commission under the ready, willing, and able rule).

Absent evidence that the broker should have known about the illness and its probable effect on the transaction, where the *Dobbs* rule is a matter of law, the vendor might still have expected to pay the commission out of the proceeds available to her at the closing, so the public policy basis of the *Dobbs* rule remains. Judgment for the vendor.

In a state in which the *Dobbs* rule is a matter of contract interpretation (such as Massachusetts), the answer may vary depending on the contract, for there the parties to the listing agreement may contract around the rule, and the question becomes whether they have done so. If an objective standard is used to interpret contracts, the broker will likely win a commission.

THE FIDUCIARY DUTIES OF REAL ESTATE BROKERS

Brokers owe certain duties to their principal (that is, their employer, usually the vendor but possibly the purchaser, so here we use the encompassing language of the law of agency). These duties are based on a preexisting relationship of trust and confidence, here normally shown by a previously executed employment agreement—the listing agreement. Fiduciary duties arise with that agreement and, as if attached to it, as implied terms.

A broker owes his principal three fiduciary duties: (1) loyalty, (2) dealing in good faith, and (3) the disclosure of facts material to the principal's acceptance of an offer. The duties of loyalty and good faith dealing are often lumped together. Taken together, these duties may occasionally give the broker a duty to investigate and disclose to a vendor facts material to a transaction, even if the vendor does not ask. They are clearly violated when the broker does not forward offers to his principal, reveals the latter's confidences, or engages in self-dealing—that is, buys the property himself or in some other way competes with the principal. Moreover, they do not end with the expiration of the listing agreement, in the sense that the broker cannot thereafter undercut the principal's position using information gained during the course of the listing.

The duty to disclose facts material to the principal is a mop-up duty breached when the broker does not reveal his violation of his first two duties or in some way misrepresents the purchaser's qualities—his readiness, willingness, or ability to contract. For example, while knowing that the purchaser's checks bounce, the broker fails to disclose this to his principal. Likewise, a failure to disclose a fact material to the vendor's view of the transaction violates this third, more encompassing fiduciary duty.

EXAMPLES

Examples

Example 18

A young couple has been driving around in Ben Broker's car for days viewing listed properties, and when getting out of the car, one says to the other, "Let's offer $250K, but we'll go as high as $300K, okay?" If Ben is listening, must he report this to the vendor?

Explanation

The answer is yes if Ben is a vendor's broker, but no if he is the couple's broker.

In many jurisdictions, the state's regulatory code for brokers will provide examples of the duties expected of brokers, and such statutes have been used to define the duty that a broker owes a client in nonregulatory litigation.

The default measure of damages for a breach of duty is the loss of a commission. Nichols v. Minnick, 885 N.E.2d 1 (Indiana 2008). Consequential damages are also available for economic loss, particularly for cases of broker self-dealing. If the broker has already been paid a commission, its disgorgement is possible under a restitution theory; here the damages are measured by the broker's gain, even when the plaintiff has suffered no proven loss or damage. Some states, however, say that the commission amount is an upper limit or a cap on damages.

EXAMPLES

Examples

Example 19

B holds a valid listing of V's property for sale at $100,000. While showing it to P, who is hesitant to make an offer, B states that "the listing price is $100,000, but offer $85,000 and see what V says." V closes the sale at $85,000, but refuses to pay B his commission when she discovers the foregoing facts. B sues V. In this suit, what result? *See* Haymes v. Rogers, 219 P.2d 339, 17 A.L.R.2d 896, modified on reh'g, 222 P.2d 789 (Ariz. 1950).

Explanation

Judgment for B on the facts, not as a matter of law. The broker has come very close to breaching his fiduciary duty of loyalty to his principal; a slight variation in the broker's words or the lack of the prospect's hesitancy might mean a different result. For example, if the broker said that "V has an offer at $80,000, but offer $85,000 and see what she says," the fact that the broker has disclosed a prior offer might make a difference. Similarly, if the broker said, "the vendor hasn't budged off $100,000, but she desperately needs the listing price to pay for an operation for her mother," the broker might well lose. The facts and circumstances surrounding what is said also matter. B might say, "the listing price is $100,000 and that's it—that price is final" when in fact V is willing to bargain further. Such a statement, standing alone, well might be regarded by the courts as only a bluff and a negotiating posture.

If the broker knew and were to disclose the price at which V would likely consider an offer, the disclosure of such information in the face of a prospective purchaser's intransigence might not breach the duty of loyalty, on the theory that the broker may disclose confidential information when it is in the best interests of the principal to do so and here the broker was only encouraging negotiations.

Example 20

B holds a valid listing of V's property. P employs B to search for property suitable for her residence. P expresses an interest in V's property to B and offers to purchase it. B does not transmit P's offer to V, but instead buys the property himself and later sells it at a profit. On learning the foregoing facts, P sues B. What result?

Explanation

Judgment for P. A broker is required to transmit every offer received. While in the employ of P, B owes P his best efforts to find suitable property, and those efforts may not be diverted for the broker's personal gain. B has violated not only the duty of good faith and loyalty but capped his disloyalty with a failure to disclose self-dealing. Hiring a broker should mean just that—hiring a broker, not a competitor. The public expects brokers not to step out of their professional role and violating those expectations by self-dealing is a breach of a broker's fiduciary duty.

What if there were no employment agreement between P and B? P's case would be more difficult to make out, but P's employment agreement might be implied in law—a quasi-contract—and, as such, have as its subject the transmittal of offers, rather than the full services of a broker. Additionally, when dealing with breaches of a fiduciary duty, think in terms of the law of torts, too: B has denied P a business or investment opportunity by not transmitting the offer, and so interfered with a prospective advantage or the contract that P might have signed.

Perhaps the remedy (besides damages) is the most interesting part of this situation. P may impose a constructive trust on B's profits or, if B still owned the property, she might force its conveyance to her. *See* Funk v. Tifft, 515 F.2d 23 (9th Cir. 1975), noted at 1976 B.Y.U. L. Rev. 513 and 12 Idaho L. Rev. 217 (1976).

On the same facts, if V sued B, V would obtain judgment. He has a listing agreement on which to base a breach of fiduciary duties: the breach of the duty of loyalty—evidenced by the nondisclosed dual representation and the failure to forward the offer—and the self-dealing—B's buying the property for himself. V need not allege damages for breach of such a duty: The breach of the duty implies injury, at least to the relationship between broker and client, so no allegation of injury is required in the complaint; nominal or consequential damages will be awarded if shown at the trial, as well as recovery of the broker's profit from the self-dealing.[3]

Example 21

P hires B as her broker in a brief but enforceable agreement. B shows P property for sale by V for $100,000. B then learns that V, aware of P's interest, will not deal with P. V and B negotiate with a third party for a sale of the property at $100,000. While these negotiations are under way, P learns that the property is worth $110,000 and asks B to offer V $105,000. B does not transmit P's offer to V, who then sells to the third party for $100,000. P sues B for breach of the duty of loyalty. In B's action, what result?

Explanation

Judgment for P, but only for nominal damages. Although the refusal to transmit an offer is generally a breach of the duty of loyalty, the breach here caused the plaintiff P no injury because of V's refusal to deal. Disgorging or denying any commission or fee is P's only remedy. (Typically B will share a commission with V's broker if any—so don't think that B is out in the cold here.)

Example 22

V owns Blackacre. B, a broker, approaches V with the information that someone is interested in purchasing the property. V replies that she does not deal with brokers and does not pay them commissions. B replies that he will get his commission from the interested party, P. Although thereafter V thought that she was selling Blackacre to P, she in fact was selling it to B, who promptly turned around and sold it to P. Discuss V's rights against B.

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3. Why do you think some states don't require any allegation or later proof of damages? It is because (1) the breach of duty nullifies the employment contract and the cause of action lies in restitution—it is one to recover money falsely obtained or obtained under false pretenses when the commission is already paid out (and if no commission is paid out, the basis for the suit is the employment relationship in the listing agreement); (2) damages may be difficult to show [*see* Restatement (3d), Agency, §8.01, comment d(2) (2006)]; (3) disgorgement or loss of the commission removes the temptation to violate the duty in the hope that no loss or damages will result; and (4) it facilitates trust between broker and client—a trust on which the fiduciary relationship is based. Overall, this rule is more prophylactic than remedial.