Management of exposure to liability

After reading this chapter, you will be able to:

- develop and implement a risk reduction program to minimize exposure to liability;
- identify the types of risk a brokerage service may be exposed to and what steps can be taken to mitigate them; and
- provide a scheme for the continual management of risk.

Learning Objectives

Brokers and agents interact amongst themselves and with members of the public. When acting under their Bureau of Real Estate (BRE) licenses, brokers and agents act in the capacity of:

- an *advisor* to an individual who has retained the services of a broker to assist in a real estate related transaction; or
- an *agent* dealing with another broker, their agents or a member of the public in an effort to find a match for the individual they represent regarding ownership, financing or the letting of real estate.

These two relationships contain *risks* as addressed in this chapter. The risk of causing another person a loss is inherent in all activities conducted in the context of agency relationships.

Key Terms

- classified risk
- errors and omissions *(E and O)* insurance
- fiduciary duty
- general duty
- pure risk

The reduction of uncertainties for harm
Agency relationships exist as either:

- **special fiduciary duties** owed to the client; or
- **general duties** which are owed to the other party, called the **customer**.

The risks taken by a broker and their agents expose the broker to liability caused by an:

- error;
- omission; or
- misunderstanding brought about by the activities of the broker or his agents.

All acts carried out by a broker or their agents present the possibility that a client or other party will be **injured financially**. This includes investigations, inspections, negotiations, the giving of advice, and the preparation of disclosures and contracts.

It is the risk of causing these losses which the broker needs to control. Risks are best limited by choosing activities which can be conducted with more certainty of a favorable result when relied on by the client or other person in a real estate transaction. Thus, brokers need to maintain a **risk reduction program** to keep claims from clients and others under control.

The five steps necessary to establish a **risk reduction program** are as follows:

1. All activities exposing the broker to liability are **identified** based on whether the activity runs the risk of causing the client or others to be injured financially.
2. Each identified activity is **broken down** into its component parts, i.e., all of the acts and events that comprise the activity, which must be properly performed to eliminate the risk of causing a loss to a client, others or the broker.
3. An **evaluation** undertaken into what sorts of loss the client, others or the broker could experience if the broker or their agents undertake the identified activity, or a modified or alternative version of the activity.
4. Brokerage activities are **chosen** and procedures and limitations **adopted** to control the parameters of the agent’s conduct when performing those activities, based on whether they fall within the broker’s comfort zone as providing the level of exposure to liability acceptable to the broker.
5. Agent **compliance** with activities authorized and limited by the broker’s policies and procedures are tracked, and ongoing remedial training and dispute resolution for claims made by clients and others are established.
To initiate an analysis for managing the risk of loss, a broker must identify and list all the activities agents perform which could potentially be the source of a claim of liability against the broker.

Also, the nature of the services offered by brokers varies by whether the activities are classified as:

- the sale of single family residences (SFRs), income property or land;
- the financing of purchases, construction or equity; or
- the leasing or management of residential or nonresidential property.

Other categories of broker activity are based on their duty owed to the client for the performance of services sought by the client. This includes the actions of a listing broker, such as:

- advising the seller;
- inspecting the listed property;
- collecting data for disclosures;
- marketing the property; and
- negotiating the terms of a sale.

Likewise included are the actions of a buyer’s broker, such as:

- selecting qualifying property;
- gathering property information;
- confirming the veracity of seller disclosures;
- evaluating the data collected;
- advising the buyer; and
- negotiating acquisitions.

Loan broker and leasing agent activities likewise have categories of duties owed to the participants in their real estate transactions.

Other risks of exposure to liability arise out of losses incurred by clients and others when they rely on information provided by their broker but received by the broker from other sources, such as the property owner or third-party inspectors.

After identifying the type of broker and agent activities which expose the broker to liability, the next step is to break down each activity into all of its essential parts. This process narrows down the acts containing uncertain results that may lead to the client suffering a loss.

The broker must determine what it is about a particular activity that could expose the broker to liability or other adverse consequences. This question is to be considered when defining the handling of an activity, such as a diligent visual inspection of property, the preparation of the transfer disclosure statement (TDS) or review of an annual property operating statement.
(A POD). This break down of the identified activity into its component parts becomes the checklist of proper and improper conduct. [See first tuesday Form 304 and 352]

Thus, a client or other persons’ risk of loss is mitigated or averted completely.

For example, one of the activities to be identified in the first step of a risk reduction program is the giving of an opinion in response to an inquiry regarding a property. [See Agency Chapter 5 and 6]

Many aspects exist in developing and giving an opinion. The failure to simply consider each aspect in a power point type review creates exposure to liability. Thus, you need a checklist of actions to take regarding the process for the agent's development of an opinion. [See Agency Chapter 6]

Activities creating risk

Excessive market conditions, manifested by the boom and bust phases of the real estate business cycle, produce dangerous aberrations in the conduct of agents when dealing with buyers and sellers.

The activities of negotiating purchase agreements and obtaining new listings are acceptable brokerage activities. However, risky actions are occasionally incorporated into an otherwise appropriate activity. These can expose the seller to loss and the broker to liability. Listing and escrow arrangements, while routine and customary, are also to be evaluated for risk.

For example, agents often do not advise sellers that property disclosures are mandated to be delivered to prospective buyers as soon as possible after the prospect first seeks further information about the property. Likewise, seller’s agents improperly present adverse information about a property to the buyer at the last minute – well after a binding purchase agreement exists, escrow is open and the buyer has arranged financing. [See Ethics Chapter 2 and 3]

Nondisclosure before entry into a purchase agreement creates an ambiguity about the property’s conditions, and thus the proper price to pay. This conduct exposes brokers to liability (read: risk) when the buyer experiences lost expectations of value. [See Risk Management Chapter 4]

Other components of an identified activity also evaluated for risk of loss include:

1. Who is the source of information given to a client?
2. How credible is the source of the information?
3. When should due diligence information gathering activity be undertaken?
4. What is the proper time for releasing known information to prospects?
5. What readily available information needs to be obtained and reviewed for unknown (but knowable)?
6. What other decisions could produce adverse consequences while performing the identified activity?
Having created a list of brokerage activities and actions a broker’s agents will be engaged in, an assessment is then conducted of the adverse consequences the activities might generate which may cause a loss for the client or others. Brainstorming needs to be undertaken to get this right. Market conditions are constantly changing and the nature of participants shifts equally as fast.

If it is determined a loss might occur, the significance of the loss must be evaluated to determine its financial impact on the client or other person – and whether the broker is exposed to liability for the loss. The evaluation process interprets, in terms of probable losses and liability arising out of an error or omission, the impact of risks taken when representing a client.

This evaluation precedes any decision by the employing broker to authorize an activity. Only after the evaluation can a broker logically undertake the risk of his agents performing the service for clients and others.

As a buffer against liability, a broker can purchase negligence insurance, called errors and omissions insurance, or more simply, E and O insurance. With the payment of a premium, E and O insurance protects brokers from the full cost of defending against a negligence claim made by a client or others. Similarly, auto insurance can be purchased to cover liabilities resulting from the agent’s use of their vehicle to conduct activities within the scope of the brokerage activities chosen and authorized by the broker for the agent to undertake.

Through both forms of insurance, the liability exposure for professional negligence and the cost of defense are shifted to corporate insurers willing to take on the financial burden of those uncertainties.

Even with insurance, each broker hiring agents must determine what level of risk is acceptable for them when undertaking a chosen brokerage activity.

For example, risks in providing information to clients and others might only result in minimal liability exposure for claims. These are absorbable risks the broker and their agents can take which are either uninsured or within the range of the deductible not paid by the insurer. When brokers authorize absorbable-risk conduct, an agent needs to agree to contribute to any settlement paid out by the broker on claims generated by the agent’s conduct.

However, some conduct in the performance of agency duties are pure risks which must be avoided since they lead to absolute liability as entirely unacceptable acts. Pure risks include:

- deceit;
- withholding known or unknown but readily available information; or
- misstating or permitting the misstatement of facts or consequences of facts which cause the person relying on the statements to suffer a financial loss.

**Evaluating the uncertainty of adverse results**

**Errors and omissions insurance**
An insurance policy protecting brokers and agents from the full cost of defending against a negligence claim made by a client.

**Avoiding acceptable levels of conflict**

**Pure risk**
Entirely unacceptable acts leading to absolute liability for the misconduct.
Substandard activity, sometimes called a **classified risk**, must be given special emphasis. This activity generally leads to a lack of proper performance. Occasionally it is the activity itself which is considered improper and automatically imposes liability for any losses it may cause.

Each broker hiring agents will have a different level of acceptable risk they are comfortable with. Whatever that level may be, policy measures must be adopted to provide guidelines and instructions on just what steps agents are to take when conducting a brokerage activity chosen by the broker as an acceptable risk.

For example, trust funds need to be explained so the agent can identify them. Then there is the handling of an agent’s receipt, recording, safekeeping and delivery to the intended recipients and the agent’s timely performance of each step. Trust fund procedures need to be laid out in clear, concise language for agents to understand if risks from mishandling are to be avoided. BRE audits may be the biggest risk of all. [See the *Trust Funds* Chapters]

The management by the agent of a purchase agreement, deposit, disclosures and the dictating of escrow instructions needs to be detailed so the expectation of the agent about their conduct is well understood.

Without an administrative structure to verify the broker’s agents are conducting themselves as intended, the broker will be exposed to an unnecessary risk of loss. Thus, continued oversight and policing are put in place to limit unilateral changes, distortions and deviations from agent conduct acceptable to the broker.

Oversight requires the commitment of financial and human resources to report unacceptable conduct, the holding of training meetings, and the maintenance of client files. In a word: **continuing management.**

The risk of causing another person a loss exposes a broker and their agents to liability due to errors, omissions or misunderstandings. Brokers control these risks by maintaining a risk reduction program identifying potential risks and tracking agent compliance with risk reduction policies.

Each activity bearing risk is broken down into their individual component actions, such as conducting a visual inspection, in order to identify critical points at which exposure to liability can occur. This breakdown becomes the checklist of proper and improper conduct for performing that part of the activity.

There are multiple types of risk. Pure risks arise from entirely unacceptable actions and lead to absolute liability. Classified risks are based on substandard activity and may expose the broker to liability.
As a buffer against liability arising out of an error or omission, a broker maintains errors and omissions (E and O) insurance.

Continued oversight and policing limits unilateral changes, distortions and deviations by agents from conduct acceptable to the broker. Continuous oversight requires the broker’s commitment of financial and human resources.
Notes:
After reading this chapter, you will be able to:

• understand the liabilities imposed upon a broker by the agents they employ;
• establish policies, procedures and rules for the continual management and supervision of licensed sales agents; and
• develop a business model for implementing the supervisory duties required of a broker.

Brokers are in a distinctly different category from sales agents. Brokers are authorized to deal with members of the public to offer, contract for and render brokerage services for compensation, called licensed activities. Sales agents are not.1

A licensed real estate salesperson is limited to the status of an agent for their employing broker. An agent cannot contract in their own name or on behalf of anyone other than their employing broker. Thus, an agent cannot be employed by any person who is a member of the public.2 [See Agency Chapter 1]

Only when acting as a representative of their broker may the sales agent perform brokerage services which only a broker is authorized to contract for and provide to others, called clients.3

Further, a sales agent can only receive compensation – fees – for their real estate related activities from their employing broker. An agent cannot

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1 Calif. Business and Professions Code §10131
2 Bus & P C §10160
3 Grand v. Griesinger (1958) 160 CA2d 397
receive compensation arising out of a fee generating transaction directly from anyone else, e.g., the seller or buyer, another licensee, or other provider of services in a transaction.4

Thus, brokers are the agents employed by members of the public. On the other hand, a broker’s sales agents are agents of the agent. Sales agents render services on behalf of the broker’s clients, and do so as the broker’s representatives.5 [See Agency Chapter 1]

As a result, brokers are responsible for all the activities their agents carry out within the course and scope of their employment with the broker.6

The broker’s mandated continuous supervision

When a broker employs a sales agent to act on behalf of the broker, the broker must exercise reasonable supervision over the activities performed by the agent. The broker who does not actively supervise their agents risks having their broker license suspended or revoked by the Bureau of Real Estate (BRE).7

The employing broker’s responsibility to the public includes:

• on-the-job training for the agent in the procedures and practice of real estate; and

• continuous policing by the broker of the agent’s compliance with the duties owed to buyers and sellers.

The sales agent’s duties owed to the broker’s clients and others in a transaction are equivalent to the duties owed to them by the employing broker.8

The duties owed to the various parties in a transaction by a broker include:

• the utmost care, integrity, honesty and loyalty in dealings with a client; and

• the use of skill, care, honesty, fair dealing and good faith in dealings with all parties to a transaction in the disclosure of information which affects the value and desirability of the property involved.9

A broker ensures their agents are diligently complying with the duties owed to clientele and others by establishing office policies, procedures, rules and systems relating to:

• soliciting and obtaining buyer and seller listings;

• negotiating real estate transactions of all types;

• the documentation arising out of licensed activities which might affect the rights and obligations of any party, such as agreements, disclosures, reports and authorizations prepared or received by the agent;

• the filing, maintenance and storage of all documents affecting the rights of the parties;

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4 Bus & P C §10137
5 Calif. Civil Code §2079.13(b)
6 Gipson v. Davis Realty Company (1963) 215 CA2d 190
7 Bus & P C §10177(h)
8 CC §2079.13(b)
9 CC §2079.16
• the handling and safekeeping of trust funds received by the agent for deposit, retention or transmission to others [See the Trust Funds Chapters];
• advertisements, such as flyers, brochures, press releases, multiple listing service (MLS) postings, etc.;
• agent compliance with all federal and state laws relating to unlawful discrimination [See the Fair Housing Chapters]; and
• the receipt of regular periodic reports from agents on their performance of activities within the course and scope of their employment.10

An employing broker implements the need for supervision by developing a business model. With it, the broker establishes the means and manner by which listings are produced and serviced, and how purchase agreements are negotiated and closed by their agents. The development of a plan of operations logically starts with an analysis of the conduct required of an agent based on established categories of administrative and licensed activities. [See Figure 1]

Categories of business and licensed activities include:

• administrative rules, covering a description of the general business operations of the brokerage office, such as office routines, phone management, sign usage, budgetary allocations for agent-support activities (advertising, farming, etc.), agent interviews, goal setting and daily work schedules;

• procedural rules, encompassing the means and methods to be used by agents to obtain measurable results (listings, sales, leases, loans, etc.);

• substantive rules, focusing on the documentation needed when producing listings, negotiating sales, leases or loans and fulfilling the duties owed by the broker to clientele and others;

• compliance checks, consisting of periodic (weekly) and event-driven reports (a listing or sale) to be prepared by the agent, and the review of files and performance schedules by the broker, office manager or assistants, such as listing or transaction coordinators; and

• supervisory oversight, an ongoing and continuous process of training agents and managing their activities which fall within the course and scope of their employment.

Brokers typically use an independent contractor (IC) form when documenting for BRE compliance the employment of agents. An IC employment form is used solely for the avoidance of income tax withholding and unemployment benefits payments by real estate brokers. [See first tuesday Forms 506 and 505]

However labeled in writings, an agent is a labor law employee and the broker is still liable as an employer for their agent’s conduct. An agent may not permissibly act independent of the broker under an IC agreement and

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10 Bureau of Real Estate Regulations §2725
the broker employing agents using an IC agreement still owes a duty of supervision (as well as a mandated worker’s compensation policy). [See first tuesday Form 506; see Agency Chapter 5]

Consider a sales agent employed by a broker under an IC agreement. The broker gives the agent total discretion in their handling of clientele and documentation.

However, the IC agreement includes a provision calling for the agent to deliver to the broker a binder for liability insurance on the agent’s car naming the broker as an insured party. The IC agreement also requires all documents and funds received on listings and sales to be entered into and taken in the name of the broker, and all advertising and business cards to identify the agent as acting for the broker as an associate licensee. [See Risk Management Chapter 1]

While the sales agent is driving their car to list a property, the agent collides with another vehicle, injuring the driver. The driver makes a demand on the agent’s broker to pay for the driver’s money losses incurred due to the agent’s negligence.

The broker rejects the demand, claiming the agent is an independent contractor, not an agent (much less an employee) of the broker. Thus, the broker claims they have no liability for the losses inflicted on the driver by the agent.

The driver claims the broker is liable since the agent is a representative of the broker and was acting within the course and scope of their employment when the injuries occurred.

Can the driver injured by the agent’s negligence recover his money losses from the agent’s broker?

Yes! The sales agent is the agent of the broker as a matter of law. This relationship exists without concern for the type of employment agreement the broker and agent have entered into.

Further, the agent is subject to supervision by their broker by BRE mandates to actively conduct their brokerage business. This mandatory supervision cannot be contracted away by an IC employment agreement allowing total discretion to the agent in the conduct of their handling of listings and sales.

Since the sales agent is an agent of the broker, and at the time of the injury the agent was acting within the course of their agency with the broker, the broker cannot escape liability for their agent’s negligence. 11

The broker who hires agents who use their own cars to conduct real estate activities not only needs to be a named insured party on the agent’s car insurance policy, but also needs to maintain:

- general comprehensive business liability insurance;

11 Gipson, supra
Risk Management, Chapter 2: An agent’s impact on their broker

- worker’s compensation coverage; and
- professional liability coverage, also known as errors and omissions (E and O) insurance. [See Risk Management Chapter 1]

Proper insurance coverage is a requisite of good brokerage practice. Tortious conduct of all sorts can arise out of listings and sales transactions solicited and negotiated by agents employed by the broker.

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### Forming a business model

Within each category of activity covering the broker’s management of his agents’ conduct for producing, servicing and negotiating listings and sales, is a list of items to be considered.

#### Administrative
- E & O insurance
- workers’ compensation insurance
- automobile insurance binder
- general comprehensive business insurance
- agent policy manual (on procedural, substantive and compliance activities)
- new agent qualifications and interview procedures
- institutional advertising franchise affiliation
- trade organization membership
- MLS subscriptions
- employment contracts with sales agents
- agent pay, advances, and escrow disbursements
- production goals
- phone/floor-time coverage
- hours/agents’ work schedules
- business cards
- storage of documents (3 years)
- office meetings/attendance
- agent contribution to expenses
- bank trust accounts
- general business bank accounts

#### Organizational Procedures
- forms to be used
- use of coordinators
- use of office equipment
- use of affiliated services
- use of controlled businesses
- attorney inquiry/referral to broker
- trust fund handling (deposit and log)
- e-mail content
- public record inspection
- servicing property listings (MLS, signs, ads, property profiles, open houses, correspondence, showings, checklists, rents, etc.)
- servicing buyers (listings, property profiles, broadcasts, wants, showings, qualifying, checklists, etc.)
- client lists and follow up

#### Substantive Activities
- taking property listings (addenda and disclosure checklists, deposits, property profiles, further approvals, fee setting, seller profiles, etc.)
- preparing offers (documents/disclosures and addenda checklists, duty checklists, advice on use of arbitration, forfeiture, escrow, title, misc. provisions, fee provisions, etc.)
- FSBO submission of offers (fee arrangements, listings, dual agency, etc.)
- preparation of documents, use of attorneys, added provisions

#### Compliance
- pay contingent on file audit and completeness
- listing logs
- transaction logs
- trust fund logs
- periodic reports
- listing reports
- sales reports
- schedule of report due dates
- other events which trigger notices or reports to management

#### Supervision
- continuous daily oversight
- constant follow-up on compliance with procedures and substantive activities
- instructions on propriety of acts within the course and scope of employment
- degree of enforcement being tight and disciplined, or lax and allowing great discretion
- use of assistants to provide oversight
Brokers are authorized to deal with members of the public to offer, contract for and render brokerage services for compensation. A sales agent cannot contract in their own name or on behalf of anyone other than their employing broker. Thus, an agent is an agent of their employing broker.

Brokers are responsible for providing reasonable supervision over all the activities their agents carry out within the course and scope of their employment. Employing brokers need to establish office policies and systems relating to all steps in the process of facilitating a real estate transaction. Thus, they ensure their agents are diligently complying with the duties owed to their clientele and others.

As part of these office policies, brokers develop a business model establishing the means and manner by which listing are produced and serviced, and how purchase agreements are negotiated and closed by their agents.

**Risk Management Chapter 2 Summary**

**Risk Management Chapter 2 Key Terms**

- **business model** .................................................................................. pg. 195
- **licensed activities** ............................................................................... pg. 193
After reading this chapter, you will be able to:

- practice the level of due diligence owed under an exclusive or open listing agreement;
- maintain an accurate client file to record your exercise of due diligence;
- gather all the information required to list and market a property for sale; and
- apply yourself to fully and fairly respond to a customer’s inquiry.

Consider a broker who enters into an exclusive listing with a seller. The broker’s efforts to market the property are limited to placing a “For Sale” sign on the property and publishing property information in the multiple listing service (MLS). The broker refuses to assist or provide additional information to buyers or their agents, except to make the listed property available for inspection through a lock-box arrangement. Phone calls and emails seeking information about the listed property are not responded to.

The broker’s effort to market the property are limited to placing a “For Sale” sign on the property and publishing property information in the multiple listing service (MLS). The broker refuses to assist or provide additional information to buyers or their agents, except to make the listed property available for inspection through a lock-box arrangement. Phone calls and emails seeking information about the listed property are not responded to.

The seller’s broker does not prepare disclosures or provide a listing package regarding the condition of the property and operating costs. The agent also does not obtain a property profile, home inspection report, natural hazard disclosure (NHD) report or pest control report. All these items are left to a buyer’s agent to obtain or for a buyer to demand in escrow.
The seller’s broker employs a transaction coordinator (TC), a real estate licensee, to prepare documents and obtain the seller’s signature as needed — at an extra charge to the seller for the TC’s services.

None of these limitations on the marketing services provided by the broker are disclosed to the seller, except for the cost of the TC on closing a sale.

No potential buyers are produced by the agent.

The seller, dissatisfied with the broker’s marketing efforts, cancels the listing without the broker’s consent. Another broker is employed by the seller to market the property. The property is sold under the new listing, but during the listing period remaining on the cancelled listing.

The original seller’s broker makes a demand on the seller for a fee, claiming they are due a fee since the property sold during the original listing period. The seller claims the agent’s lack of due diligence in marketing the property and locating buyers bars the broker from collecting a brokerage fee.

Is the seller’s broker entitled to the fee?

No! The efforts of the seller’s broker to market the property and locate buyers were insufficient to entitle the broker to a fee on any sale after the seller canceled the listing for good cause.

When employed under an exclusive listing agreement, a broker and their agents are obligated:

- to inform the seller about the brokerage services to be rendered; and
- to diligently perform the agreed-to services in pursuit of buyers who are ready, willing and able to purchase the listed property.

A concerted, continuing effort to sell

Agents fulfill their agency duty owed under an exclusive listing by making a concerted and continuing effort to locate a buyer, called a due diligence effort. All services are to be performed at a level meeting the owner’s reasonable expectations. Otherwise, the owner has good cause to terminate the agency and cancel the employment under the listing without becoming obligated to pay a fee.

The diligent effort of a broker under an exclusive listing is measured by the conduct and actions taken by the broker and their agents, including:

- analyzing the property — a responsibility imposed on the broker or their agent to gather readily available information and adverse facts about the listed property at the earliest opportunity, before marketing begins. This information is included in a listing package handed to prospective buyers; and

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1 Coleman v. Mora (1968) 263 CA2d 137
2 Jue v. Smiser (1994) 23 CA4th 312
marketing the property – which includes advertising in MLSs or other broker-associated publications, making phone calls, putting up “For Sale” signs, distributing fliers, holding open house, broadcasting the property at pitch sessions, etc.

The agent needs proof they exercised due diligence in their analysis and marketing of a property. The best evidence of diligence is provided by keeping detailed records. Records avoid unwarranted cancellation of the listing. Records of all solicitations, contacts, money spent, advertisements placed, buyers contacted, etc., are maintained on worksheets in a physical file separately maintained on the listed property. [See first tuesday Form 520 and 525]

The methods for gathering adverse facts about the property’s fundamental characteristics, as required on the sale of a one-to-four unit residential property, include:

• conducting a competent visual inspection of the property to observe conditions which might adversely affect its market value. Any observations of adverse conditions are noted on the seller’s TDS — if not already noted on the TDS by the seller or inconsistent with the seller’s disclosures, regardless of whether a home inspector’s report has been obtained by the seller;

• assuring seller compliance with the seller’s duty to deliver mandated disclosure statements to prospective buyers as soon as possible. These mandated disclosures cover a variety of routine facts about natural hazards (NHD), the condition of the property (TDS), environment hazards (TDS), Mello-Roos liens, lead-based paint, neighborhood industrial zoning, occupancy and retrofit ordinances, military ordnance locations, condo documents, etc. [See first tuesday Form 304, 314 and 308];

• reviewing and confirming that all the information and data in the disclosure documents received from the seller are consistent with the seller’s broker’s knowledge, and if not, correct the information and data. Further, if the listing agent has reason to believe information might not be accurate, either investigate and clarify the information, or disclose their uncertainty about the information to the seller and the prospective buyer in the documents;

• advising the seller on risk avoidance procedures by recommending the seller obtain third-party inspections of the property’s condition and its components (roof, plumbing, septic, water, etc.). Inspections reduce the seller’s and their broker’s exposure to claims by a buyer who might discover deficiencies in the property, before or after closing, not known to the seller or the seller’s broker; and

• responding to inquiries by the prospective buyer or buyer’s agent into conditions relating to any aspect of the property. Seller’s agents are to respond with a full and fair answer of facts known to them which are or might be detrimental to the value of the property. The inquiry itself

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3 Calif. Civil Code § 2079
makes the subject matter a material fact about which the prospective buyer seeks more information before completing negotiations or acquiring the property. Thus, the response of the seller’s agent to the inquiry may not suppress further investigation or inquiry by the buyer or the buyer’s agent. A contingency provision addressing the subject needs to be included in any purchase agreement or counteroffer entered into by the buyer.

These methods are also used to determine those facts which enhance the property’s value.

**The fiduciary duty owed to the client under an exclusive listing**

An exclusive listing agreement entered into by an agent on behalf of their broker creates a client relationship with the buyer or seller who employs them. The employment imposes special duties on the broker and the agent, owed to the client as their fiduciary, to use due diligence in a continuous and meaningful effort to meet the objective of the employment. [See first tuesday Form 102 §1.2]

The promise of due diligence is the consideration a broker and their agents give their client in exchange for employment and a promise to pay a fee. The promise to use due diligence in the employment is stated in the exclusive listing agreement. If not, it is implied as existing by law.

The broker granted exclusive representation by a client is to take reasonable steps to promptly gather all material facts about the property being marketed it for sale. In addition to gathering material facts about the property, the broker’s agent proceeds to do every reasonable and ethical activity to pursue, with utmost care, the purpose of the employment.

In contrast to an exclusive listing, a broker and agents entering into an open listing are not committed to the seller to render any services at all. The brokers and agents are said to have only a best-effort obligation to act on the employment.

However, when an agent under an open listing enters into preliminary negotiations with a buyer, a due diligence obligation owed to the seller arises.

At this point, the seller’s agent is to provide the utmost care and protection of the client’s (the seller’s) best interests.

Having acted on the open listing having contact with a buyer, the agent needs to promptly inspect the property, if they have not already done so, and gather all the readily available information on the property under consideration. Further, the agent is to advise the seller on the nature of the information and any ramifications the transaction might have on them.

Once the seller’s agent begins to perform services under an open listing, the agent has acted on the employment. The due diligence standards of duty owed to the seller then apply to the agent’s future conduct with all parties involved.
Typically, the agent who produces a listing becomes the agent in the broker’s office responsible for the care and maintenance of the **client’s file**.

On entering into a listing, a **physical file** is created to store information and document all the activity which arises within the broker’s office due to the existence of the listing. At minimum, the physical file on a property listing contains:

- the original listing agreement;
- any addenda to the listing agreement; and
- all the property disclosure documents the seller and seller’s agent are to provide to prospective buyers seeking additional information on a property, and always before the seller accepts or counters a buyer’s offer to purchase their property.

Further, the file needs an **activity sheet** for the entry of information on all manner of file activity. The activity sheet is evidence of the due diligence efforts rendered on behalf of the client. [See **first tuesday** Form 520]

Any paperwork, notes, messages, billings, correspondence, email printouts, fax transmissions, disclosure sheets, worksheets, advertising copy, copies of offers/counteroffers and rejections, and all other related documentation are kept in the physical file. Essentially, everything which occurs as a result of the client employment is placed and retained in the file.

The file is owned by the broker as it is the **broker’s file**, not the file of the broker’s agent. However, it will likely remain with the broker’s agent until the close of a transaction or expiration of the listing. The agent then hands the broker the completed file on close of escrow or expiration of the listing. Delivery of the complete file is usually a **condition precedent** to payment of the agent’s share of the fee received by the broker.

Guidelines used to build a file’s content are available in many forms. These include:

- checklists prepared by a broker or their listing coordinator;
- a transaction coordinator’s (TC’s) closing checklist [See **first tuesday** Form 521];
- escrow worksheets [See **first tuesday** Form 403];
- work authorization forms;
- advance fee and advance cost checklists; and
- income property analysis forms. [See **first tuesday** Income Property Brokerage (IPB) Suite of Forms]

Checklists are contained in the physical file. They are reviewed periodically by the agent, office manager, TC or employing broker as mandated by oversight requirements for work to be done to better service the listing and earn a fee.
Information, activities, events and advice

Information to be gathered, activities to be performed, events to be arranged and advice to be given to a seller by a seller’s agent when listing and marketing a property for sale include:

1. A **property profile** of the seller’s title from a title company reviewed to identify all owners needed to list, sell and convey the property and trust deeds recorded on title.

2. A **condition of property** disclosure sheet, also known as a *Transfer Disclosure Statement*, filled out and signed by the seller and the seller’s broker or agent. [See *first tuesday* Form 304]

3. A **home inspection report** paid for by the seller and attached to the *transfer disclosure statement (TDS)* to shift liability for missed property conditions from the broker to the inspector. [See *first tuesday* Form 304]

4. A **natural hazard disclosure (NHD)** on the property from a local agency or a vendor of NHD reports, paid for by the seller, and reviewed and signed by the seller and the seller’s broker or agent. [See *first tuesday* Form 314]

5. An **annual property operating disclosure (APOD)** statement covering the expenses of ownership and any income produced by the property, filled out and signed by the seller, together with a **rent roll** and copies of lease forms used by the owner. [See *first tuesday* Forms 352 and 562]

6. Copies of all the Covenants, Conditions and Restrictions (CC&Rs), disclosures and assessment data from any **homeowners’ association (HOA)** involved with the property. [See *first tuesday* Form 309 and 150 §11.9]

7. A **termite report** and clearance paid for by the seller.

8. Any replacement or repair of defects noted in the home inspection report or on the TDS, as authorized and paid for by the seller.

9. An occupancy **transfer certificate** (including permits or the completion of retrofitting required by local ordinances) paid for by the seller.

10. A statement on the amount and payment schedule for any special district property **improvement bonds** which are liens on the property (these are not property taxes), as shown on the title company’s property profile.

11. A **visual inspection** of the property and a survey of the surrounding neighborhood by the seller’s broker or agent to become informed about readily available facts affecting the marketability of the property.

12. **Advising** the seller about the marketability of the listed property based on differing prices and terms for payment of the price, and for property other than one-to-four residential units, the financial and tax consequences of various sales arrangements which are available by using alternative purchase agreements, options to buy, exchange agreements and installment sales.
13. A **marketing (listing) package** on the property compiled by the seller’s agent and handed to prospective buyers or buyer’s agents before the seller accepts any offer to purchase the property, consisting of copies of all the property disclosures, required or volunteered, to be handed to prospective buyers or the buyer’s agent by the seller and seller’s broker.

14. A **marketing plan** prepared by the seller’s agent and reviewed with the seller for locating prospective buyers, such as by distributing flyers, disseminating property data in the MLS, newspapers and periodicals, broadcasts at trade meetings attended by buyer’s agents, press releases to radio or television, internet sites, posting “For Sale” signs on the premises, hosting open house events, posting on bulletin boards, mailing to neighbors and using all other advertising media available to reach prospective buyers.

15. A **seller’s net sheet** prepared by the seller’s agent and reviewed with the seller each time pricing of the property is an issue, such as when obtaining a listing, changing the listed price, reviewing the terms of a purchase offer or when substantial changes occur in charges or deductions affecting the net proceeds from a sale. [See **first tuesday** Form 310]

16. Informing the seller of their agent’s **sales activities** through weekly communications, advising what specifically has been done during the past several days and what the seller’s agent expects to do in the following days, as well as what the seller can do in response to comments from buyers and their agents, and on any changes in the real estate market.

17. **Keeping records** in a client file of all activities and documents generated due to the listing.

In a real estate transaction, brokers and their agents need to be certain who their client is. Likewise, agents need to determine who isn’t their client, but is a **customer** with whom the broker is directly negotiating or who is represented by another broker. The seller’s broker only owes a customer a **general duty** to deal fairly and honestly.

A seller’s broker and their agents have a **special fiduciary agency duty** owed solely to the seller who has employed the broker. The **fiduciary agency duty** requires the broker or agent to diligently market the listed property for sale. The objective of this employment is to continually and conscientiously work to locate a prospective buyer who is ready, willing and able to acquire the property on the listed terms.

On locating a prospective buyer, either directly or through a buyer’s agent, the seller’s agent owes the prospective buyer a limited, non-client **general duty** to voluntarily provide information on the listed property, collectively called **disclosures**.
The information disclosed by the seller’s agent need only be sufficient in content to place the buyer on notice of material facts which may have an adverse effect on the property’s value or the buyer’s use of it.

Thus, the disclosure obligations of the seller’s agent to voluntarily inform prospective buyers about the fundamentals of the listed property limit the seller’s agent’s ability to exploit the prospective buyer. The seller’s agent may not:

- deliver up less than the minimum level of information to put the buyer on notice of the property’s fundamentals for determining its value;
- give unfounded opinions or deceptive responses in response to the buyer’s inquiries; or
- stifle buyer inquiries about the property in the pursuit of the best financial advantage obtainable for the seller (or the seller’s agent).

The statutory duty a seller’s agent owes to prospective buyers to disclose facts about the physical condition of a one-to-four unit residential property is limited to their:

- prior knowledge about the property; and
- observations made while conducting their mandatory visual inspection.

To complete the disclosure process, the seller’s agent filters property information provided by the seller before it is provided to the prospective buyer.

Accordingly, all property information received from the seller is reviewed by the seller’s agent for inaccuracies or untruthful statements known or suspected to exist by the listing agent. Corrections or contrary statements by the seller’s agent necessary to set the information straight are entered on the disclosure forms before the information is used to market the property and induce prospective buyers to purchase, called fair and honest dealings.

The extent to which disclosures about the physical condition of the property are to be made is best demonstrated by what the seller’s agent is not obligated to provide. Everything else adversely affecting value and known to the seller’s agent are to, as a matter of law, be brought to the attention of prospective buyers.

As a minimum effort to be made before handing a prospective buyer information received from the seller, the seller’s agent is to:

- review the information received from the seller;
- include comments about the agent’s actual knowledge and observations made during their visual inspection of the property which expose the inaccuracies or omissions in the seller’s statements; and
- identify the source of the information as the seller.
A seller’s agent on a one-to-four unit residential property owes no affirmative duty to a prospective buyer to gather or voluntarily provide any facts unknown to the seller’s agent about:

- the property’s title conditions, consisting of encumbrances such as easements, Covenants, Conditions and Restrictions (CC&Rs), legal descriptions, trust deed provisions, etc.;
- the operating expenses and any tenant income the buyer will experience during ownership, such as utilities and property taxes;
- the zoning or other use restrictions which may affect the buyer’s future use of the property, except for the existence of industrial zoning which affects the property, and nearby military ordnance locations;
- the income tax aspects of the buyer’s acquisition of the property, such as limitations on interest deductions;
- the suitability of the property to meet the buyer’s objectives in the acquisition; and
- information or data on any mixed use of the property, such as acreage included in the purchase for use as subdividable lands, groves or other farming operations, or for use for tenant income or as a vacation rental.

Further, the seller’s agent owes no duty to prospective buyers to:

- give advice;
- make recommendations;
- offer suggestions;
- comment on the extent of any adverse facts disclosed;
- state an opinion; or
- explain the effect on the buyer of any facts about the property’s physical, natural or environmental conditions which have been provided by the listing agent.

Further, a seller’s agent does not owe a duty to the prospective buyer to explain the consequences of the customer’s failure to further investigate or analyze adverse facts sufficiently disclosed by the agent to put the buyer on notice of the condition.

However, when asked by the prospective buyer or buyer’s agent about any aspect, feature or condition which relates to the property or the transaction in some way, the seller’s agent is duty-bound to respond fully and fairly to the inquiry. The response is to include material facts known to the seller’s agent about the subject matter of the inquiry and not contain misleading statements.

Conversely, it is the buyer or the buyer’s agent who has a duty to care for and protect the buyer’s best interests.
The buyer’s agent, not the seller’s agent, are to determine what due diligence efforts are necessary to learn the extent to which the facts disclosed by the seller’s agent interfere with the buyer’s expectations for the use and enjoyment of the property.

A buyer is entitled to far more assistance from their buyer’s agent than the naked suggestions or recommendations contained in preprinted advisory disclosures about the availability of various enumerated services. The duty of the buyer’s agent goes well beyond the seller’s agent’s limited fundamental factual disclosure obligations they owe to the buyer and the buyer’s agent.

Here, the buyer’s broker and their agent limit their use of an advisory statement of recommended investigations to that of a checklist of activities to be considered. From this checklist the buyer’s agent is to identify those services they believe the buyer needs to undertake for the buyer to best protect their interests in the proposed transaction.

More importantly, services the buyer’s agent has reason to believe the buyer needs to engage in are made the subject of contingency provisions included in the purchase offer. Thus, the buyer’s agent provides their buyer with the opportunity to investigate and analyze the agent’s concerns prior to closing, with the right to cancel and avoid the transaction if the investigation discloses unacceptable conditions.

For example, a buyer’s agent has an affirmative duty to protect their buyer by pointing out why a recommended activity needs to be undertaken when the activity may uncover a situation which, if it exists, is to be dealt with before closing.

The buyer’s agent using an advisory statement of recommended activities as a checklist will:

- determine which of the itemized activities their buyer needs to undertake before closing;
- assist the buyer to weigh the probability of discovering undisclosed defects or conditions which might have consequences adverse to the buyer’s objectives after closing; and
- help the buyer analyze the risk of loss upon discovery of defects of the type suspected will likely be discovered after closing.
Diligent effort on the part of the seller’s agent is broadly achieved by making a concerted and continuing effort to locate a buyer. An agent’s failure to exercise due diligence gives the seller cause to terminate the agency relationship, voiding their obligation to pay a fee.

On entering into a listing, a physical file is set up to house information and document all the activity which arises due to the existence of the listing. Guidelines, checklists and activity sheets are used to build a file’s content, and are kept in the file to be reviewed periodically by the agent, broker or office manager.

In a real estate transaction, brokers and agents only owe a general duty to deal fairly and honestly with the opposing party who is not their client. The seller’s agent’s limited general duty owed to a prospective buyer is to put the buyer or the buyer’s agent on notice of facts which might, if known, adversely affect their valuation of the listed property.

The duty of the buyer’s agent goes well beyond limited disclosure obligations owed the buyer and the buyer’s agent by the seller’s agent. A buyer’s agent has an affirmative duty of care to protect their buyer.
Notes:
After reading this chapter, you will be able to:

- order a home inspection report (HIR) to assist in a risk free preparation of the mandatory Transfer Disclosure Statement (TDS);
- judiciously select a qualified, insured home inspector to prepare an HIR;
- confirm the accuracy and completeness of the seller’s disclosures to a buyer; and
- understand when to disclose a death on the property to a buyer.

### Key Terms

**home inspection report (HIR)**

**Transfer Disclosure Statement (TDS)**

A seller’s broker or their agent, before marketing a one-to-four unit residential property for sale, are to:

- conduct a visual inspection of the property on behalf of the seller;¹ and
- disclose their observations and knowledge about the property on a Transfer Disclosure Statement (TDS) or other separate document to be handled to prospective buyers.²

When preparing the TDS, the seller’s broker or their agent may rely on specific items in a home inspection report (HIR) to prepare their final TDS. Importantly, their reliance on an HIR prepared by a home inspector in preparation of the TDS relieves the seller and broker from liability for errors in their disclosures which are unknown to them to exist.

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¹ Civil Code §2079
² CC §1102.1
However, to rely on the HIR, the seller and broker cannot be negligent in their selection of the home inspector who prepares the HIR. Thus, the seller’s broker must exercise ordinary care when they or their agents select the home inspector.

The home inspector who holds a professional license or is registered with the state as a general contractor, architect, pest control operator or engineer is deemed to be qualified. If licensed or registered, their selection meets the ordinary care requirement, unless the broker or agent knows of information to the contrary.

When hiring a home inspector, the qualifications to look for include:

- *educational training* in home inspection related courses;
- *length of time* in the home inspection business or related property or building inspection employment;
- errors and omissions insurance covering professional liability;
- professional and client references; and
- membership in the California Real Estate Inspection Association, the American Society of Home Inspectors or other nationally recognized professional home inspector associations with standards of practice and codes of ethics.

By hiring a home inspector to assist the seller and the seller’s agent to accurately prepare the TDS and better represent the actual condition of the property to prospective buyers, the risk of error is reduced.

Use of an HIR by the seller’s agent does not replace or relieve the agent (or their broker) of their duty to conduct the mandatory visual inspection of a listed one-to-four unit residence.3

Home inspectors occasionally fail to detect and report a material defect in their report which is relied on by the seller’s broker, the seller, and the buyer. Often, the cost to correct the oversight is significant and the negligent home inspector is liable for that cost. However, unless the home inspector is insured, the buyer is at a disadvantage in any recovery effort against the home inspector.

Likewise, if the same defect was negligently missed by the seller’s agent during the agent’s mandatory visual inspection, the broker and the seller’s agent are also liable to the buyer for the costs of curing the defect. However, the broker and seller’s agent, though possibly negligent in their visual inspection, have an *indemnification claim* against the home inspector for payment of all or a portion of the buyer’s loss.

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3 CC §1102.4(a)
Unless the home inspector has insurance coverage, the ability of the seller's broker to force the home inspection company to pay the home inspector's share for failing to observe the same defect will be limited to the home inspector's personal assets.⁴

A seller and their agent must disclose to a prospective buyer all known and observable property conditions which adversely affect the value of the property.

A TDS completed by the seller and their agent, without the benefit of an HIR, too often does not fully reveal the significant property defects or code violations which exist, whether known or unknown to the seller or agent.

When the seller does not authorize the preparation of an HIR at the time of the listing, or at least prior to their entering into a purchase agreement, the prudent buyer always needs to order out an HIR, a concern of the buyer's agent. Also, when the seller's agent does not provide an HIR with the TDS, the buyer or the buyer's agent needs to order the preparation of an HIR to independently confirm the condition of the property.

An inspection undertaken by a buyer avoids:

- after-closing discoveries of defects which require correction; and
- after-closing claims made by the buyer against the seller to recover the value lost or the costs incurred to correct the defects.

The buyer's discovery of defects after acceptance of the purchase agreement and prior to closing, whether by the buyer's investigation or by the seller's tardy disclosure, does not alter the buyer's rights if the buyer proceeds to close escrow. Thus, the buyer may acquire the property and pursue the seller and seller's broker to recover costs to cure the defects or the loss of value in the price paid for the property.

Armed with an HIR containing findings of material defects not known to the buyer or disclosed at the time the purchase agreement was accepted, the buyer can then make the necessary demands for corrections on the seller. Thus, the buyer ensures the property will be delivered in the condition as disclosed by the seller and made known to the buyer at the moment of entering into the purchase agreement, whether a TDS was received prior to or after acceptance of the buyer's offer.

The duty of each agent in a transaction to disclose facts which may adversely affect the property's value is not limited to disclosures of the property's physical condition.

Consider a buyer who enters into a purchase agreement. The offer includes the seller’s TDS disclosures about the condition of the property and environmental hazards surrounding the property. However, the buyer is unaware multiple murders occurred on the property.

⁴ Leko v. Cornerstone Building Inspection Service (2001) 86 CA4th 1109
The seller’s agent is aware that the notoriety of the murders adversely affects the market value of the property, placing its value below the price the buyer agreed to pay. The seller’s agent does not disclose the murders.

The transaction closes and the buyer later learns of the murders on the property. The buyer seeks to collect their price-to-value money loss from the seller’s agent, claiming the agent had a duty to disclose deaths since, due to the stigma of the deaths, the property’s market value was measurably lower than the purchase price paid by the buyer.

Did the agent have an affirmative duty to disclose the deaths?

Yes! Even though the deaths did not affect the physical condition of the property, the deaths had an adverse affect on the property’s market value. Further, the deaths are a material fact affecting value and were known to the agent and not disclosed. The agent deliberately concealed the deaths, being deceitful by silence. Every agent has an affirmative duty to disclose prior deaths when the death might affect the buyer’s valuation or desire to own the property.5

Further, on direct inquiry by the buyer or the buyer’s agent, the seller’s agent must disclose their knowledge about whether deaths have occurred on the real estate, no matter when they occurred.6 [See Ethics Chapter 12]

The broker’s illegal “as-is” sale

Consider a seller’s agent who, on conducting their visual inspection, senses the property fails to conform to building and zoning regulations.

A buyer submits a purchase agreement offer. The seller’s agent knows the prospective buyer is unaware of the possible violations, and might view the property’s value differently if they learn of the conditions. The seller’s agent prepares a counteroffer, inserting an “as-is” disclaimer provision. The disclaimer states the agent “makes no representations regarding the property and incurs no liability for any defects, the buyer agreeing to purchase the property ‘as is.’” The counteroffer is accepted.

After closing, the city refuses to provide utility services to the residence due to building code and zoning violations.

The buyer makes a demand on the seller’s agent for the buyer’s money losses due to the cost of corrective permits and repairs. The buyer claims the seller’s agent breached their general agency duties owed the buyer by failing to disclose material defects known by the seller’s agent.

The broker claims the buyer waived their right to collect money damages when they signed the purchase agreement with the “as-is” disclaimer.

Does use of an “as-is” provision shield a listing broker from liability?

No! The seller’s broker and agent have a general duty to personally conduct a competent visual inspection of the property sold. Based on that level of

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5 Reed v. King (1983) 145 CA3d 261
6 CC §1710.2(d)
expertise for their inspection, they are to disclose all known and observable property conditions which adversely affect the value and desirability of the property for the use intended which are not already known to the buyer. The failure to disclose is not excused by writing an “as-is” disclaimer provision into the purchase agreement in lieu of factual disclosures.7

“As is” provisions become an unnecessary distraction for an explanation of the property’s condition when information regarding defects is included in the seller’s TDS and handed to the buyer. The seller and the seller’s agent simply disclose the defects, whether or not the seller agrees to make repairs. [See Ethics Chapter 3]

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7 Katz v. Department of Real Estate (1979) 96 CA3d 895

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Seller’s brokers and agents must conduct a visual inspection of a property for conditions that adversely affect the property’s value or use. In turn, their observations and any prior knowledge they have of property defects are entered on the Transfer Disclosure Statement (TDS) initially prepared and signed by the seller.

After the seller’s agent completes their visual inspection of the listed property, they may use a home inspection report (HIR) to assist them prepare their entries on the seller’s TDS. If used to prepare the TDS, an HIR completed by a qualified home inspector relieves the seller’s broker and their agents from liability for unreported defects that were unknown to them to exist.

Any agent ordering a HIR is to verify the home inspection company has professional liability insurance coverage before hiring the company to conduct an investigation and prepare a report.

A seller’s agent must also disclose any knowledge about deaths on the property on a direct inquiry from a buyer about the matter. Also, if the deaths are significant to the extent of being a material fact, the agent is to voluntarily disclose the circumstances of the deaths.

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Risk Management
Chapter 4
Summary

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Transfer Disclosure Statement (TDS) .................................... pg. 211

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Risk Management
Chapter 4
Key Terms
Notes:
A seller’s residence in foreclosure

After reading this chapter, you will be able to:

• identify an equity purchase (EP) transaction;
• comply with the statutory procedures for equity purchase transactions;
• provide a seller-in-foreclosure with notice of their right to cancel an equity purchase transaction;
• recognize the disadvantages of accepting an exclusive listing on a property in foreclosure; and
• avoid circumstances which allow a seller-in-foreclosure to claim an investor created an unconscionable advantage in an equity purchase and to rescind the sale.

Key Terms

- equitable indemnity
- equity purchase
- equity purchase investor
- right of rescission
- unconscionable advantage

An equity purchase (EP) transaction takes place when the owner-occupant of a one-to-four unit residential property in foreclosure conveys the property to a buyer who acquires it for rental, investment or dealer purposes. The non-occupying buyer taking title to the residence of a seller-in-foreclosure is called an EP investor. Unique statutory rules apply to all equity purchase transactions.

Editor’s note – Alternatively, an EP transaction does not occur and the EP rules do not apply if the buyer acquires the property for use as his personal residence.
Equity purchase statutes apply to all buyers who are EP investors, regardless of the number of EP transactions the investor completes. The investor does not need to be in the business of buying homes in foreclosure for the statutes to apply.¹

Both the EP investor and their agent are to comply with EP law or be subject to penalties.

The EP regulations extend to control the type of form used to document the EP sale. The EP agreement signed by an EP investor will be printed in bold type, ranging from at least 10-point to 14-point font size, and be in the same language used during negotiations with the seller-in-foreclosure.² [See Figure 1, first tuesday Form 156]

The written EP agreement is to also contain the required statutory EP notices. Failure to use the correct forms subjects the EP investor and the agents to liability for all losses incurred by the seller-in-foreclosure, plus further penalties.³

Editor’s note — first tuesday’s Equity Purchase Agreement, Form 156, complies with all statutory requirements and properly sets forth the right of the seller-in-foreclosure to cancel. [See Figure 1, first tuesday Form 156]

Upon entering into an agreement to sell their principal residence and after proper notice of their rights, a seller-in-foreclosure has a statutory five-business-day right to cancel the EP agreement. Thus, the seller may avoid closing the sale, with or without cause.

The statutory right to cancel within five-business-days is contained in the mandated boilerplate language contained in an equity purchase agreement. If the seller cancels before the period expires, the sale under the purchase agreement may not be closed. As the EP agreement automatically incorporates the seller’s five-business-day right to cancel before a closing may take place, compliance is assured.

The seller’s cancellation period ends:

- midnight (12:00 a.m.) of the fifth business day following the day the seller enters into an equity purchase agreement with an EP investor; or
- 8:00 a.m. of the day scheduled for the trustee’s sale, if it is to occur first.⁴

The seller-in-foreclosure’s five-business-day right to cancel does not begin to run until proper notice of the cancellation period is given to the seller.⁵

Failure to use a purchase agreement containing the mandatory notice of right to cancel allows the seller to cancel the sales agreement and escrow until proper notice and the time for cancellation has run. Further, the seller may even rescind the sale after closing when the notice of right to cancel

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¹ Segura v. McBride (1992) 5 CA4th 1028
² Cal. Civil Code §§1695.2, 1695.3, 1695.5
³ Segura, supra
⁴ CC §1695.4(a)
⁵ CC §1695.4(b)
was not delivered more than five business days before closing. The right to rescind the closed sales transaction and recover ownership of the property remains until the running of five business days after notice is ultimately given.

A **business day** is any day except Sunday and the following business holidays:

- New Year’s Day;
- Washington’s Birthday;
- Memorial Day, Independence Day;
- Labor Day;
- Columbus Day;
- Veterans’ Day;
- Thanksgiving Day; and
- Christmas Day.

Saturday is considered a business day under EP law, unless it falls on an enumerated holiday. Many state holidays are not included as holidays.6

Until expiration of the right of the seller-in-foreclosure to cancel the transaction, the EP investor may not:

- *accept or induce a conveyance* of any interest in the property from the seller;
- *record any document* regarding the residence signed by the seller with the county recorder;
- *transfer an interest* in the property to a third party;
- *encumber any interest* in the residence; or
- *hand the seller* a “good-faith” deposit or other consideration.7

However, escrow may be opened on acceptance and deeds and funds deposited with escrow. This does not violate the right to cancel since the seller-in-foreclosure does not convey the property to the buyer and will not receive funds until the close of escrow.

**Cancellation** of the purchase agreement by the seller-in-foreclosure is **effective on delivery** of the signed written notice of cancellation to the EP investor’s address in the purchase agreement.8

When the EP investor receives the seller-in-foreclosure’s written notice of cancellation, the EP investor is to return all original contract documents within ten days following receipt of the notice. This includes the original EP agreement bearing the seller’s signature to the seller.9

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6 CC §1695.1(d)
7 CC §1695.6(b)
8 CC §1695.4(b)
9 CC §1695.6(c)
When the cancellation period expires for lack of a cancellation, the purchase agreement becomes enforceable and escrow may be closed, unless other contingencies exist.

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**False representations prohibited**

In negotiations with the seller-in-foreclosure, the EP investor may not make false representations or misleading statements about:

- the value of the property in foreclosure;
- the net proceeds the seller will receive on closing escrow [See first Tuesday Form 310];
- the terms of the purchase agreement or any other document the EP investor uses to induce the seller to sign; or
- the rights of the seller in the EP transaction.\(^{10}\)

These rules also apply to the EP investor’s agent.

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**Brokers limited to listing property**

The buyer’s broker representing an EP investor is to deliver to all the parties to an EP transaction a written EP disclosure statement. The EP disclosure statement confirms the agent for the EP investor is a licensed real estate broker.

The broker is to also provide proof of licensure to the seller-in-foreclosure.\(^{11}\)

If the buyer’s agent fails to deliver either the EP disclosure or the proof of licensure to the relevant parties, the EP agreement is **voidable** at the discretion of the seller any time before escrow closes.

Also, the EP investor is liable to the seller-in-foreclosure for any **losses arising** out of the EP investor’s agent’s nondisclosure of licensing requirements.\(^{12}\)

However, the EP investor is entitled to **equitable indemnity** from his agent. **Equitable indemnity** is available to the EP investor who, without active fault, is forced by legal obligation to pay for losses created by their agent’s nondisclosure.\(^{13}\)

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**Broker as principal**

The EP legislation does not restrict the ability of an individual, who may be licensed as a broker or sales agent, to act solely for their own account as a **principal** purchasing property as an investor in an EP transaction.

Thus, a licensed real estate broker or agent may be the EP investor. This eliminates use of the agency law disclosure and avoids licensee disclosure and proof requirements, unless a broker fee is paid in the transaction to the buyer/licensee. The licensed real estate broker or agent, acting solely as an

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\(^{10}\) CC §1695.6(d)

\(^{11}\) CC §1695.17(a)

\(^{12}\) CC §1695.17(b)

\(^{13}\) San Francisco Examiner Division, Hearst Publishing Company v. Sweat (1967) 248 CA2d 493
TERMS: Buyer to pay the purchase price as follows:

2. This agreement is comprised of this six-page form and ______ pages of addenda/attachments.

4. h. Buyer may, within ten days after receipt, terminate this agreement based on a reasonable disapproval of the property information received.

h. Buyer to inspect the property twice:

11.2 After acceptance, Broker(s) are authorized to extend any performance date up to one month.

11.4 Buyer’s close of escrow is conditioned on Buyer’s prior or concurrent closing on a sale of other property, commonly referred to as _______________________________________________________.

11.8 Should Buyer breach the agreement, Buyer’s monetary liability to Seller is limited to

11.10 Seller’s Neighborhood Security Disclosure [See ft Form 321]

12.1 Seller to furnish prior to closing:

12.5 Seller’s Natural Hazard Disclosure (NHD) Statement [See ft Form 314]

12.6 Buyer acknowledges receipt of a booklet and related Seller disclosures containing [Environmental Hazards: A Guide for Homeowners, Buyers, Landlords and Tenants] and ______% per annum from closing, due _____________, 20______, after closing.

Payment of $_______________. ___________________________________________

Buyer may terminate this agreement based on a reasonable disapproval of the property information received.

11.11 This offer to be deemed revoked unless accepted in writing or presentation, or within days after offer, and acceptance is personally delivered or handed to Offeror or Offeror’s Broker within this period.

11.2 Seller’s Condition of Property Disclosures — Transfer Disclosure Statement (TDS) [See ft Form 306]

12.6 Buyer to inspect the property twice:

12.16 Notice: Pursuant to Section 290.46 of the Penal Code, information about specified registered sex offenders may be available to the public. The information includes the name and address of the offender and the offense for which the offender was convicted. California law requires that this information be made available to the public. After acceptance, Buyer may inspect the property for the purpose of verifying the information provided.

12.19 Buyer’s property improvements are no greater than

12.2 Seller’s Transfer Fee Disclosure Statement [See ft Form 34-4]
Figure 1 (cont.) Form 156 Equity Purchase Agreement

15. FURTHER CONDITIONS: ____________________________________________________________________

16. NOTICE OF YOUR SUPPLEMENTAL PROPERTY TAX BILL:
California property tax law requires the Assessor to ravelue real property at the time
the ownership of the property changes. Because of this law, you may receive one or two
supplemental tax bills, depending on when your loan closes.
You may cancel this contract for the sale of your house, without any penalty or obligation, at any time before
_____  , _____________, 20______.

NOTICE REQUIRED BY CALIFORNIA LAW:
Until your right to cancel this contract has ended, (Buyer)
or anyone working for (Buyer)
CANNOT ask you to sign or have you sign any deed or any other document.
You may cancel this contract for the sale of your house, without any penalty or obligation at any time before
_____  , _____________, 20______.

See attached Notice of Cancellation form for an explanation of this right.

NOTICE OF CANCELLATION:
To cancel this transaction, personally deliver a signed and dated copy of this cancellation notice, or send
a telegram to __________________________ (Buyer)
NOT LATER THAN    ______:______, ______.m. on _____________, 20______.

I hereby cancel this transaction.
Date: ____________________________

Seller’s Signature: ____________________________

FORM 156  03-13 ©2013 first tuesday
EP investor, is a buyer who coincidently holds a real estate license. As the licensee is not acting as an agent for anyone in the transaction, their licensed status need not be disclosed since it is not relevant.

Conversely, if a real estate broker is employed as the seller-in-foreclosure’s broker, and the broker decides to directly or indirectly buy the property, the broker is to disclose to the seller-client the broker is also acting as a principal in the transaction.¹⁴

Prudent brokers and agents are inclined not to solicit or accept an exclusive right-to-sell listing from a seller-in-foreclosure.

Property in foreclosure has to be sold and escrow closed before the date of the trustee’s foreclosure sale if the seller’s goal of selling the property is to be achieved. Unless the delinquent loan is brought current prior to five business days before the trustee’s sale, or paid in full before the trustee’s sales is completed, the home will be sold at the trustee’s sale. When sold by foreclosure, the objectives of the listing employment are lost. Thus, the agent is not entitled to a fee.¹⁵

As a listing complication, the agent for a seller-in-foreclosure usually finds themselves in market conditions which require more time to locate a buyer and close escrow. In a troubled market, the frequency of foreclosures is inversely related to the frequency (volume) of negotiated sales; more distress sellers than ready buyers.

Time constraints imposed on the seller’s agent by a trustee’s sale date place extra pressure on the broker employed under an exclusive listing agreement to locate a buyer. As always, the seller’s agent under an exclusive listing is to perform their agency duties by properly marketing the property with care and diligence.

Further, the seller-in-foreclosure is financially weak, if not completely insolvent, and not particularly forthcoming about closing issues. These cash-poor ownership situations lead to clouds on title, deferred maintenance and lack of upkeep on the listed property. These conditions make it difficult for the agent to market the property or perform and close escrow on a transaction.

Expectations of a seller-in-foreclosure are a further complication. They expect the broker to save what equity they may have (based on the listed price) by negotiating a sale of the property and closing escrow before the property is lost to the foreclosing lender.

If the insolvent seller loses their equity, they may claim a lack of due diligence or unprofessional conduct on the part of the broker. These risks face licensed brokers and agents who list property which is in foreclosure.

¹⁴ Calif. Business and Professions Code §§10176(d), 10176(g), 10176(h)
¹⁵ CC §§2924c(e), 2903
Two-year right of rescission

A two-year right of rescission period allows a seller-in-foreclosure to recover their residence if there is evidence the EP investor took unconscionable advantage of them when negotiating the purchase of the property.

Consider a Notice of Default (NOD) recorded on a homeowner’s personal residence after several months of delinquencies.

The homeowner, now in foreclosure on recording the NOD, is willing to sell on almost any terms to salvage their remaining equity in the property. The property is listed and the seller’s agent markets the property primarily to buyers who will occupy the property as their personal residence.

Avoiding the agent, an offer is submitted directly to the seller-in-foreclosure by an EP investor. The EP investor is not represented by a broker. Under the EP offer, the seller-in-foreclosure will receive cash for their equity. Additionally, the EP investor will cure the seller’s loan delinquencies and take over the loan, a classic equity purchase arrangement.

On review of the offer, the seller-in-foreclosure’s broker recommends the seller accept the EP investor’s offer. The broker further recommends that if an acceptable backup offer is received within the five-business-day cancellation period, the seller is to accept the backup offer and cancel the EP agreement.

The seller-in-foreclosure accepts the EP investor’s offer. The five-day cancellation period expires without receiving a backup offer. The EP transaction is later closed and the property conveyed.

Does the EP investor receive good title when they accept the grant deed?

No! The EP investor’s title remains subject to the seller-in-foreclosure’s right of rescission for two years after closing. If at any time during the two years following the close of escrow and the recording of the grant deed the seller believes the EP investor’s conduct and the price paid gave the EP investor an unconscionable advantage, the seller may attempt to rescind the transaction and recover the home they sold, called restoration.16

These rescission conditions are more prevalent during periods of swift upward price movement. The market conditions which favor speculator activity are precisely the same conditions that cause a seller of a home to demand it be returned. A profit has come about within two years which is now sought by both the investor who speculated and gained by a flip, and the seller who believes they were ripped off of the profit taken by the investor.

The legislature has not clearly defined what exactly constitutes an act of unconscionable advantage by an EP investor. Thus, showing the existence of an unconscionable advantage in the EP investor’s conduct is problematic. It is difficult for the seller-in-foreclosure to prove, and for the EP investor to refute.

16 CC §1695.14
What a reasonable sales price might have been under the circumstances at the time the EP transaction was entered into might appear to be unconscionable to the seller in the future. Thus, an EP investor assumes not only the risk that a rising economy may provide a profit on a flip, but that it will provoke the seller into attempting to rescind the sale to capture that profit as part of the original sale.

If real estate values rise rapidly and significantly, the “greed factor” may set in. This dynamic transforms a formerly desperate seller-in-foreclosure into an astute rescinding seller.

However, the test of unconscionable advantage is not based on events occurring after the seller-in-foreclosure enters into the purchase agreement. Thus, any increase in the value of the property after acceptance of the EP investor’s offer may not be considered. It is the fair market value (FMV) of the property at the time of the EP investor’s acquisition that is critical.

Market circumstances existing at the time of the negotiations, or when the parties entered into the agreement, are the economic considerations which form one of the two elements for testing unconscionable advantage.\(^{17}\)

Unconscionability has two aspects:

- the lack of a meaningful choice of action for the seller-in-foreclosure when negotiating to sell to the EP investor, legally called procedural unconscionability; and
- the purchase price or method of payment is unreasonably favorable to the EP investor, legally called substantive unconscionability.

To deprive the seller-in-foreclosure a meaningful choice between the EP investor’s offer and offers from other buyers, a misrepresentation or other fraudulent activity needs to exist to establish the lack of a meaningful choice or alternative to the EP investor’s offer.

The price paid, like any other provision in a purchase agreement, might be considered unconscionable. When determining the unconscionability of the purchase price, justification for the price at the time of the sale and the terms of payment of that price will be examined.

An unconscionable method of payment could include:

- carryback paper with a below market applicable federal rate interest rate (AFR), long amortization or a due date on the note that bears no relationship to current payment schedules; or
- an exchange of overpriced land, stock, gems, metals or zero coupon bonds at face value with a 20-year maturity date.

A form of payment which is uncollectible, unredeemable and with no present value is also unconscionable.

\(^{17}\) Colton v. Stanford (1890) 82 C 351
An equity purchase (EP) transaction occurs when an owner-occupied, one-to-four unit residential property is acquired for rental, investment or dealer purposes by an EP investor. EP investors and their agents are subject to harsh penalties if they fail to adhere to all the regulations governing equity purchase transactions.

A seller-in-foreclosure is granted a statutory five-business-day right to cancel an equity purchase agreement, with or without reason. The seller also has a two-year right of rescission after closing the sale to recover their residence if they can demonstrate the EP investor took unconscionable advantage of them when negotiating the purchase of the property. An unconscionable advantage occurs if the EP investor exploits an element of oppression or surprise and exacts an unreasonably low and favorable purchase price or terms of payment.

An unconscionable advantage occurs if the EP investor exploits an element of oppression or surprise and exacts an unreasonably low and favorable purchase price or terms of payment. These are elements of fraud from threats, undue influence or deceit.

**Oppression** by the EP investor exists when the inequality in bargaining power results in no real negotiations, a “take it or leave it” environment. The foreclosure environment itself often presents a one-sided bargaining advantage for an aggressive EP investor to exploit.

**Surprise** occurs due to the post-closing discovery of terms which are hidden in the lengthy provisions of the agreement or escrow instructions.

The greater the marketplace oppression or post-closing surprise discovered in the transaction, the less an unreasonably favorable price paid by an EP investor will be tolerated.\(^\text{18}\)

\(^{18}\) *Carboni v. Arrospide* (1991) 2 CA4th 76

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### Un-American activity coupled with a low price

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A broker representing an EP investor is to deliver to all the parties to the EP transaction a written EP disclosure statement confirming they are a licensed real estate broker, along with proof that their license is current and valid in the State of California. If the broker or agent themselves are the EP investor, use of the agency law disclosure and proof licensure are eliminated.
Risk Management, Chapter 5: A seller’s residence in foreclosure

Key Terms

- equitable indemnity ....................................................... pg. 220
- equity purchase ............................................................. pg. 217
- equity purchase investor ............................................. pg. 218
- right of rescission ......................................................... pg. 224
- unconscionable advantage ......................................... pg. 224
Notes:
For brokers and agents, providing real estate brokerage services to members of the public is a rewarding profession. That said, the occupational hazard of a dispute with a client or another party will inevitably surface to cause a moment of hesitation for a broker or sales agent. Even when brokers and agents fulfill all of their agency duties, act diligently and cooperate fully with the client and other parties, disputes may arise.

Unless the conflict with the client or other party is resolved at the earliest possible moment, the continuing aggravation takes a toll on a broker’s time and effort – and possibly cash reserves.

Also, disputes with a client tend to make continued representation of the client less effective. During an extended dispute, the broker or agent may be rendered incapable of logically making normal discretionary decisions in the course of fulfilling their agency obligations owed to the client.
Worse, the unreasonable interference of an uncompromising client creates a stressful condition which can easily lead to errors in an agent’s judgment.

As always, disputes need to be put to rest quickly. Otherwise, they may turn into correspondence with attorneys, or worse, litigation. When a settlement is not promptly resolved so the employment can continue on sound footing, the agency relationship needs to be terminated.

To terminate an agency relationship due to a dispute, a release and waiver is entered into by all parties concerned.

**Agency disputes** arise during one of three periods in the representation of a client:

- the **marketing period** beginning on the client employment and authorization of the broker and their agent’s to sell, locate, finance, lease or manage a property. The marketing period normally ends on the client’s entry into an agreement to sell, buy, finance or lease the property in question;
- the **escrow period** beginning on the client’s entry into a purchase agreement, loan agreement or lease. The escrow period typically ends on the close of escrow, the transfer of possession or the failure of the transaction to close; or
- the **post-closing period** following the closing of the purchase agreement, loan or lease transaction.

Misunderstandings sometimes occur regarding the extent of the **marketing services** a client expects of their broker and the broker’s agents. The client’s extraordinary expectations might have existed before entering into the employment agreement. Or they may originate when the agent explained what will be done to market or locate property. Also, outside influences during the marketing period may cause the client to believe the agent ought to be doing more.

Conversely, a seller might become uncooperative in the marketing of the property. For example, the seller might refuse to hand over property information needed by the seller’s agent to effectively locate a buyer willing to make an offer on the property.

Reports a seller ought to be asked to provide, in order to contribute to the creation of a better marketing package presented to prospective buyers, include:

- home inspection reports;
- natural hazard disclosures [See *first tuesday* Form 314];
- common interest development (CID) documents;
- local ordinance compliances;
- property operating expense sheets [See *first tuesday* Form 352]; and
- rental income data. [See *first tuesday* Form 352-1]
Without proper disclosure of fundamental property information, prospective buyers cannot ascertain the value of the property and distinguish it from other properties they are considering.

The marketplace normally works this way, *speculator interference* being a damaging diversion from the norm.

To resolve disputes when a compromise is unattainable, it becomes prudent to consider *terminating the agency*. If the client decides to unilaterally withdraw the property from the market, cancel the employment or continue to interfere in the sales effort without justification, the client owes the broker the fee due under the employment agreement. However, to justify collection of their fee when the client interferes, the seller’s agent must have diligently performed the brokerage services owed the seller under the listing, whether or not a buyer has been located.

To formally end the agency relationship with a client, a *release and cancellation of employment agreement* is prepared and entered into. The resolution negotiated by the broker might be a mutual cancellation of the listing given in exchange for the client’s payment of a fee. [See *first tuesday* Form 121]

The *consideration for cancellation* ranges from payment of the entire fee due under the listing on cancellation, to an agreed on lesser amount. For example, the client may agree to pay a fee when the client relists the property with another broker or sells the property, leases it, etc., during a fixed period after the mutual cancellation of the listing. [See *first tuesday* Form 121]

On entering into a *release and cancellation agreement*, the broker’s exposure to future claims based on a purported failure of agency duties is eliminated.

After opening a sales escrow for the purchase of real estate, disputes under two types of conditions might arise. Either type of dispute may ultimately require the termination of the agency relationship.

One set of disputes is classified as *agency disputes*. *Agency disputes* arise between the agent and their client after the client has entered into a purchase agreement. If the dispute cannot be resolved and the representation continued, the agency is terminated in the same manner as the listing period disputes discussed in the previous section.

The other set of disputes is classified as *principal disputes*. *Principal disputes* develop between the buyer and seller and result in a refusal of one or the other to act further to close escrow. The refusal of one party to proceed with the transaction might be excused, justified or constitute a *breach* of the purchase agreement.

Negotiations to resolve the misunderstandings and close escrow might not be successful. If the escrow dispute becomes irresolvable, the agent needs...
to consider recommending the buyer and seller terminate the purchase agreement. At the same time the buyer and seller cancel the transaction, they need to release each other from any claims they may have against one another, by entering into a **cancellation, release and waiver agreement**. [See Form 181 accompanying this chapter]

The **cancellation, release and waiver agreement** entered into by the buyer and **seller releases everyone involved** in the transaction. Thus, any **liability exposure** the agents and client may have due to the transaction is eliminated.

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**FORM 181**

Cancellation of Agreement

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**CANCELLATION OF AGREEMENT**

Release and Waiver of Rights with Distribution of Funds in Escrow

Prepared by: Agent ____________________________  Broker ____________________________

Phone ______________________ Email ______________________

**DATE:** _________, 20_____, at __________________________, California.

*Items left blank or unchecked are not applicable.*

**FACTS:**

1. This mutual cancellation and release agreement with waiver of rights pertains to the following agreement:
   - Purchase agreement
   - Exchange agreement

1.1 dated _____________, 20_____, at __________________________________________, California,

1.2 entered into by _________________________________________________________, as the Buyer, and

1.3 whose real estate brokers (agents) are
   - Buyer’s Broker _________________________________________________________
   - Seller’s Broker _______________________________________________________.

a. If an exchange is involved, the first and second parties to the exchange are here identified as Buyer and Seller, respectively.

1.4 regarding real estate referred to as ____________________________________________

1.5 Escrow Agent ____________________________  Escrow Number _________________

**AGREEMENT:**

2. Buyer and Seller hereby cancel and release each other and their agents from all claims and obligations, known or unknown, arising out of the above referenced agreement.

3. The real estate broker(s) and escrow agent(s) are hereby instructed to return all instruments and funds to the parties depositing them.

4. Costs and fees to be disbursed and charged to □ Seller, or □ Buyer.

4.1 $_______________ to ___________________________________________________________________

4.2 $_______________ to ___________________________________________________________________

4.3 ______________________________________________________________________________________

5. The parties hereby waive any rights provided by Section 1542 of the California Civil Code, which provides:

   "A general release does not extend to claims which the creditor does not know or suspect to exist in his or her favor at the time of executing the release, which if known by him or her must have materially affected his or her settlement with the debtor."

I agree to the terms stated above.

[ ] See attached Signature Page Addendum. [FT Form 251]

Date: _____________, 20_____  Buyer’s Name: ______________________________

Signature: ____________________________________

[ ] See attached Signature Page Addendum. [FT Form 251]

Date: _____________, 20_____  Seller’s Name: ______________________________

Signature: ____________________________________

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FORM 181  03-11 ©2011 first tuesday, P.O. BOX 20069, Riverside, CA 92516 (800) 794-0494
The expectations of a buyer in a purchase transaction are always high. Further, the condition of a property is almost never as rosy as it appeared before taking possession.

Thus, after closing a transaction, brokers and their agents are occasionally brought into annoyance disputes by buyers. These buyers may be disgruntled over the condition of the property, its improvements, the neighborhood, hazards of the location, zoning, easements held by neighbors, fence locations, operating expenses, tenant problems, etc.

Buyers, believing they have gotten less than they bargained for, often attempt to shift responsibility for payment of expenses they have incurred to cure superficial obsolescence or deterioration. Worse yet, they may seek to recover a portion of the purchase price on a claim the property value received was measurably less than the price they paid.

As mortgage rates rise, the value and pricing complaint will be heard more often than it was during the declining rate years of 1980 through 2013. This thirty-year prior run was reversed by zero lower-bound interest rates, rates that can only go up for a few decades to come.

However, the seller’s broker, while responsible for his services, is not the guarantor of an obligation the seller may owe the buyer for property deficiencies. As the gatekeeper to real estate ownership, it usually is the broker who is the first person put upon by a disgruntled buyer to “cure the problem.”

Brokers and agents often pay some of these claims to permanently remove themselves from a disputed purchase. On any settlement of a dispute on a closed transaction, the broker needs to demand a release and waiver settlement agreement. Once the buyer has “raided the cookie jar” for a few dollars, they may come back for more. The release and waiver provisions in a settlement agreement put an end to it. [See first tuesday Form 526]

A mutual cancellation agreement, which does not include a release of claims and waiver of rights, merely serves to terminate any further activity under the existing agreement or agency relationship. Thus, all parties are excused from further performing since the agreement and relationship have been terminated.

In essence, the cancellation “does away with” the remainder of the purchase agreement that has not yet been performed. A cancellation, by itself, does not affect the responsibilities of the buyer, seller, brokers or agents, for their activities which preceded the cancellation.

Conversely, a release and waiver of rights, commonly called a rescission and restoration agreement, returns the parties to the respective positions they held before entering into the terminated agreement. [See first tuesday Form 526]
Disputes with a client or another party occasionally arise in real estate transactions. Agency disputes may arise during the marketing period, escrow period and post-closing period. These disputes might become significant enough that an agent’s best option is to terminate the agency relationship. To do this, a release and waiver must be entered into by all parties concerned as part of the cancellation agreement.

A release agreement, signed by all parties to a transaction as part of a cancellation agreement, retroactively extinguishes all known claims in disputes the parties have between themselves. Thus, the general release ends all liability between the parties for those claims actually known to the parties to exist in the dispute.

However, a general release does not affect unknown claims later uncovered.¹ Thus, under a general release a category of claims remain unresolved, i.e., those which might exist, come into existence or be later established and are unknown to the parties on entering into a general release. These claims are called unknown and unsuspected claims. To eliminate these unknown claims, a waiver of the right to later pursue these claims must be included with a general release and made part of the mutual cancellation agreement.²

A written, signed release agreement does not require new consideration to be paid for the cancellation, release and waiver to be enforceable as a bar to further claims.³

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¹ Calif. Civil Code §1542
² CC §1542
³ CC §1541

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Risk Management
Chapter 6
Summary

Disputes with a client or another party occasionally arise in real estate transactions. Agency disputes may arise during the marketing period, escrow period and post-closing period. These disputes might become significant enough that an agent’s best option is to terminate the agency relationship. To do this, a release and waiver must be entered into by all parties concerned as part of the cancellation agreement.

A mutual cancellation agreement terminates any further activity under the existing agreement or agency relationship. A release agreement, signed by all parties to a transaction as part of a cancellation agreement, retroactively extinguishes all known claims and ends all possible liabilities in disputes the parties have between themselves.

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Risk Management
Chapter 6
Key Terms

agency disputes ................................................................. pg. 230
principal disputes ............................................................ pg. 231
unknown and unsuspected claims ................................. pg. 234