The Case for Statutory Changes in Commercial Real Estate Representation

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SB 1171 Seeks To Require Conflict Disclosures for Commercial Real Estate Brokers

Whenever there is a conflict of interest, there exists an opportunity for those seeking representation to be exploited. This is undeniably true for commercial real estate buyers and tenants. Current commercial real estate law prescribes fiduciary duties upon brokers, but at the same time permits dual agency. Dual agency occurs when one broker represents both landlord and tenant (or seller and buyer) in the same transaction. In fact, the law is specific regarding a dual agent's responsibility to not share any inside information between the parties. The dual agent is essentially limited to acting as a go-between, simply moving information back and forth between the two sides.

While the law governing residential real estate transactions requires written disclosure of the dual agent relationship, a description of the duties owed by the agent, and signed, written consent from the client for the dual agent to represent the client, current commercial real estate law does not require such disclosures. As we will further detail, these current shortcomings in the law have driven Hughes Marino to propose and support SB 1171. Extending these residential real estate protections to commercial transactions (which SB 1171 proposes) will close this ethical loophole and increase transparency in commercial real estate deals and broker-client relationships.

Dual Agency and Loyalty

Dual agency inherently creates a conflict of interest in the typical commercial real estate transaction because the broker's loyalty is divided between the two sides. In fact, despite the practice being permitted by law, commercial real estate brokers cannot truly uphold their fiduciary duties when acting as a dual agent, as explained by California courts. "[A] broker's fiduciary duty to his client requires the highest good faith and undivided service and loyalty. The broker as a fiduciary has a duty to learn the material facts that may affect the principal's decision. He is hired for his professional knowledge and skill; he is expected to perform the necessary research and investigation in order to know those important matters that will affect the principal's decision, and he has a duty to counsel and advise the principal regarding the propriety and ramifications of the decision. The agent's duty to disclose material information to the principal includes the duty to disclose reasonably obtainable material information." (Assilzadeh v. California Federal Bank (2000) 82 Cal.App.4th 399, 414-415, quoting Field v. Century 21 Klowden-Forness Realty (1998) 63 Cal.App.4th 18, 25-26.)

Additionally, "[a] fiduciary must tell its principal of all information it possesses that is material to the principal's interests. A fiduciary's failure to share material information with the principal is constructive fraud, a term of art obviating actual fraudulent intent." (Michel v. Palos Verdes Network Group, Inc. (2007) 156 Cal.App.4th 756, 762.)

"`Constructive fraud is a unique species of fraud applicable only to a fiduciary or confidential relationship.' Most acts by an agent in breach of his fiduciary duties constitute constructive fraud. The failure of the fiduciary to disclose a material fact to his principal, which might affect the fiduciary's motives or the principal's decision, which is known (or should be known) to the fiduciary, may constitute constructive fraud. Also, a careless misstatement may constitute constructive fraud even though there is no fraudulent intent." (Salahutdin v. Valley of California, Inc. (1994) 24 Cal.App.4th 555, 562.)

One of the inherent issues caused by such dual representation is actually addressed in the current statutes governing residential real estate transactions: a dual agent cannot tell the buyer

Jason Hughes, President & CEO (left) and Robert Bello, General Counsel (right), Hughes Marino.

that the seller would take less and cannot tell the seller the buyer would pay more unless that agent receives written consent from each side first. (Civil Code, § 2079.21.) Yet this is the very information that causes a client to hire a broker in the first place.

Due to the clear conflict of interest, it is not only reasonable but imperative that a commercial real estate broker be required to disclose his representation of both parties, to both parties. Consider Glenn v. Rice (1917) 174 Cal. 269, a case involving the sale of land from the land owner to the San Diego Construction Company where only one party knew that the broker was being paid by both sides. Key holdings include:

• If an agent is engaged by both parties to effect a sale of property from one to the other, or an exchange between them, not as a mere middleman to bring them together, but actively in inducing each to make the trade, he cannot recover compensation from either party, unless both parties knew of the double agency at the time of the transaction.

• The reason for the rule is that he thereby puts himself in a position where his duty to one conflicts with his duty to the other, where his own interests tempt him to be unfaithful to both principals, a position which is against sound public policy and good morals.

Finally, another problem with dual agency is that, given the relationship and the extensive time spent working together, the seller/landlord usually has a much closer relationship with the dual agent – and the dual agent is privy to the seller's motives, thoughts and agenda. This gives the seller or landlord yet another advantage in the transaction.

Why Commercial Real EstateHas Been Excluded

The reason that commercial real estate brokers have been exempt from these written disclosure requirements stems from the holding in Easton v. Strassburger (1984) 152 Cal. App.3d 90. In that case, the Appellate Court held real estate licensees owed certain fiduciary duties to buyers even while representing the sellers in a residential home transaction. In the Easton case, the Appellate Court withheld judgment relating to commercial transactions, stating in dictum: "[u]nlike the residential home buyer who is often unrepresented by a broker, or is effectively unrepresented because of the problems of dual agency ..., a purchaser of commercial real estate is likely to be more experienced and sophisticated in his dealings in real estate and is usually represented by an agent who represents only the buyer's interests ...." (Id. at p. 102, fn. 8.)

The Court provided absolutely no basis for this conclusion however. How did those three justices determine that commercial real estate tenants or buyers were automatically sophisticated? Later the next year, the Legislature then refined and codified this holding with the initial statutes that make up this portion of the Civil Code. In fact, when compared to landlords, most commercial

tenants do not have anywhere close to the same experience and sophistication since a tenant will likely negotiate a lease once every five years, while the landlord negotiates multiple leases every year with the help of a team of sophisticated professionals.

SB 1171: Argument For Demading Transparency In Commercial Real Estate Law

The fact that commercial real estate brokers are not required to disclose in writing their dual agent status is just plain wrong. It would be like saying that an attorney should be able to represent the defendant and the plaintiff without providing and obtaining informed, written consent. Except that in this case, the defendant and the attorney have a long and prosperous relationship – essentially putting the plaintiff in a subordinate position with his or her own attorney.

This begs the question: Shouldn't your commercial real estate broker have undivided loyalty too? Shouldn't the same basic ethical requirements that apply to residential brokers and attorneys also apply to commercial real estate brokers? Currently, commercial dual agents merely have to provide oral disclosure (which is almost impossible to enforce since any dispute quickly devolves into a he said/she said swearing contest).

Existing law requires residential real estate listing and selling agents or brokers to provide parties to a transaction with a real estate agency relationship disclosure form. This should apply to commercial brokers too. The financial loss a company (or law firm) may experience by working with a dual agent can be substantial. Why should your commercial real estate broker be held to any less of a standard than a residential broker?

This is why we proposed and support SB 1171. This bill calls for greater transparency in commercial real estate transactions by requiring brokers to provide written disclosure as to who they represent – the landlord, tenant, or both. It also requires brokers acting as dual agents to obtain written consent from their clients. But truth be told, it should really go much further than simple disclosure. Given the substantial economic commitments companies make based on the advice of their real estate broker, it makes sense that a broker's advice should be 100% un-conflicted. This simple concept acts as the foundation for all of our services at Hughes Marino, and is why we only serve tenants and buyers in commercial real estate transactions.

This Appellate Court said it well: "Common sense and ancient wisdom join the law in teaching that an agent is not permitted to simultaneously serve two principals whose interests conflict about the matter served — at least, not without full disclosure and consent from both." (Brown v. FSR Brokerage, Inc. (1998) 62 Cal.App.4th 766, 778.)

SB 1171 is just the first step. In the future we hope to sponsor legislation that also includes a requirement that all real estate brokers must provide Errors & Omissions Insurance.

Proof of this insurance should be provided to the client prior to engaging in a working relationship. But Rome wasn't built in a day, so we have got our work cut out for us.

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***Jason Hughes** is president & CEO of Hughes Marino, a Southern California commercial real estate company specializing in tenant representation for lease and building purchases. Contact Jason direct at (619) 238-2111 or jason@hughesmarino.com to learn more.*

***Robert Bello** is general counsel for Hughes Marino, a Southern California commercial real estate company specializing in tenant representation and building purchases. Contact Robert direct at (619) 238-2111 or rob@hughesmarino.com to learn more.*