Real Estate Agents, Duty and Disclosure

(What you don't know can hurt you)

Real Property Section of the State Bar of Arizona
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1. Real Estate Agents and Legal Advice.

a. Real Estate Agents Practice Law.

i. Attorneys Not Required. Article 26 to the Arizona Constitution permits licensees to prepare any of the documents used in a real estate transaction. Although forms approved and prepared by Arizona Association of Realtors ("AAR") are used in the residential arena, agents are not limited to using those forms, and forms aren't available for a number of documents, such as the "deeds, mortgages, leases, assignments" that Article 26, Section 1, expressly allows licensees to prepare:

> Any person holding a valid license as a real estate broker or a real estate salesman regularly issued by the Arizona State Real Estate Department when acting in such capacity as broker or salesman for the parties, or agent for one of the parties to a sale, exchange, or trade, or the renting and leasing of property, shall have the right to draft or fill out and complete, without charge, any and all instruments incident thereto including, but not limited to, preliminary purchase agreements and earnest money receipts, deeds, mortgages, leases, assignments, releases, contracts for sale of realty, and bills of sale.

ii. Agents Must Have Attorney Level Knowledge. Our courts have stated that the privilege of performing legal functions requires that real estate licensees undertake that duty competently:

> Having achieved, by virtue of [Article 26, Section 1] the right to prepare any and all instruments incident to the sale of real property, including promissory notes, real estate brokers and salespersons also bear the responsibility and duty of explaining to the persons involved the implications of these documents. Failure to do so may constitute real estate malpractice. ***Morley v. J. Pagel Realty & Ins.***, *27 Ariz. App. 62, 66, 550 P.2d 1104 (1976)*.

> [A]rticle 26, Section 1 of the Arizona Constitution authorizes brokers and salesmen to engage in limited law practice involving real property transactions. If a broker can practice law in the area of real property sales, it is reasonable to hold him to a full understanding of the implications of the statute of frauds. ***Olson v. Neale***, *116 Ariz. 522, 525, 570 P.2d 2094 (App. 1977)*.

iii. The Training of Agents is Insufficient. Holding contract preparation and advice given to an attorney level is a duty real estate agents cannot comply with. Arizona salespeople are not required to have a high school diploma, and need only ninety hours of pre-licensing education to obtain a license (Cosmetologists need 1450 hours of training). These requirements haven't changed for years, despite the increasing complexity of real estate law and practice in Arizona. It is unrealistic to assume that licensees' incomplete knowledge allows them to create acceptable legal language, or even to accurately explain legal documents.

Even with standard forms available, because the facts of each transaction and the needs of clients will differ, agents create language for the contract documents. This is especially common on the buyer side, as buyer agents prepare the contracts under our residential system.

Inevitably, contract preparation errors, such as language that makes no legal or logical sense and completely frustrating the intent of the buyer or seller, and that which creates ambiguities, happen on a regular basis.

2. Conflicting Permissions and Prohibitions.

a. Substantive Policy Statement 2005.13. The Arizona Administrative Procedure Act permits an agency to create Substantive Policy Statements, ("SPS") which are defined as "an agency's current approach to, or opinion of, the requirements of the . . . [law]." A.R.S. §41-1001.21. SPS 2005.13 of the Arizona Department of Real Estate ("ADRE") provides, in part, as follows:

> An agent has an obligation to exercise reasonable care in obtaining and communicating information that is material to the client's interests and relevant to the contemplated transaction. Reasonable care or competence may include recommending that a client seek professional or technical advice when the matter is beyond the expertise of the agent.

This Statement requires that an agent advise that a client obtain "professional or technical" advice when the matter is beyond the agent's expertise. ADRE considers any advice beyond the agent's expertise if a license is required to supply those services. So anything that requires a contractor's license or a home inspector's license is not a permissible area in which an agent could provide advice. If that is the case, agents can't act as attorneys as they don't have a Juris Doctor.

In a comment to the policy, ADRE states: "real estate brokers or agents are not expected to perform services normally provided by . . . lawyers . . . or other professionals." So although providing lawyer-like services is not expected, it is not prohibited, despite the admonition in 2005.13.

i Rule R4-28-1101(H). The ADRE has promulgated administrative rules under the Administrative Procedure Act, which are found in the Arizona Administrative Code. Those rules are often called "the Commissioner's Rules." They include:

> R4-28-1101. Duties to Client.
> (H) The services that a salesperson or broker provides to a client or a customer shall conform to the standards of practice and competence recognized in the professional community for the specific real estate discipline in which the salesperson or broker engages.
>
> A salesperson or broker shall not undertake to provide professional services concerning a type of property or service that is outside the salesperson's or broker's field of competence without engaging the assistance of a person who is competent to provide those services, unless the salesperson's or broker's lack of expertise is first disclosed to the client in writing and the client subsequently employs the salesperson or broker.

Needless to say, being a lawyer is outside an agent's "field of competence." Therefore, pursuant to this rule, agents should be retaining counsel in situations where it is warranted, or should be prominently disclosing in writing that they don't have the expertise to prepare contractual language or give legal advice.

ii. The Code of Ethics. The National Association of REALTORS® ("NAR") has a Code of Ethics which all Realtors are required to follow. Article 13 of the Code prohibits Realtors from practicing law. It also requires that "Realtors . . . recommend that legal counsel be obtained when the interest of any party . . . requires it." So it appears that under the Code, a Realtor in Arizona can't "engage in limited law practice", and like R4-28-1101, an agent needs to recommend legal assistance in certain situations.

b. The Advisability of Attorney Legal Assistance.

i. Language Preparation. Brokers could retain attorneys to prepare language for their agents' use in common situations. These "boiler plate" provisions could be used thereafter without further attorney participation. In any instance where "non boiler plate" specialty language is required, the assistance of an attorney to help draft the language could be sought. The trick is to know when special language is needed.

ii. Contract Review. Brokers or agents could use counsel to review the contract and all of the associated documents for accuracy and consistency after its preparation, in case that are additions or corrections that should be made before it presentation to the other side.

iii. Use of an Attorney Review Clause. An attorney review clause gives the attorney for a party the right to void the purchase agreement (for example, within three business days after the attorney's receipt of the agreement). Using this method, the attorney provides the client or the real estate licensee with the attorney review clause in advance, with instructions that it is placed in the contract when prepared by the agent. This removes the attorney from the middle of the time sensitive and stressful negotiations inherent in the contract agreement process.

An attorney review clause can involve more than just approval of the language of the deal; it may allow the attorney to advise the client of the advisability of the deal itself. New York's highest court, the Court of Appeals of New York, considered the use of a review clause in a contract to convey residential property where the attorney for the buyer decided the property was overpriced. The court reasoned that the historical purpose of an attorney approval clause is to prevent real estate professionals from engaging in the unauthorized practice of law. The clause also gives the parties the opportunity to protect their legal interests because it prevents any contractual rights from vesting in either party until after the completion of the attorney review period. That the clause was used to cancel based on price did not breach the duty of good faith and fair dealing. ***Moran v. Erk***, *901 N.E.2d 187 (N.Y. 2008).*

The logic of protecting clients from the errors that can arise from the "unauthorized practice of law" would appear to be particularly appropriate in Arizona, due to its lack of attorney involvement in contract preparation as well as the entire residential transaction process.

3. Fiduciary Duty and its Negation: Dual Agency.

Pursuant to R4-28-1101 and agency law, real estate licensees have a fiduciary duty to their clients.

a. The Elements of Fiduciary Duty.

The traditional component parts of fiduciary duty include the Duty to Account, the Duty of Obedience, the Duty of Disclosure, the Duty of Reasonable Care/Diligence, and the Duty of Loyalty. The most important elements of fiduciary duty as to Arizona licensees found in agency law are as follows:

i. The Duty of Disclosure. An agent must disclose any facts affecting the value or desirability of the property, as well as any other relevant information pertaining to the transaction, such as the other party's bargaining position or information concerning the ability or willingness of the buyer to offer a higher price. *See* ***Liegh v. Lloyd***, *74 Ariz. 84, 244 P.2d 356 (1952).* But an agent's duty of disclosure to a client must not be confused with an agent's duty to disclose any known material facts about the property to customers.

ii. The Duty of Confidentiality. An agent is obligated to safeguard the client's lawful confidences and secrets. Therefore, an agent must keep confidential any information that may weaken a client's bargaining position. For example, the seller's agent cannot reveal to the buyer or the buyer's agent any information that could be used to the disadvantage of the seller. On the other hand, the duty of confidentiality also precludes the buyer's agent from disclosing the buyer's willingness to pay more than the listing price or the buyer's motivation for buying. *See* ***Cook v. Orkin Exterminating Co., Inc****., 227 Ariz. 331, 258 P.3d 149 (App. 2011)*. This duty is "characterized by great intimacy, disclosure of secrets, [or] intrusting of power" (quoting ***Standard Chartered PLC v. Price Waterhouse***, *190 Ariz. at 24, 945 P.2d at 335 (App. 1996)*).

The duty of confidentiality does not include an obligation by a broker who represents a seller to withhold known material facts about the condition of the seller's property from the buyer or to misrepresent the property's condition. ***Aranki v. RKP Investments, Inc.****, 194 Ariz. 206, 979 P.2d 534 (App. 1999)*.

iii. The Duty of Reasonable Care/Diligence. An agent is obligated to use reasonable care and diligence when representing the client. See ***Liegh v. Lloyd***, *74 Ariz. 84, 244 P.2d 356 (1952).* The standard of care is to act as a competent real estate professional, or to not act negligently. ***Lombardo v. Albu****, 199 Ariz. 97, 14 P.3d 288 (2000)*; A.A.C. § R4-28-1101. In addition, a licensee owes his or her client the specific duty to effect a sale to the clients' best advantage. ***Vivian Arnold Realty v. McCormick****, 19 Ariz. App.289, 506 P.2d 1074 (1973).* "In a fiduciary relationship, the fiduciary holds 'superiority of position' over the beneficiary . . . [through] a substitution of the fiduciary's will." ***Standard Chartered PLC v. Price Waterhouse***, *190 Ariz. 6, 24, 945 P.2d 317, 335 (App. 1996).*

iv. The Duty of Loyalty. Loyalty is the most fundamental fiduciary duty an agent owes to the client. The duty obligates an agent to act at all times, solely in the best interests of the client, excluding all other interests, including that of the agent. "A fiduciary relationship has been described as something approximating . . . [a] family tie impelling or inducing the trusting party to relax the care and vigilance he would ordinarily exercise." ***Taeger v. Catholic Family and Cmty Servs***, *196 Ariz. 285, 290, 995 P.2d 721, 726 (App. 1999)*.

b. The Evolving Nature of Fiduciary Duty.

Traditionally, the primary role of real estate brokers was to find suitable property for the client using specialized sources. The advent of electronic sources of information (the Multiple Listing Service in residential, and to a lesser extent, Loopnet and CoStar in commercial) has completely changed this role. At least as to residential real estate, MLS is the only source an agent located in the metro Phoenix area needs to find homes for their buyers (although this may not be the case in other states or countries).

Conversely, the expertise required to prepare the documents, give appropriate "legal" advice, and manage the transaction has increased. Although the elements of fiduciary duty have not changed, the emphasis on being loyal and providing competent guidance so the client can make informed, reasonable business decisions should be seen as the predominant functions of a modern licensee. In other words: the client has many choices - who makes sure the client is aware of the best ones? That is the real estate licensee's job.

As a result, now what is important is that the agent provide the expertise necessary to competently advise the client. As seen above that includes areas that are typically that of attorneys, areas which agents have insufficient knowledge.

c. The Emasculation of the Duty of Loyalty (and Disclosure).

i. Disclaimers in Commercial Listing Agreements.

The commercial real estate industry in particular has attempted to neutralize both fiduciary duty and the standard of care through disclaimers and other limiting language in commercial listing agreements:

> Scope of Agent's Authority and Responsibility: Except for confidential information regarding Seller's business or financial condition and the negotiation of the terms of a purchase agreement between Seller and a prospective purchaser, Seller and Agent agree that **their relationship is at arm's length and is neither confidential nor fiduciary in nature**.
>
> Affiliated Brokers/dual Agency: Seller understands that this authorization may result in Brokers representing both Seller and another party to a Transaction, and **Seller hereby authorizes and consents to such dual agency**.
>
> Indemnification and Limitation of Agent/broker Liability: Seller further agrees that, except to the extent of Agent/Broker's or such affiliated person's or entity's gross negligence or willful misconduct, any liability of Agent/Broker and its affiliated persons and entities arising out of its efforts at marketing of the Property, or its services rendered in the course of any Transaction involving the Property, **shall be limited to the greater of $50,000 or the amount of compensation actually received by Agent/Broker in any Transaction hereunder**. *Emphasis added*.

ii. The Dual Agency Paradox.

Dual agency occurs when an agent acts for both of the principals/clients (buyer and seller) in the same transaction. This means the agent represents both the buyer and seller simultaneously.

Real estate agents engage in dual agency because *they can claim both the sellers' and buyers' side of the commission*; in other words, they can "double dip" and receive all of the commission dollars. This is despite the fact that by not providing full fiduciary representation to either, they are in actuality providing a lower level of service, as they are emasculating the duty of loyalty.

Fiduciary duty requires that an agent put the client's interest ahead of all others. An attorney can't induce a client to waive the obligation to provide fiduciary duty. In almost all circumstances, one attorney is not allowed to represent both the buyer and the seller (See ER 1.7(a)). The reason is obvious - it is a "non consentable conflict." (See ER 1.7(a), comment 14). The interests of the buyer and seller conflict because the buyer wants the lowest price - the seller wants the highest price; the buyer wants the best terms - but the seller wants those terms to be slanted in its favor; the buyer wishes the least legal liability - but the seller wants the exact opposite, and so on.

Fiduciary duty is compromised and virtually eliminated for all practical purposes, because the agent is unable to favor the interests of one client over the other. That means the agent can't give his or her side specific advice or recommendations - which is what should be demanded from a real estate agent.

It would appear that no client would ever agree to dual agency, as the client not only gains nothing by it, and may be actually harmed. But dual agency transactions occur every day in our metropolitan Phoenix area market. The reason is that the only requirement of ADRE is that the clients agree to dual agency in writing.

The AAR has created a form entitled "Consent to Limited Dual Representation," to be used by agents to get that written consent. Here is how that form explains the disadvantages of dual agency:

> "There will be conflicts in the duties of loyalty, obedience, disclosure and confidentiality [by your agent]."

That brief statement fails to completely and adequately explain to the buyer or seller that he or she is about to do something not in their best interest. Obviously, ADRE doesn't require "informed" consent, which would require that the disadvantages of dual agency be actually be understood by the client.

A recent case appears to require a heightened standard. In ***Lerner v. DMB Realty, LLC*** , the Court held that when obtaining consent to dual agency, "the broker must deal fairly and in good faith with each of them, and 'disclose all material facts that the [broker] knows, has reason to know, or should know would reasonably affect the principal's judgment'," unless the principal knows the facts or doesn't want to know them. *2012 WL 5910800.* This appears to require a discussion much more comprehensive than that contained in the AAR form.

As you might expect, dual agency is acceptable to the NAR. Its official position is that "dual agency poses no ethical dilemmas as long as it's fully disclosed." Since there is no actual disclosure and no informed consent, this conclusion is incorrect as to Arizona.

Thus real estate licensees can engage in the "irreconcilable conflict" of dual agency, and can induce a client to waive it without explanation. But that conflict may be a breach of fiduciary duty.

iii. Dual Agency Creates Licensee Liability.

Real estate agents take a great risk when engaging in dual agency. An explanation of the potential liability was supplied by Judge Holohan in an article written some years ago in the Arizona Journal of Real Estate & Business. Judge Holohan explained that even though dual agency is allowed in Arizona, "[t]he prior consent [by the clients] for multiple representation is really an opportunity for the agent to be placed in an impossible position."

The "impossible position" occurs because it is a legal impossibility to adequately discharge a fiduciary duty to two parties who have opposite interests. This means that a single real estate licensee acting in a dual agency capacity has essentially no defense to a claim for breach of fiduciary duty - because being a dual agent is itself essentially a breach of fiduciary duty!

Or as Judge Holohan put it, the "impossible position" is because a real estate professional "can't serve two masters." As a result, even though agents can do dual agency, he cautioned that "what is permitted is not always the wisest course."

If a client is damaged by an agent who is the only representative of the parties, the agent will have difficulty creating a defense, and the only question may be being how much he or she will lose. In ***Jennings v. Lee***, *105 Ariz. 167, 461 P.2d 161 (1969)* the Court quoted a California case with approval:

> "the fact that a[n] . . . agent in a real estate transaction is the agent for both parties is no defense to an action by one of the parties to hold the other party responsible for misrepresentations with regard to such other party's property made to him by the . . . agent."

Agency related issues are the number one problem of real estate brokerages according to the 2011 Legal Scan. The NAR Legal Scan is a biennial research project undertaken by the NAR that collects information on issues from real estate brokerages that involve the legal liability of real estate licensees nationwide. The Scan showed that agency representation issues outrank all other liability generating areas, including the failure to provide adequate disclosures, ethics, and fair housing laws.

This illustrates that single agent, dual agent licensees are vulnerable to claims and litigation under Arizona law. And in dual agency situations, damages may be provable without an allegation of failure to comply with the standard of care. In a study conducted by Redfin, sellers in Maricopa County received 2.4% less - the equivalent of $7,285 on a $300,000 home, when a single agent represented both sides.

4. The Unequal Disclosure Requirements.

Material facts must be disclosed by buyers, sellers and their agents, but the standards applicable to the type or extent of disclosure differ.

a. Statutory and Administratively Required "Disclosures."

i. Lead Based Paint Disclosure - Pre-1978 Properties: Title X;

ii. Notice of Swimming Pool Barrier Regulations: A.R.S. §36-1681(E);

iii. Resale of planned unit development and condominium units disclosure information: A.R.S. §33-1806 and 33-1260;

iv. Notice of soil remediation: AR.S. §33-424.01 and 49-701.02;

v. Affidavit of Disclosure - land in unincorporated areas, except subdivided AR.S. §33-422;

vi. Airport influence areas and military airports: A.R.S. §28-8481, 8483 and 8484; A.R.S. §28-8485;

vii. Interstate Land Disclosure Act: 15 U.S.C. §§1701-1720.

b. The Materiality Standard.

A fact is material if it is one to which a reasonable person would attach importance in determining the person's choice of action in a transaction. ***Amerco v. Shoen****, 184 Ariz. 150, 158 n. 10, 907 P.2d 536, 544 n. 10 (App. 1995)*. The Restatement defines the duty to disclose material facts as follows:

> "A party has an affirmative duty to disclose material facts where:
>
> 1. Disclosure is necessary to prevent a previous assertion from being a misrepresentation or from being fraudulent or material;
>
> 2. Disclosure would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if nondisclosure amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing;
>
> 3. Disclosure would correct a mistake of the other party as to the contents or effect of a writing, evidencing or embodying an agreement in whole or in part;
>
> 4. The other person is entitled to know the fact because of a relationship of trust and confidence between them."
>
> *Restatement (Second) of Contracts* §161 and *Restatement (Second) of Torts* §551.

c. Obligation to Disclose May Exist even when not Material.

A duty to disclose may arise where the buyer makes an inquiry of the seller, regardless of whether or not the fact is material. ***Universal Inv. Co. v. Sahara Motor Inn, Inc****., 127 Ariz. 213, 215, 619 P.2d 485, 487 (1980).*

d. Exception to Disclosure: AR.S. §32-2156: Real Estate Sales and Leases.

The "stigmatized property law" lists items that do not need be disclosed by sellers, landlords or their agents, although may be deemed material by a buyer or tenant:

> A. No criminal, civil or administrative action may be brought against a transferor or lessor of real property or a licensee for failing to disclose that the property being transferred or leased is or has been:
> 1. The site of a natural death, suicide or homicide or any other crime classified as a felony.
> 2. Owned or occupied by a person exposed to the human immunodeficiency virus or diagnosed as having the acquired immune deficiency syndrome or any other disease that is not known to be transmitted through common occupancy of real estate.
> 3. Located in the vicinity of a sex offender.
> B. Failing to disclose any fact or suspicion as set forth in subsection A shall not be grounds for termination or rescission of any transaction in which real property has been or will be transferred or leased.

In ***Lerner v. DMB Realty, LLC****,* the Court held that the statute did not violate the anti-abrogation clause of the Arizona Constitution.

c. The Seller's Obligation.

i. Duty to Disclose (Residential): A residential seller has a duty to disclose facts materially affecting the value of the property which are not known to the buyer. Under certain circumstances non-disclosure of a fact known to one party may be equivalent to the assertion that the fact does not exist. Non-disclosure may be equated with and given the same legal effect as fraud and misrepresentation

In ***Hill v. Jones****, 151 Ariz. 81, 725 P.2d 1115 (App. 1986),* the buyer and sellers entered into a contract for a home with a wood floor. The buyer noticed a small "ripple" in the wood floor. The buyer asked if the ripple could be termite damage and the seller answered that it was water damage. The wood infestation report reflected no visible evidence of termite infestation, and that there was no visible physical damage or evidence of previous treatment. After close of escrow, the buyer noticed that the wood on a part of the flooring was crumbling, and learned from a neighbor that the house had past termite infestation. After their lawsuit was filed, the buyer learned that the sellers had received two termite guarantees from the previous owner, had treated the house twice for termites, and existing termite damage had not been repaired.

ii. Duty to disclose (Commercial as-is): When commercial property is sold "as-is," a seller must disclose facts materially affecting the value of the property which are "latent" or not readily observable, and which would not be discovered by a reasonable inspection.

There is a bifurcation of disclosure duties based on property type and contractual terms, as established by ***The S Development Co. v. Pima Capital Management Co.****, 201 Ariz. 10, 31 P.3d 123 (App. 2001)*. In ***The S Development Co.***, the buyer and seller executed a contract for the purchase of two apartment complexes. The buyer retained two engineering companies to inspect the property, and no substantial problems were found with the plumbing. However, about two years after closing, the buyer discovered the presence of polybutylene pipe (PB pipe), a defective type of plumbing that leaks when used to transport warm water. The buyer filed suit for failure to disclose the existence of the PB pipe, and a jury awarded a judgment against the seller in the amount of $3,690,000.00 at trial. On appeal, the seller argued that they didn't know about the PB pipe, and even if they did, an "as-is" clause in the contract shifted the burden of discovering material defects to the buyer, and relieved them of any duty to disclose.

> "[I]n the face of an "as-is" sale, the rule of *caveat emptor* continues to apply . . . " [and there will be no liability for failure to disclose] "facts basic to the transaction if the facts at issue are patent, or if the purchaser has been given an appropriate opportunity to discover latent defects . . . If the [seller] fails to disclose a known latent defect or fails to give appropriate opportunity to discover latent defects, *caveat emptor* does not apply and the [seller] must disclose the defect." *Id. at 17, 15, 31 P.3d at 130*.

In other words, when commercial property is sold "as-is," a seller has a duty to disclose facts materially affecting the value of the property which are: **1.** "latent" or not readily observable; **2.** would not be discovered by a reasonable inspection; and **3.** are not known to the buyer.

A logical extension of ***The S Development Co.*** holding might be that patent defects and/or those that could have been discovered by a reasonable inspection do not have to be disclosed by the commercial as-is seller, no matter how material they may be.

f. The Buyer's Obligation.

The buyer has a duty to the seller to disclose facts critical to ability to perform; the financial wherewithal of the buyer to perform the contract is not confidential information.

In ***Lombardo v. Albu****, 199 Ariz. 97, 14 P.3d 288 (2000),* the sellers were behind in their house payments and a trustee's sale was started. The sellers entered into a contract to sell the home with a loan contingency. The buyer husband had filed for bankruptcy and was subject to IRS tax liens. As a result, the wife applied for a loan in her name only in the hope that the lender would extend credit to her. The sellers' lien holder continued the trustee's sale date in order to give the sellers an opportunity to close. Despite several extensions of the closing and trustee's sale date, the buyer was never able to obtain a loan or close and the sellers lost their equity in the property at a trustee's sale.

The sellers alleged that they were never aware of the buyers' poor financial position, and that they or the wife would not be able to get a loan. The sellers alleged that the buyers told their agent all of those things, but the buyers and the buyers' agent did not disclose this information to the sellers.

The Court held that the major consideration flowing from the buyer to the seller is the price. The buyer cannot present him or herself as a ready, willing, and able buyer if he or she knows that there is a significant risk that the deal will never close because of inability to perform. If the buyer's agent had knowledge of these matters, failure to disclose these facts would violate the buyer's duty to deal fairly (also see R4-28-1101.A). Thus although ordinarily not disclosed, a buyer's financial situation and inability to obtain financing are not confidential if they could result in an inability to close.

g. A Licensees' duty.

A real estate salesperson's duty of disclosure is augmented by the Commissioner's Rules. R4-28-1101.A requires an agent to treat all persons fairly, which is defined as being honest. *See* ***Brown v. ADRE****, 181 Ariz. 320, 890 P.2d 615, 623-24 (App.1995)*. What must be disclosed is contained in section B:

> B. A licensee participating in a real estate transaction shall disclose in writing to all other parties any information the licensee possesses that materially or adversely affects the consideration to be paid by any party to the transaction, including:
> 1. Any information that the seller or lessor is or may be unable to perform;
> 2. Any information that the buyer or lessee is, or may be, unable to perform;
> 3. Any material defect existing in the property being transferred; and
> 4. The existence of a lien or encumbrance on the property being transferred.

In ***Lombardo***, the Court stated that under Arizona law, this rule provides minimum standards of care for licensees toward non-clients (customers). *199 at 101,14 P.3d at 292*. This means that a violation of this rule constitutes negligence, and a customer can bring an action under the theory of negligence per se. In that event, violation of the rule creates liability and the customer only needs to prove causation and damages.

There is a difference between the disclosure obligation of sellers for commercial property sold "as-is" as articulated in ***The S Development Co.***, and that for real estate licensees. Despite the language that in that case that only "latent," or not readily observable defects, and those which would not be discovered by a reasonable inspection need to be disclosed by the seller, that cannot be the correct standard for real estate licensees. R4-28-1101.B.3 states that a licensee shall disclose in writing "[a]ny material defect existing in the property to be transferred." So there is no exception for patent defects and/or those defects that could have been discovered by a reasonable inspection as to licensees. Although the disclosure standard for commercial, "as-is" sellers is different from a residential seller's disclosure obligation, the standard is the same for a licensee in both circumstances; a licensee must disclose all known material defects, without any exclusion for defects that are known, "patent" or observable.

5. The "Triumvirate of Liability."

After the typical transaction closes in which a buyer or seller were damaged, there are a minimum of three potential defendants. This is the "Triumvirate of Liability," or as named by another attorney "the Circular Firing Squad." Typically this involves the buyers suing the sellers, the sellers' agent, and their own agent.

The buyers' agent is in the line of fire, due to fiduciary duty. This might involve whether the agent adequately advised the client on whether it was reasonable to rely on the disclosure by the sellers and their agent (or lack thereof). In addition, which due diligence should have been done, and who should have done it, may not have been competently addressed. In other words, the requirement of buyers' agent to protect the client required certain advise or actions that may have not been supplied or done.

The sellers may also have grounds for a cross claim against their agent. Sellers will often have no choice to blame their agent when they are sued by the buyer for non-disclosure. The sellers will claim they were not sophisticated in real estate disclosure law and requirements, and that they relied on their agent to advise them what needed to be disclosed.

Where there is a finding of breach of fiduciary duty, the sanctions can include a "commissionectomy." Refund of the commission may be required to make a damaged client whole. *See* ***Jennings v. Lee***, 105 Ariz. *167, 461 P.2d 161 (1969)*. Punitive damages may also be available where damages arise from a breach of fiduciary duty. ***Marquette Venture Partners II, L.P., v. Leonesio****, 227 Ariz. 179, 181, 254 P.3d 418, 420 (App. 2011)* (punitive damages awarded on breach of fiduciary duty claim).

The Triumvirate of Liability doesn't include the brokers or brokerage, but they are also potential defendants. Brokerages are employers, potentially liable for the acts of their employees under the doctrine of respondeat superior. ***Barnes v. Lopez****, 25 Ariz. App. 477, 544 P.2d 694 (App. 1976)*. In addition, designated (or self employed) brokers are required to reasonably supervise their licensees under R4-28-1103.A, and therefore may also be appropriate defendants in litigation.

Note that arbitration provisions in listing agreements can frustrate the seemingly efficient nature of a Triumvirate of Liability action. The employment agreements and the contract form supplied by the AAR include such provisions (as well as mediation), and brokerage prepared forms in commercial transactions usually include the same.

6. Sources/Alternate Avenues.

Other sources in the law may establish liability, and avenues exist which can put maximum pressure on the licensee or result in compensation to the client.

a. Potential Sources of Liability:

i. A.R.S. § 32-2153(A)(3) prohibits a licensee from violating the Rules; A.R.S. §32-2153(A)(22) - prohibits a licensee from being negligent; A.R.S. §32-2153(A)(24) - prohibits a lack of mental competence to be able to perform the responsibilities of a licensee.

ii. R4-28-1103: The brokers' liability for failure to supervise an agent. "An employing broker and a designated broker shall exercise reasonable supervision and control over the activities of brokers, salespersons, and others in the employ of the broker";

iii. NAR Code of Ethics.

b. Potential Avenues of Recovery:

i. Other parties who may have liability - home inspectors, contractors, homebuilders;

ii. Complaint with the AAR (if a Realtor) where the Code of Ethics has been violated;

iii. Complaint with the ADRE where there are grounds for disciplinary action against a licensee;

iv. Real Estate Recovery Fund - A.R.S. §32-2186.

v. Error & Omissions insurance coverage - will be available for negligence, not exclusively fraud; punitive damages are not covered by most errors and omissions insurance policies, nor is malfeasance when a licensee is dealing with his or her own property.

vi. Right of rescission - subdivisions and unsubdivided land. A.R.S. §32-1283: if no public report; A.R.S. §32-2185.02: if no permanent access; A.R.S. §32-2185.06, failure to disclose right to a public report; A.R.S. §32-2185.01.D: 7 days for an unimproved lot; A.R.S. §32-2185.01.E: 6 months if executed a contract to buy without having physically seen an unimproved lot; A.R.S. §32-2195.01.D: 7 days for an unsubdivided land; A.R.S. §32-2195.01.E: 6 months if executed a contract to buy without having physically seen an unsubdivided land;

vii. Right of rescission - A.R.S. §33-422: Failure to supply an Affidavit of Disclosure.