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Real Estate Brokers Owe More Than Statutory Duties to Their Clients

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In *Carl Michel v. Palos Verdes Network Group, Inc.* (Nov. 1, 2007) 2007 WL 3208735, the Second District Court of Appeal analyzed the duties real estate brokers owe to their clients. The court found that a real estate broker owes fiduciary duties to its client and that said duties are more extensive than the non-fiduciary statutory duties imposed by Civil Code §§2079 *et. seq.* **Background Facts.**

In early 2000, Mike Kirkpatrick, a real estate agent working for Larry Moore & Associates Realtors, Inc. ("Moore"), inspected a home in Rolling Hills Estates owned by a friend's parents, hoping to become the listing agent if the parents decided to sell their home. He took notes of the property's defects, including possible water leaks, cracked interior walls, and damage to the pool. He intended to use his notes if he ever obtained the listing to identify needed repairs and possible disclosure items to potential buyers. *Michel v. Palos Verdes, supra*, 2007 WL3208735 at 1.

In June 2000, the house was placed on the market, but Kirkpatrick did not receive the seller's listing. However, one of his colleagues at Moore, Nicola Lagudis, represented the potential buyers, Carl and Sydne Michel. Kirkpatrick showed the home to the Michels, but he did not point out any of the defects from his notes. At that time the Michels were misinformed and believed that Kirkpatrick represented the sellers, rather than acting as an associate of their agent. Based on that misimpression, the Michels gave Kirkpatrick a written offer to buy the house, which was not responded to. A few weeks later, they revisited the property and submitted a new offer to the actual listing agent. *Id.*

Shortly thereafter, the Michels and the sellers agreed on terms of sale and entered escrow. At the end of July, Lagudis, the Michels' agent, visually inspected the property and gave the Michels her transfer disclosure statement ("TDS"). But, her TDS did not disclose all the defects listed in Kirkpatrick's notes taken months earlier. *Id.*

Kirkpatrick, as one of Moore's transaction coordinators, was responsible for reviewing sales files of Moore's agents to ensure that the sales paperwork was in order before escrow closed. Thus, he reviewed Lagudis' TDS, and even though he knew of his notes as he reviewed Lagudis' TDS, he did not tell Lagudis about his own notes, nor did he add to the TDS anything from his notes. Thus, the Michels never knew the contents of Kirkpatrick's notes before escrow closed. *Id.*

Later in the year, after the winter rains came, cracks emerged throughout the home. Ultimately, the Michels hired an engineer who found substantial damage to the house foundation which he estimated would cost approximately \$500,000 to repair. At that time the Michels met with Kirkpatrick, and he informed them that he had noticed some substantial defects when he conducted his inspection at the beginning of 2000, and he even provided the Michels with a copy of his notes. *Id.* at 1-2. The Michels ended up suing Moore, alleging claims for violating Civil Code §2079 due to Lagudis' failure to competently inspect the property, for fraudulent concealment for the failure of the TDS to disclose all defects known by Moore, and the Michels alleged a cause of action for negligent nondisclosure for not telling the Michels about all the problems Moore knew about the property. *Id.* at 2.

Trial Court Proceedings

Before the Michels' opening statement, Moore moved for a judgment of nonsuit on the negligent nondisclosure cause of action. The trial court granted the motion. Trial proceeded only on the causes of action for violation of Civil Code §2079 and fraudulent concealment. The jury returned a verdict for Moore, finding that: (1) Moore did not fail to conduct a reasonably competent diligent visual inspection of the property and did not fail to disclose to Michels any material fact about the property that an investigation would reveal, and (2) Moore did not conceal or suppress any material fact from the Michels.

Appellate Court Ruling

The Second District noted that a broker has a fiduciary duty to his or her client, and that said fiduciary duty is greater than the negligence standard of due care under Civil Code §2079. *Id.* at 3. The court stated that a broker can be professionally competent under Civil Code §2079 without satisfying the greater duty of a trusted fiduciary. *Id.* In fact, a fiduciary has a duty to tell its principal of all information it possesses that is material to the principal's interest, and the failure to share material information is constructive fraud. *Id.* (citations omitted). The *Michel v. Palos Verdes* court then quoted *Assilzadeh v. California Federal Bank* (2000) 82 Cal.App.4th 399, 415, to emphasize the distinction as follows:

"a real estate agent, as a fiduciary, is ' . . . liable to his principal for constructive fraud even though his conduct is not actually fraudulent. Constructive fraud is a unique species of fraud applicable only to a fiduciary or confidential relationship.' [Citation.] 'As a general principle constructive fraud comprises any act, omission, or concealment involving a breach of legal or equitable duty, trust or confidence which results in damage to another even though the conduct is not otherwise fraudulent. 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.' ' "

Id., quoting *Assilzadeh v. California Federal Bank* (2000) 82 Cal.App.4th at 415; *Salahutdin v. Valley of California, Inc.* (1994) 24 Cal.App.4th 555, 562.

The court then compared the Michels' causes of action and found that the Michels' negligent nondisclosure theory rested on Moore's fiduciary duty to disclose material information within its possession, *i.e.*, the information that Kirkpatrick knew which was not disclosed to the Michels. The court found that the standard for establishing the negligent nondisclosure cause of action only required the Michels to prove constructive fraud, a much easier standard than proving actual fraudulent intent necessary to establish its cause of action for fraudulent concealment. *Id.* at 4. Similarly, the standard for establishing the negligent nondisclosure cause of action required a different test than determining if Moore conducted a competent visual inspection of the property. *Id.* But, because the trial court had granted Moore's motion for nonsuit, the jury never had the opportunity to determine if Michels had met the easier burden.

Therefore, the court remanded the matter for further proceedings on the Michels' cause of action for negligent nondisclosure. *Id.* at 5.

BROKER'S DUTIES

Given the holding, it is important that brokers realize they are obligated to comply with all applicable statutes, as well as the heightened duties owed by fiduciaries. Otherwise, they could subject themselves to substantial liability and damages.