HANDLING IN-HOUSE SALES AS A "DUAL AGENT"

I. OVERVIEW OF AGENCY RELATIONSHIPS.

Law involves the study of legal relationships. Agency is the fiduciary relationship which results from the consent of one person that another shall act on his behalf and subject to his control, and the consent of the other to so act (Restatement of Agency, §1). Agency thus is a consensual relationship. Typically real estate agents are special agents, that is agents authorized to conduct a particular transaction or series of transactions. Seller's agents include the listing broker and the licensees affiliated therewith as well as authorized subagents, such as MLS participants who accept this status or co-brokers who make such ad hoc arrangements. Buyer's agents include the buyer's broker and the licensees affiliated therewith.

A real estate firm should develop an office policy with respect to the agency relationships which it will perform. Some firms serve as agents only for sellers or only for buyers exclusively, while others will serve as the agent for either party to a transaction but not both. This approach is known as "single agency." For firms which are willing to serve as agents for buyers and for sellers, there is the further possibility of a consensual "dual agency."

Under the common law, which continues to be recognized in New York, it is also permissible to act as a dual agent with full disclosure and informed consent. The Restatement of Agency provides:

"An agent who, with the knowledge of two principals, acts for both of them in a transaction between them, has a duty to act with fairness to each and to disclose to each all facts which he knows or should know would reasonably effect the judgment of each in permitting such dual agency…" (Restatement of Agency, §392).

Dual agency thus requires disclosure of all material facts and the informed consent of the parties to that relationship. In a dual agency situation, the agent has a duty of fairness to both principals and an obligation to maintain the confidentiality of their separate confidences, such as the best price they are willing to pay or accept. In situations where one principal discloses confidential information to the agent which is of such a nature that he cannot fairly give advice to one without disclosing it, he cannot properly continue to act as adviser (Restatement of Agency, §392 Comment b). Such a situation might exist

where the seller indicates that he/she is intent on violating the laws against housing discrimination or concealing material defects in the premises or where the buyer indicates that he/she is in fact unable or unwilling to complete a purchase transaction.

II. IN-HOUSE TRANSACTIONS.

If the broker has an agency relationship with a buyer ("buyer's broker") and that buyer expresses interest in a property owned by a seller who also has an agency relationship with the broker ("seller's broker"), a conflict has arisen. This conflict can be resolved by the broker either ceasing to act or refraining from acting as agent for one of the parties or, upon full disclosure to and informed consent of both the buyer and the seller, the broker may become a consensual dual agent.

In-house transactions definitionally involve the sale of one of the firm's listings to a buyer without the assistance of another broker. Prior to the evolution of buyer's brokerage, in-house sales were typically arrangements between a seller "client" (i.e. a principal) and a buyer "customer" (i.e. an unrepresented party). This continues to be a valid alternative. Where both the proposed buyer and seller are principals of the firm and propose to engage in a purchase and sale transaction, a dual agency situation would arise. Full disclosure and mutual, informed consent are required for this to be a valid alternative.

In-house sales thus offer consumers the options of (i) one consumer dissolving his/her agency relationship with the firm (with the broker taking all necessary steps to release that consumer from any broker employment contract and cancelling any listings thereby with the MLS) or (ii) both consumers consenting to dual agency. The consumer's choice should be memorialized by the execution of a new statutory disclosure notice. Under approach (i), the transaction would no longer be considered an "in-house" sales unless the firm remained the seller's listing broker and the buyer became an unrepresented party rather than a principal for whom the firm served as agent.

There thus are conceptually two basic ways that an in-house sale may be handled by a single firm: the traditional approach (with the seller as "principal" and the buyer as an unrepresented party) or a consensual dual agency approach (with both buyer and seller as "principals" of the firm). HUD's current rules with regard to ancillary services similarly recognize the valid alternative for consumers to utilize a single firm for "one-stop-shopping" for an array of services, including real estate licensee services, mortgage brokerage services, title insurance services and home inspection services. Irrespective of

whether the firm offers these further services, with proper disclosure and consumer consent it is permissible for a single firm to provide the real estate licensee services to both buyer and seller. It is critical to the proper performance of a licensee's obligations that there be timely and meaningful disclosures with regard to the broker's role and responsibilities and a discussion of the advantages and disadvantages of dual agency. Such disclosures are required by the License Law (Real Property Law, Article 12-A and regulations thereunder) and NAR's Code of Ethics.

III. RULES GOVERNING LICENSEE CONDUCT - DUEAL AGENCY SITUATIONS.

(A) The License Law (Article 12-A of the Real Property Law) and Regulations Thereunder (19 NYCRR Part 175).

Real Property Law §441 requires licensees to have a working knowledge of the law of contracts, agency and real property, which are fundamental to the performance of a licensee's responsibilities and the underpinning of DOS' regulation of real estate licensees. The statutory disclosure requirements of Real Property Law §443 do not change the common law, which recognizes dual agency as generally unlawful, but provides an exception to that prohibition under certain stringent circumstances: full disclosure and informed consent of the principals.

Real Property Law §443 expressly recognizes that a consensual dual agency may only be undertaken with both full disclosure and informed consent. Its disclosure requirements in connection with the sale or lease of one to four family residential dwellings co-exists with the abiding license law disclosure regulation, applicable to all real estate transactions. 19 NYCRR §175.7 "Compensation" requires that a real estate broker shall make clear for which party he is acting and he shall not receive compensation from more than one party except with the full knowledge and consent of all parties. Department of State administrative decisions and declaratory rulings interpret and apply the license law and regulations, as do Court decisions.

(B) Law of Agency.

Section 392 of the Restatement of Agency expressly recognizes that "an agent employed by both parties to a transaction, with knowledge by them of his double employment, has the same duty to act with fairness to each that an agent has in dealing with his principal on his own account. If he is employed to complete a transaction for them, he must act

with consideration for the interest of each; if he is employed by each to give advice, his advice must be impartial." This obligation of fairness co-exists with a duty of disclosure. The agent's disclosure must include not only the fact that he is acting on behalf of the other party, but also all facts which are relevant in enabling the principal to make an intelligent determination, such as the prior relations between the agent and the other party and the knowledge or lack of knowledge by the other party that the agent is acting for the principal. The agent, however, is under no duty to disclose, and has a duty not to disclose to the principal, confidential information given him by the other, such as the price he is willing to pay. If the information is of such a nature that he cannot fairly give advice without disclosing it, he cannot properly continue to act as adviser.

Department of State administrative decisions and declaratory rulings, as well as Court decisions, interpret and apply the common law of agency.

(C) Law of Contracts.

The common law recognizes and effectuates the freedom of parties to make consensual agreements. A covenant of "good faith" and "fair dealing" may be implied. Such principles are particularly germane in connection with licensee obligations, due to their abiding license law obligations of trustworthiness and competence. Department of State administrative decisions and declaratory rulings, as well as Court decisions, interpret and apply the common law of contracts.

IV. NAR Code of Ethics.

The Code of Ethics was adopted by NAR as a means of facilitating REALTORS' compliance with their legal and ethical obligations. It is recognized that a licensee's legal obligations are governed by the Real Property Law, the regulations and determinations of the Department of State, and the common law of agency and contracts, all of which supersede the Code of Ethics in the event of a conflict. Accordingly, the Department of State is not in the position of approving the Code of Ethics insofar as it addresses legal obligations.

Article 1 of NAR's Code of Ethics addresses the obligation of fidelity to one's client, which co-exists with the obligation to treat all parties honestly. Article 7 of NAR's Code of Ethics addresses the same concerns as DOS license Regulation 175.7 and prohibits

acceptance of compensation from more than one party without full disclosure to all parties and informed consent of the client.

V. EFFECT OF A CONSENSUAL DUAL AGENCY WITH FULL DISCLOSURE AND INFORMED CONSENT.

Under a consensual dual agency, the licensee has an obligation of fairness to both parties. The licensee must indicate that he is acting for both and cannot provide the full range of fiduciary services. It is particularly important to emphasize that the licensee cannot provide undivided loyalty and must refrain from divulging confidential client information.

As noted above (at p.2), if the confidential information furnished by one client is of such a nature that the dual agent cannot give advice without disclosing it, he/she cannot continue to act as adviser.

NAR's March, 1992 Report of the Presidential Advisory Group on Agency noted that:

"Disclosed dual agency is a viable agency procedure, but only if full disclosure is made and all parties consent following such disclosure, similar to that practiced in the legal profession." (p. 12).

It must be emphasized that disclosure must be both (1) timely and (2) meaningful.

VI. CONSENSUAL DUAL AGENCY - APPOINTMENT OF DESIGNATION AGENTS

A consensual dual agency arises where a single real estate licensee represents both buyer and seller, with their informed consent. Under this approach the "dual agent" acts under a duty of fairness to both principals in endeavoring to arrange a mutually agreeable transaction.

Under the license law and regulations (as interpreted and applied by the Department of State and Court decisions), a licensee's agreement with a principal (whether an exclusive listing agreement with a seller principal or an exclusive buyer representation agreement with a buyer principal) is taken in the name of the brokerage firm. The brokerage firm is the agent. This opens the possibility that two sales associates affiliated with the same firm could independently commit the firm to agency agreements with a seller principal and a

buyer principal, respectively, who might become interested in contracting with each other. Such a proposed in-house transaction raises dual agency issues and requires the firm to disclose and resolve the conflict in the fiduciary duties (particularly that of undivided loyalty) to each principal. As agency is a consensual relationship, there may be a refinement of the consensual dual agency approach. It is permissible, by mutual agreement, for both principals to agree to appoint a "designated agent" for each of them: e.g., for the listing agent to be the designated agent to negotiate for the seller principal and for the buyer's agent to be the designated agent to negotiate for the buyer principal. The firm continues as a dual agent representing both the buyer and the seller in the same transaction while the designated agents, by virtue of the new agreement with the buyer and seller, act as single agents to their respective clients, providing them with full fiduciary duties, including undivided loyalty. This approach has been recognized by Secretary of State Alexander "Sandy" Treadwell as set forth in the Secretary of State's April, 1998 "Ask the Secretary" column (see April, 1998 NYR, p. 8 - copy attached). The Secretary stated that the consent of both the buyer and the seller to proceed as a dual agent must be obtained utilizing the "Agency Disclosure Form." The Secretary further noted that if, after full discussion, the buyer and seller agree to a designated agency arrangement, they can then appoint designated agents. These arrangements should be in writing and copies of all forms should be provided to all parties.

At the outset of the firm's relationship with a prospective client (whether buyer or seller), the Agency Disclosure Form is provided to that client. While it is appropriate to discuss the possibility of a dual agency with the prospective client at the outset and to set forth alternatives in the listing agreement with the seller and the buyer representation agreement with the buyer, informed consent to dual agency is sought and obtained on a transactional basis when a buyer client has a specific interest in acquiring property of a seller client. At that juncture, the parties may also consider whether they wish to consent to designate a particular agent of the firm to represent the seller exclusively and another agent of the firm to represent the buyer exclusively, while the firm itself continues as a dual agent representing both the buyer and the seller in the transaction.

If an in-house transaction approach is to be considered, it is recommended that at first substantive contact the firm disclose its policies with regard to agency alternatives and cooperation, the liability ramifications of utilizing subagents, and (if offered) the concept of "consensual dual agency" and "designated agents." The firm should not attempt to secure a client's final consent to dual agency at first contact. Rather, the following steps are recommended:

(1) Advise the client at the time a listing is taken or at the time the buyer agency agreement is entered into regarding the possibility of and their alternatives for handling potential in-house transactions, including (if offered) the availability of a consensual dual agency approach and designated agents, noting their advantages and disadvantages, and set forth those alternatives in the agreement with the client.

(2) Do not seek to obtain blanket consent to dual agency at the outset.

(3) Obtain the principal's instructions regarding a possible "in-house" transaction between a buyer principal and a seller principal who each have hired the firm to serve as agent (i.e., which alternatives are conceptually acceptable). It is preferable to have selected the mutually agreed alternative prior to any showing. While it may be possible to obtain informed consent that the house may be shown pending the parties' decision as to how the proposed transaction will be handled, with the understanding that no negotiations will be pursued until they have selected the alternative to be utilized, any such consent to a showing should only be sought for good reason, such as to address the possibility of logistical difficulties.

(4) Seek informed consent to a dual agency approach only after a specific purchase transaction is identified and the parties' alternatives are explained and considered. Do not conduct any negotiations unless and until informed consent is obtained.

(5) Confirm both buyer and seller's consent in writing, executing a new statutory Agency Disclosure Form.

(6) If the designated agency approach to dual agency is desired by the parties, it is recommended that the following steps be taken:

(a) The "Acknowledgment of Prospective Buyer and Seller to Dual Agency" section of the Agency Disclosure Form be completed by inserting the firm's name on the line for the "name of the firm" and checking the box indicating that it is a "dual agent," while inserting a notation such as "see annexed Designated Agent Agreement" in the space for the "name of licensee." The parties should also attach the Designated Agent Agreement setting forth the property involved, the name of the firm which is a dual agent, and the name of the individual agent appointed to represent only the buyer, as well as the individual agent appointed to represent only the seller.

(b) At the time the parties enter into a contract for the specified premises, it is recommended that on the Agency Disclosure Form, the "Acknowledgment of the Parties

to the Contract" should be completed in a comparable fashion. Thus, the "name of the firm" serving as a "dual agent" should be inserted in section 2, while a notation such as "see annexed Designated Agent Agreement" (or a similar reference) should be inserted in the space for "name of licensee." The Designated Agent Agreement (setting forth the property involved, the firm which is a dual agent, the individual agent appointed to represent only the buyer and the individual agent appointed to represent only the seller) should then be appended to the Agency Disclosure Form.

Attached are samples of the Agency Disclosure Form and the Designated Agent Agreement marked as suggested above. For ease of presentation, the three stages when the Agency Disclosure Form would be utilized are all marked on a single sheet, but annotated as step 1, 2 or 3, respectively. In the example provided, the buyer and the seller have separately entered into representation agreements with XYZ Realty. This, at step 1 (in this example 5/15/98), Bill Buyer acknowledges that B.A. of XYZ Realty is the Buyer's Agent. Similarly, Sally Seller acknowledges that S.A. of XYZ Realty is her seller's agent. At step 2 (in this example 5/26/98), when the actual issue of a dual agency arises because the buyer client becomes interest in the 1 Elm Street listing of the seller client, both buyer and seller sign the Acknowledgement of Prospective Buyer and Seller to Dual Agency, as well as the Designated Agent Agreement appointing B.A. as the buyer's agent and S.A. as the seller's agent. At step 3 (in this example on June 3, 1998), when the buyer and seller have agreed to contractual terms, the Acknowledgment of the Parties to the Contract is completed and the previously signed Designated Agent Agreement is appended thereto.

It is important to note that there may be other approaches to appointing designated agents, perhaps utilizing only an annotated Agency Disclosure Form. Unless and until the marketplace develops preferable alternatives or the Department of State specifies what must be done, the above approach is suggested.

(7) Do not proceed under a consensual dual agency approach if either buyer or seller profess any reluctance or concern with the approach.

VII. CONSEQUENCES OF UNDISCLOSED DUAL AGENCY.

In an undisclosed dual agency there are unreconciled and conflicting fiduciary duties, particularly those of undivided loyalty. Indeed, in the 1991 unpublished manuscript authored by the former General Counsel to the Secretary of State, dual agency is generally defined as follows:

"A phrase to describe when a fiduciary having already agreed to represent one principal, seeks also to represent one or more other principals in the same transaction. Dual agency refers to a breach of an agent's fiduciary duty of undivided loyalty."

DOS enforces the common law prohibition against dual agency. The DOS refers to dual agents as "double agents." If a licensee is charged with dual agency in a DOS administrative hearing or in any civil action, the burden is squarely on the licensee to prove full disclosure with informed consent. The potential consequences of dual agency without full disclosure and informed consent include recision or loss of the deal, the loss of the licensee's commission and the loss of the licensee's real estate license.

VIII. STRICT SCRUTINY BY THE DEPARTMENT OF STATE. Fully informed consensual dual agency is lawful under the common law and Real Property Law §443. DOS emphasizes (i) that full disclosure with informed consent is an affirmative defense to a charge of dual agency and (ii) that it is perilous for a licensee to engage in dual agency. DOS will look carefully at whether the burden of full disclosure and informed consent is met under the particular facts and circumstances of a case. Licensees must take care to ensure that they make timely and meaningful disclosures.

-With the recognition that it is the licensee's obligation to assure that full disclosure and informed consent has been secured prior to acting as a dual agent, DOS has recognized that the parties can choose to address the handling of an in-house sale in their agreement with their agent and stipulate how such a situation will be dealt with. An appropriate clause in a seller listing agreement or a buyer representation agreement must reflect the fact that an in-house sale presents a classic case of dual agency, which is the exception to the general rule that agents serve one principal. The Appendix sets forth a sample clause which could be utilized to address the alternatives offered to consumers regarding proposed in-house sales. The option selected by the parties would then be confirmed by the signing of a new statutory disclosure notice. As with any contract provision, its terms are negotiable, as is the compensation to be paid to the licensees.
In summary, if real estate licensees seek permission from their principals to engage in dual agency, they should do so with extreme caution, understanding the attendant risks and potential consequences. In addition to the standard disclosure rule of thumb of "when in doubt disclose," it is strongly recommended that brokers (i) "go the extra mile" in making disclosures in proposed in-house transactions; (ii) utilize a contract provision to identify the alternatives offered to consumers, (iii) execute a new statutory disclosure notice to memorialize the approach to be followed in the particular transaction and (iv) where selected, utilize a Designated Agent Agreement. DOS emphasizes that whether or

not what was done in a given situation is enough to constitute full disclosure and informed consent will be a question of fact.

IX. SUMMARY OF IN-HOUSE "CONSENSUAL DUAL AGENCY"

(A) At the outset, address the potential conflicts of the firm, due to the co-existence of other consumer principals (both sellers and buyers) and the alternatives offered for their resolution, including the advantages and disadvantages thereof, preferably utilizing a contract provision setting forth those alternatives.

(B) Obtain principal's preliminary views on the possibility and the appropriate handling of an in-house transaction. It is preferable to have selected a mutually agreed alternative prior to any showing. While it may be possible to obtain informed consent that the house may be shown, without any negotiation, pending the parties' decision on the alternative for handling an in-house transaction, such consent should only be sought for good reason, such as to address the possibility of logistical difficulties.

(C) When, as and if the potential of an in-house transaction arises, the consumers should be provided with an informed discussion of their alternatives in the context of a specific transaction, including the advantages and disadvantages thereof. The alternatives could include (1) treating one as an unrepresented party rather than as a principal, (2) releasing one principal from their representation agreement, in order that they may seek representation from another firm; (3) referring one party to a "contract negotiator" or lawyer; or (4) obtaining informed consent to a dual agency approach, which may include the parties' appointment of designated agents. Experience suggests that many firms prefer retaining their agency relationship with the seller (i.e. to dissolve their agency relationship with the buyer and either (i) treat the buyer as a an unrepresented party to (ii) have the buyer represented by another firm where the parties do not consent to dual agency), due to the possibility that the proposed transaction does not close and the firm's investment in advertising and related expenses on behalf of the listing.

(D) Ensure that both buyer and seller appreciate the consequences of the consensual dual agency approach upon which they have mutually agreed. It is important to emphasize that the dual agency would be impermissible as a breach of the duty of undivided loyalty unless both the buyer and the seller provided their informed consent after full disclosure. With such informed consent, the firm brokers the transaction with the duty of fairness to both principals, including the duty to preserve their respective confidences. Note that the confidential information given by one principal may already be known to the firm and its

agents. Moreover, the principals can stipulate how the in-house situation will be dealt with and appoint designated agents for each principal. For example, the consumer is able, by mutual consent of both principals, to have negotiations conducted on his/her behalf by the particular licensee who arranged the firm's agency relationship with that consumer. Those designated agents are single agents giving undivided loyalty to their respective clients while the firm remains a dual agent bound to act under a duty of fairness.

(E) The consensual dual agency, if any, offered by the firm should be indicated in the underlying agency agreement between the firm and the consumer principal (i.e. the buyer representation agreement with the buyer and the listing agreement with the seller). The parties' consent to the dual agency approach should be memorialized by the execution of a new Real Property Law §443 disclosure form, with both consumers signing the "ACKNOWLEDGMENT OF PROSPECTIVE BUYER AND SELLER TO DUAL AGENCY." If designated agents are to be utilized, a separate writing identifying the particular licensee who will represent each respective principal should be utilized memorializing their consent.

X. CONCLUSION.

A consensual dual agency offers a workable alternative approach to an in-house sale, but is an exception to the general rule that agents serve one principal. The key to its validity is the providing to consumers of timely and meaningful disclosure of their options and securing their informed consent to the alternative of their mutual choice. If the possibility of a consensual dual agency is disclosed at the outset in dealing with consumers there may be consumers who will be interested in the concept. By securing only preliminary or conceptual approval at the outset, the consumers will have the opportunity to reassess the situation when, as and if a specific in-house transaction crystallizes. At that time, both principals (buyer and seller) must be notified that the dual agency situation has arisen. The consumers then have the freedom to choose how they will proceed. One valid choice is a consensual dual agency. By mutual agreement, the consumers may further appoint designated agents within the firm to represent each of them, respectively.

Whether or not a consensual dual agency approach is offered for in-house transactions, consumers must be given timely and meaningful disclosure of an agent's roles and responsibilities. Effective disclosure may involve clarification of an agent's duties; admonishment that a consumer should not tell the other party's agent anything they wouldn't want the other party to know; notification of each consumer's option to be represented by their own agent; a description of what the licensee can and cannot do

when acting in a particular role; the possibility of conflict or competition with other clients of the firm (buyer and/or sellers); and (if applicable) the availability of enhanced compensation or other incentives to in-house sales.

Real estate licensees perform valuable services in arranging consensual real estate transactions. An in-house transaction involves the adversarial positions of buyer and seller which co-exist with their mutual interest in securing an agreeable transaction. There are alternative representational roles in which a licensee can validly serve in the transaction, but the licensee must always act in conformity with the standard of "making clear" for whom they are acting and not acting for more than one party without full disclosure and informed consent of all parties (see 19 NYCRR §175.7). Licensees should make consumers aware of their alternatives (such as through the use of an "in-house sale" clause in the firm's agreement with the buyer and seller, respectively), discuss their advantages and disadvantages, and record their choices on a new statutory disclosure notice and, if applicable, in a separate designated agent agreement.